

Rowan University

## Rowan Digital Works

---

Rohrer College of Business Faculty Scholarship

Rohrer College of Business

---

Summer 2011

### Thompson v. Western States Medical Center: An Opportunity Lost

J. S. Falchek

Edward J. Schoen

*Rowan University*, [schoen@rowan.edu](mailto:schoen@rowan.edu)

Follow this and additional works at: [https://rdw.rowan.edu/business\\_facpub](https://rdw.rowan.edu/business_facpub)



Part of the [Business Commons](#), and the [Law Commons](#)

---

#### Recommended Citation

Falchek, J. S. & Schoen, E. J. (2011). Thompson v. Western States Medical Center: An Opportunity Lost. *Atlantic Law Journal*, Vol. 13 (Summer 2011), 201-223.

This Article is brought to you for free and open access by the Rohrer College of Business at Rowan Digital Works. It has been accepted for inclusion in Rohrer College of Business Faculty Scholarship by an authorized administrator of Rowan Digital Works.

**ATLANTIC LAW JOURNAL**  
**VOLUME 13**  
**2011**

**CONTENTS:**

EDITORS' CORNER

EDITORIAL BOARD & STAFF EDITORS

EDITORIAL BOARD ANNOUNCEMENTS

ARTICLES

TEACHING INTERNATIONAL BUSINESS LAW AND CONTRACTS VIA EXPERIENTIAL LEARNING: A CASE EXAMPLE BEVERLEY EARLE* & GERALD MADEK	1
EXPLORING ETHICAL ISSUES AND EXAMPLES BY USING SPORT ADAM EPSTEIN & BRIDGET NILAND	19
A FOCUS ON THE FOREIGN CORRUPT PRACTICES ACT (FCPA): <i>SIEMENS AND HALLIBURTON</i> REVISITED AS INDICATORS OF CORPORATE CULTURE RICHARD J. HUNTER, JR., DAVID MEST & JOHN SHANNON	60
BALANCING CUSTOMER SERVICE, SAFETY ISSUES, AND LEGAL REQUIREMENTS: IT'S ALL ABOUT SAFETY GREGORY P. TAPIS, KATHRYN KISSKA-SCHULZE, KANU PRIYA & JEANNE HASER	92
INTERNATIONAL AUDIT COMMITTEE INDEPENDENCE REQUIREMENTS: ARE POLICYMAKERS PUTTING THE ACADEMIC RESEARCH TO USE? J. ROYCE FICHTNER	117
THE SERVICEMEMBERS CIVIL RELIEF ACT: CONTEMPORARY REVISIONS TO THE SOLDIERS' AND SAILORS' CIVIL RELIEF ACT OF 1940 REGARDING RIGHTS AND RESPONSIBILITIES OF THE MILITARY, THEIR DEPENDENTS AND THOSE WHO DO BUSINESS WITH THEM MICHAEL A. KATZ	146
<i>THOMPSON V. WESTERN STATES MEDICAL CENTER:</i> AN OPPORTUNITY LOST JOSEPH S. FALCHEK & EDWARD J. SCHOEN	164
USING AN ARBITRATION SIMULATION TO TEACH CRITICAL SKILLS HARVEY M. SHRAGE	191

INFORMATION FOR CONTRIBUTORS



## EDITORS' CORNER

The *Atlantic Law Journal* is a double blind peer reviewed journal. The *Journal* attracts large numbers of submissions from professors and scholars located across the United States and overseas. The current acceptance rate for the *Journal* is less than 25%. The *Journal* is listed in *Cabell's Directory of Publishing Opportunities in Management and Marketing*. It is published annually.

We encourage all readers to prepare and submit manuscripts for publication in the *Journal*. Submission information is located at the back of this volume.

The *Journal* is the official publication of the *Mid-Atlantic Academy for Legal Studies in Business, Inc.* It is available both electronically and in print versions deposited in college and university libraries.

- *The Editors*

EDITORIAL BOARD & STAFF EDITORS

**BRIAN J. HALSEY**  
EDITOR-IN-CHIEF  
WEST CHESTER UNIVERSITY

**-STAFF EDITORS-**

**STEPHANIE BARDWELL**  
CHRISTOPHER NEWPORT UNIVERSITY

**GLENN D. BARNES**  
PEIRCE COLLEGE

**ROBERT C. BIRD**  
UNIVERSITY OF CONNECTICUT

**STACEY B. LEE**  
JOHNS HOPKINS UNIVERSITY

**CAROL J. SHERMAN**  
PEIRCE COLLEGE

**DONNA M. STESLOW**  
KUTZTOWN UNIVERSITY

**SANDRA M. TOMKOWICZ**  
WEST CHESTER UNIVERSITY

**PATRICK D. WALKER**  
CHRISTOPHER NEWPORT UNIVERSITY

**MARY ELLEN WELLS**  
ALVERNIA UNIVERSITY

## EDITORIAL BOARD ANNOUNCEMENTS

### STAFF EDITORS

Staff Editors review *Journal* submissions. If you wish to review manuscripts for the *Journal*, please contact the editors with a letter or email indicating your current position, your scholarly interests and/or your areas of expertise. Ideally staff editors attend the spring annual meeting of the *MAALSB*, but attendance is not required.

### ADVERTISING

The *Journal* accepts both paid advertisements and exchanges of advertising or display space. Full and half page formats are welcome.

### CONTENTS & OPINIONS

The opinions expressed in the articles are solely those of their respective authors and do not reflect the opinions of the *Mid-Atlantic Academy for Legal Studies in Business*, the *Journal* itself, or the editors and reviewers. This publication is designed to give accurate and authoritative information with regard to the subject matter. It is distributed with the understanding that neither the publisher nor the editors are engaged in the rendering of legal advice, political opinion, or any other professional service. If legal advice or other expert assistance is required, please seek the services of a competent professional.







**- ARTICLES -**

TEACHING INTERNATIONAL BUSINESS LAW AND  
CONTRACTS VIA EXPERIENTIAL LEARNING:  
A CASE EXAMPLE

By

*Beverley Earle\* & Gerald Madek\*\**

I. INTRODUCTION

The pressure to cover material in a law course in business school is intense and a professor may conclude that there is no room for a time-consuming exercise in experiential learning. While it may seem like a luxury to spend a class period engaged in a negotiation or simulation, research has validated the important role such an exercise plays in learning.<sup>1</sup>

---

\* Professor and Chair of the Law, Taxation and Financial Planning Department, Bentley University and the McCallum Graduate School of Business, Fellow, Bentley Center for Business Ethics.

\*\* Professor of Law, Taxation and Financial Planning, Bentley University.

<sup>1</sup> See David A. Garvin, *Making the Case: Professional Education for the World of Practice*, 106(1) HARV. MAG. 56 (2003), available at <http://harvardmagazine.com/2003/09/making-the-case-html>; but see Barry Mitnick, *The Case Against the Case Method*, HARV. BUS. REV. BLOGS, Apr. 29, 2009, <http://blogs.hbr.org/how-to-fix-business-schools/2009/04/the-case-against-the-case-meth-1.html> (providing a critique of case method experiential or problem learning).

The use of cases in business education leads to several outcomes. As David Garvin, the C. Roland Christensen Professor of Business Administration at Harvard Business School explains, there are three benefits to case discussions: “[T]hey help students develop diagnostic skills in a world where markets and technologies are constantly changing”; “[They] help students develop persuasive skills”; and “[A] steady diet of cases leads to distinctive ways of thinking and acting. It . . . puts the student in the habit of making decisions.”<sup>2</sup>

Harvard Business School has endorsed the usefulness of the case method since 1920 (fifty years after the Harvard Law School had adopted it).<sup>3</sup> While case studies used at the graduate level are usually lengthy and detailed, the case study method can be easily adapted to an undergraduate curriculum. Case exercises are valuable at any level because they force students to put themselves in a participatory role and to make practical decisions as if they were running their own businesses. Short business cases function as a useful adjunct to the case book used in most *Legal Environment of Business* or *International Business Law* classes.

Professors who have graduated from law school are more than familiar with the case method using appellate cases but find using business school cases to teach legal concepts to managers a less comfortable experience. Fortunately, there are effective resources to support professors as they introduce the case method into their business courses. The *Academy of Legal Studies in Business* makes available both information about teaching with the case method<sup>4</sup>

---

<sup>2</sup> Garvin, *supra* note 1, at 62 (quoting Powell Niland, a Harvard Business School alumnus who is now at Washington University).

<sup>3</sup> *Id.* at 56 (discussing the difference between law, business and medical schools’ use of cases).

<sup>4</sup> The portal to ALSB resources can be found at [www.alsb.org](http://www.alsb.org) (last accessed Jan. 9, 2011); see also *Harvard Business School: Inside the Case Method, Part 2 of 2*, YOUTUBE, <http://www.youtube.com/watch?v=JJ7aVrtTbg0> (last accessed Apr. 20, 2011).

and teaching resources for specialized cases.<sup>5</sup> These resources can help professors over the initial hurdles of introducing the case method.

Additionally, Doug Lemov, an expert on teaching methodology, may be a particularly useful resource for college professors introducing the case study method to undergraduate courses. In his book, *Teach Like a Champion*,<sup>6</sup> Lemov studied the characteristics of good teachers and made a surprising discovery. He found that “what looked like natural born genius was often deliberate technique in disguise.”<sup>7</sup> Lemov reduced the techniques which he observed good teachers using to a “taxonomy.” Although the techniques in this taxonomy were originally used in a pre-college setting,<sup>8</sup> they can be equally helpful for college professors introducing the case method to their classrooms. Lemov’s techniques guide teachers through an analysis of their teaching and allow them to make strategic improvements. This approach offers the hope that teachers can learn to be better—exemplary teaching is not simply an innate trait.

---

<sup>5</sup> For example, the *Journal of Legal Studies Education* recently published two cases to be used in business law classes. See Lamar Odom & Analco Gonzalez, *Kelo v. City of New London: An Ideal Case to Teach Ethical and Legal Principles*, 25 J. LEGAL STUD. EDUC. 343 (2008); Susana Monseau, *Beer, Free Speech, and Barriers to Interstate Commerce: A Case of Imported Beer*, 25 J. LEGAL STUD. EDUC. 307 (2008).

<sup>6</sup> DOUG LEMOV, *TEACH LIKE A CHAMPION* (2010). Lemov’s book is profiled in Elizabeth Green, *Building a Better Teacher*, N.Y. TIMES MAG., Mar. 2, 2010, at MM30, available at <http://www.nytimes.com/2010/03/07/magazine/07Teachers-t.html?ref=magazine&pagew>. See also *id.* (“When Bill Gates announced recently that his foundation was investing millions in a project to improve teaching quality in the United States, he added a rueful caveat. ‘Unfortunately, it seems that the field doesn’t have a clear view of what characterizes good teaching,’ Gates said. ‘I’m personally very curious.’”).

<sup>7</sup> Green, *supra* note 6, at MM30.

<sup>8</sup> See Green, *supra* note 6, at MM30.

In his taxonomy of effective teaching techniques, Lemov stresses that effective professors bring the “J Factor,” or joy factor, into the classroom. Lemov defines the “*J Factor*” in the following manner:

The finest teachers offer up their work with generous servings of energy, passion, enthusiasm, fun, and humor—not necessarily as the antidote to hard work but because those are some of the primary ways that hard work gets done. It turns out that finding joy in the work of learning—the J Factor—is a key driver not just of a happy classroom but of a high achieving classroom.<sup>9</sup>

Building a class around a case analysis actually increases the “J Factor” for students by increasing their level of engagement.<sup>10</sup> The case method forces all students to participate—leaving no one as an observer. During case analyses, students are forced to ask themselves questions such as: Do I want to sign this term sheet? Is this a contract I am comfortable with? Can I live with its financial consequences? The case ceases to be an abstract problem when students are required to confront the same problems as real participants in a business venture.

The case method also offers an excellent opportunity to use Lemov’s other successful teaching strategies. For example, when moving students through a case analysis, the professor can use the “*Strong Voice*”<sup>11</sup> (where the professor uses a loud, commanding voice to rivet attention in an almost theatrical way). With this technique, the professor can capture students’ attention and systematically work through the terms of the case, lobbing questions to either individuals or groups much like a ball in a

---

<sup>9</sup> *Id.* (elaborating on the Joy Factor).

<sup>10</sup> LEMOV, *supra* note 6, at 214 (discussing Technique 46).

<sup>11</sup> *Id.* at 182 (discussing Technique 38). “Strong voice” means using a commanding, loud voice to grab students’ attention and hold it as the professor goes through the exercise of posing questions.

tennis match or at softball practice. Other techniques described by Lemov are also appropriate for use in discussion of short business school type cases in the college classroom. These include the “Hook”<sup>12</sup> (starting with a question, picture or statement to focus interest), “Cold Call” (creating the expectation for students that they can be called on at anytime),<sup>13</sup> “Wait Time” (giving students a chance to ponder the question),<sup>14</sup> “Circulate” (walk around the class to hold students’ attention and to engage them not just with voice but with your proximity),<sup>15</sup> and “Take a Stand” (engaging students by asking if they agree with a previous student’s statement and then asking follow up questions).<sup>16</sup>

The article introduces the concepts used by Lemov<sup>17</sup> to improve teaching in conjunction with a contracts case exercise appropriate for both undergraduate and graduate students. The article will also address how to use the case in class from both a pedagogic and substantive perspective.<sup>18</sup>

## II. CASE

*RIGA FURNITURE*  
*International Sale of Goods:*  
*Furniture to Switzerland?*

Watson owns Riga, Inc. of Boston, MA. He sells handcrafted furniture all over the world. He recently met a hotel owner from Switzerland, Rachel Schweitzer, who wanted to furnish a small (forty-room) luxury hotel in Switzerland with Watson’s furniture.

---

<sup>12</sup> *Id.* at 75 (discussing Technique 12).

<sup>13</sup> *Id.* at 111 (discussing Technique 22).

<sup>14</sup> *Id.* at 134 (discussing Technique 25).

<sup>15</sup> *Id.* at 84 (discussing Technique 15).

<sup>16</sup> *Id.* at 106 (discussing Technique 21).

<sup>17</sup> *Id.*

<sup>18</sup> For an example of another case with similar instructions, see Odom & Gonzalez, *supra* note 5.

Schweitzer forwarded a draft contract with these provisions. The costs are those quoted to Schweitzer when she visited the showroom in Boston.

*CONTRACT TERMS*

*Description of Goods:*

40 sleigh beds, king size	\$ 80,000
80 nightstands	\$ 40,000
40 desks	\$ 40,000
40 luggage stands	\$ 20,000
80 small tables	\$ 20,000
40 bureaus	<u>\$ 30,000</u>
	\$220,000

*Time for Performance:*

Delivery shall be made to Zurich between Dec. 1st and Dec. 20th, 2010. All goods must be delivered by Dec. 20, 2010. Failure to deliver by said date will be considered a fundamental breach.

*Choice of Law:*

The parties agree to have Swiss law apply to this contract.

*Choice of Forum:*

The parties agree to have any disputes arising under the terms of the contract heard by the appropriate court in Switzerland.

*Shipping Terms:*

DDP, Zurich (Incoterms).

*Force Majeure:*

Either party will be excused from performance in the event an act of God, such as earthquake or hurricane, war, act of terrorism or fire, renders performance impracticable. In the event the hotel is destroyed on or before December 20, 2010, the buyer may, at his election, cancel the contract.

*Liquidated Damage Clause:*

In the event the seller is unable to deliver the entire order by December 20, 2010, the buyer will be entitled to \$275,000. The additional sum will include the cost of finding substitute goods at such a late date. If the buyer breaches, the seller will be paid the difference between the contract price and what he was able to sell the furniture for within six months, using good faith efforts.

*Inspections:*

The buyer reserves the right to inspect the goods both at the factory before shipment and prior to delivery in Zurich.

Watson assumed that he would be sending the term sheet, but now he has to deal with the term sheet sent by Schweitzer.

III. USING THE CASE IN CLASS

The objective of studying the Riga Case is to give students the experience of being part of a contract negotiation and to develop their understanding of the import of terms that are offered. In this exercise, students have to evaluate what the contract offers and identify what is missing that should be there. This exercise forces students to think about what they have studied and apply this information to a specific business situation. Students have to experience the confusion and uncertainty of how to structure an agreement to get what they want and to protect their interests. When students complete analysis of the case, they will understand firsthand how contracts are a way to price and manage risk.

A. *Pre-class Preparation*

The Riga Case has been used successfully for both undergraduate and graduate students studying international business law. However, its use must be preceded by the study of a number of chapters on contracts, the Convention on Contracts for the



International Sale of Goods (CISG) and letters of credit.<sup>19</sup> Feedback from both levels of students has been uniformly positive. Students were pleased to be able to engage in applying their knowledge and to work in teams. Analyzing the Riga Case allowed them to see the relevance of what they had learned.

Students should be asked to read the case and ponder the following questions: 1. What concerns do you have from Watson's point of view? 2. What new provisions do you think should be included to protect Watson? 3. Does the contract really protect Schweitzer? 4. Should Watson ignore Schweitzer's term sheet and just send his own?

Professors may structure preparation of answers to these questions in several ways: 1. Ask groups to meet outside of class and come up with a common sheet of concerns. 2. Pass out the case in class and have groups work on it without having studied it before—almost like an in-class group exam. 3. Have the students prepare individually but then give them twenty minutes in class to compare their analysis with that of their fellow group members. 4. Use the case as an individual in-class exam. 5. Have individuals prepare and come to class (no groups) and have a class discussion.

### B. *Class Discussion*

The professor may begin either by asking, “What is the biggest problem here?” or by asking for an analysis of the provisions sequentially. The class discussion should then proceed through the most troubling provisions or methodically through the term sheet. Whether groups are used or not, Lemov's<sup>20</sup> techniques should be kept in mind to keep the momentum of the class strong and interest

---

<sup>19</sup> For example, a textbook used in conjunction with this case is RICHARD SCHAFFER, FILIBERTO AGUSTI & BEVERLEY EARLE, INTERNATIONAL BUSINESS LAW AND ITS ENVIRONMENT (South-Western, 7th ed. 2009).

<sup>20</sup> LEMOV, *supra* note 6.

high. The class should begin with a “Hook”<sup>21</sup> to grab the students’ attention. The other Lemov techniques, such as “J Factor,” “Take a Stand” and “Circulate,” should also be used to grab and hold the students’ focus.

### C. *Substantive Contract Issues*

Discussion of the “Description of Goods” section is important because it offers an opportunity for students to focus on the central problem in contract formation—getting what they want. Students should focus on how to maximize the chances that this happens, what the limits of the contract are and how one selects a party with whom to contract in the Internet age. Discussing this section in class also illustrates the problem with assumptions. If parties make assumptions which are not actually in the contract and there is a subsequent disagreement, there may be problems. Students have to think about what assumptions they are making.<sup>22</sup> With these points in mind, students should be guided to see that this description of goods needs more detail. The following list identifies some areas for discussion: Does the contract include mattresses? SKU? Description of the finish? Are these the actual prices? Currency? Are measurements appropriate to reduce uncertainty? Assembly included? Mistake in the adding? Payment terms? Any advance payment required? Might the seller propose other terms? Does the price for the seller work if goods are shipped from Waltham? Letter of credit? Taxes? Import and export issues? Connection to trade terms?

---

<sup>21</sup> *Id.* at 75.

<sup>22</sup> See *Frigalment Importing Co., Ltd. v. B.N.S. Int’l Sales Corp.*, 190 F. Supp. 116 (S.D.N.Y. 1960). *Frigalment* deals with a conflict about the sale of chicken and what is chicken. It is memorable because it takes what at first seems obvious—chicken—and lets the student grapple with the complexities that there are really many different kinds of chicken. If there are these many problems with describing chicken, then the student deduces that product descriptions are critical in negotiations.

The “Time for Performance” section also raises some issues for the students to discuss. For example, where will delivery be? What about the definition of fundamental breach? Is this within the contractor’s control?

The “Choice of Law” provision should be a central point on which students focus since the Riga Case lends itself to in-depth discussion of the implications of choice of law in international sales transactions. Students should consider first what the CISG says about choice of law. The CISG does not limit the choice of law in any way.<sup>23</sup> However, for US business people entering into a contract with a party to the CISG, the issue of supremacy complicates this choice. Because the US is a signatory of the CISG, the US Constitution in essence declares that this treaty supersedes other laws. Efforts to stipulate a choice of law must take this reality into account. Failure to clearly opt out of the CISG may mean the CISG will apply. On the other hand, choosing the law of California, in some contracts, will bring in the CISG in international contracts where one party is from the United States and the other party is from a country that has signed the CISG. The CISG is also much more flexible in allowing evidence extrinsic to the contract and trade usage.<sup>24</sup> So, if the CISG is the law of choice, a party could be surprised when a court allows in parol evidence to explain a contract provision. The CISG necessarily overlaps with local contract law, and, on some basic contract issues, departs from local contract law. In addition, signatories to the CISG can exclude parts of this treaty from their acceptance. Since the initial offering

---

<sup>23</sup> There are restrictions on how to opt out of the CISG. A purported opt out may not be effective. For example, selecting the “laws of California” when the parties are both from CISG signatory countries will bring in the CISG because the CISG is the law of California. See SCHAFFER ET AL., *supra* note 19, at 122 (discussing a choice of law clause in *Asante Techs. v. PMC-Sierra, Inc.*). See generally *CISG Database*, PACE LAW SCHOOL, <http://www.cisg.law.pace.edu/> (last accessed Apr. 20, 2011) (providing source materials and commentary on the CISG).

<sup>24</sup> SCHAFFER ET AL., *supra* note 19, at 127 (discussing CISG Articles 8 and 9 at A-2).

indicates Swiss law as the law of choice, students should examine this choice in light of the CISG. How might a battle of the forms play out here? Considering how choice of law impacts the contract issues highlighted above will broaden students' understanding of why this choice is particularly important in international transactions.

Next, students should focus on the differences between the Uniform Commercial Code (UCC) and the CISG. In this context, students might be directed to examine the areas in which the UCC and CISG define basic contractual functions differently. This analysis will illuminate the underlying concepts of contract law<sup>25</sup> while illustrating the different results which flow from different choices of law. The resulting discussion will further emphasize the importance of choice of law. In addition, students who consider choice of law in this context will be forced to think critically about contracts in a context that they will likely remember.

Class discussion of the UCC and the CISG should focus on how each law views several key elements pertaining to contracts. One important difference between the CISG and the UCC is that the CISG (Article 11) does not require a writing for a contract to be formed.<sup>26</sup> The CISG recognizes oral offers as irrevocable under certain circumstances, while the UCC requires that an offer be written to be considered irrevocable.<sup>27</sup> Another difference between these laws is that the CISG upholds the mirror-image rule, which stipulates that, for a contract to be formed, the terms of the acceptance must mirror exactly the terms of the offer.<sup>28</sup> This differs from practice under the UCC which ignores the mirror-image rule, allowing acceptances with additional terms to result in a contract. The CISG does allow additional terms which "do not materially alter" the contract to qualify as an acceptance unless the

---

<sup>25</sup> *Id.* (Chapter 4 provides a complete discussion of the CISG and the UCC).

<sup>26</sup> *Id.* at 124 (noting that the CISG allows the parties "flexibility").

<sup>27</sup> *Id.* at A-2 (CISG Article 16).

<sup>28</sup> *Id.* at 135 (discussing the mirror image rule).

offeror objects either orally or in writing.<sup>29</sup> However, the CISG's definition of what is material is so broad that almost anything could be deemed material.<sup>30</sup> Again, the UCC accepts the mailbox rule which holds that a contract is created when the acceptance is transmitted, rather than when the offeror actually receives the acceptance. However, the CISG does not recognize the mailbox rule, stipulating that a contract is actually formed only when the offeror receives the acceptance. Focusing students on these different views of what constitutes a contract will deepen their understanding of what contracts are and encourage them to evaluate the logic of each approach while cementing the importance of carefully considering choice of law in all contract negotiations. The "Choice of Forum" clause also highlights several problems with the Riga contract as written. In this context, students should be guided to consider the expense of traveling to Switzerland to settle disputes.<sup>31</sup> Students should also consider the alternative dispute resolution mechanism of arbitration, with its concomitant advantages and disadvantages. Because the New York Convention offers certainty of enforcement of arbitration in countries that are signatories, there are distinct advantages to using this convention.<sup>32</sup> What are the implications if a country has not signed the New York Convention? The "Force Majeure" clause raises questions about its adequacy. What are the consequences if

---

<sup>29</sup> *Id.* at A-3 (quoting CISG Article 19(2)).

<sup>30</sup> *Id.* at A-3 (quoting CISG Article 19(3): "[A]dditional or different terms relating, among other things, to the price, payment, quality and quantity of the goods, place and time of delivery, extent of one party's liability to the other or the settlement of disputes are considered to alter the terms of the offer materially.").

<sup>31</sup> For another example that the students may be familiar with, see *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972) (discussing the problem of a party who signed a forum selection clause and later wanted to get out of it).

<sup>32</sup> See Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3; see also New York Convention and enforceability of judgments discussed in SCHAFFER et al., *supra* note 19, at 90. For another case example see *Scherk v. Alberto Culver Co.*, 417 U.S. 506 (1974) (enforcing an arbitration provision).

goods are in transit and the hotel is destroyed? Are the conditions broad enough? Is the clause slanted toward the buyer?

Is the “Liquidated Damage Clause” enforceable? Is it arbitrary? If one small piece is not delivered, is the buyer entitled to the entire \$275,000? Does this make the clause a disguised punitive damage clause? Why would that matter?<sup>33</sup> Does this contract provide a less equitable remedy for the seller?

Class discussion of the Riga Case can also serve as an opportunity to review INCOTERMS as well as shipment and destination contracts. What are the differences between shipment and destination contracts? Do destination contracts entail more responsibility for the seller? At a minimum, such discussion will help students to comprehend this fundamental difference.

Students should also consider how inspections would be handled under this contract as written. It is easy for students to understand why inspections might be desired but the discussion should also address how logistics can be reflected in the contract language and how they interact with payment and letter of credit provisions. Other questions may also be pertinent, such as: Time period? Any limitations? Responsibility for cost? Are two inspections reasonable? What is the connection between inspection and trade terms? Is there a confusion of responsibilities?<sup>34</sup>

Professors should emphasize that, after reviewing provisions in any document, one needs to look at what provisions are missing and should be included. In this context, students should discuss what further provisions should be added to the Riga contract. Professor DiMatteo, in his book *The Law of International*

---

<sup>33</sup> See United Nations Convention on Contracts for the International Sale of Goods (CISG), arts. 74-77, Apr. 11, 1980, 1489 U.N.T.S. 3, 19 I.L.M. 668.

<sup>34</sup> See *Biddell Bros. v. E. Clemens Horst*, 1 K. B. 934 (1911) (a comparison with UCC § 2-513 is discussed in SCHAFFER ET AL., *supra* note 19<sub>2</sub> at 171).

*Contracting*,<sup>35</sup> suggests other contract provisions which might be relevant to Riga, including the following: warranty, return insurance, trigger date, letter of credit, termination clause, bankruptcy, confidentiality, modifications, non-assignment, indemnification, time is of the essence, and Nachfrist notice.<sup>36</sup>

Finally, use of the Riga Case allows the professor to explore the ethical issues connected to contracts. Many of these arise in any generic contract. For example, what if vagueness in the contract allows the seller to ship less expensive goods? Would doing so be ethical?<sup>37</sup> Is it ethical to drive a hard bargain? What is the framework one uses to answer—deontological questions (absolute, Kantian), or teleological questions (ends justify the means, a balancing test)?<sup>38</sup> Is it ethical to breach an agreement as long as one faces the legal consequences?

#### D. *Lessons for Business*

At the conclusion of this case discussion, students should appreciate what parties are trying to accomplish in contract negotiations and understand the following business lessons:

- Both parties to any contract need to understand the intricacies of the business and the products involved in the contract. Otherwise they won't recognize an inadequate product description. On the other hand, if the parties to a contract know the product and the business, they will be able to anticipate problems and insure that these problems are addressed in the contract.

---

<sup>35</sup> LARRY A. DIMATTEO, *THE LAW OF INTERNATIONAL CONTRACTING* (2000).

<sup>36</sup> *Id.* at 26-33. Nachfrist is specifically discussed at 28 and refers to CISG Articles 47-48 and 63 (If, when asking for extra time, the other party does not respond, then extra time is automatically given.).

<sup>37</sup> For a good discussion of ethical theories which are accessible to students, see MICHAEL J. SANDEL, *JUSTICE* 1-166 (2009) (discussing utilitarian, Kantian and virtue ethical theories).

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

- One party to a contract might try to control the negotiations by quickly sending a one-sided term sheet. The other party must respond quickly to problems with the term sheet.
- A party to a contract must identify what he/she does not know and then get the needed information. This point is sometimes difficult for students to grasp, but students must, by the end of this exercise, understand that they will not succeed in contract negotiations, unless they can identify what they do not know, both factually and legally, and then seek the needed information.
- If one doesn't understand the cost and performance obligations of destination contracts, one might well negotiate a contract that loses money.
- Learning where one can afford to compromise and which terms are critical for the deal will lead to a successful negotiation.
- Papering over disagreements with either vague language or omissions may work in some instances but students need to understand that this strategy merely postpones disagreements.

#### IV. CONCLUSION

While the case method has been long and frequently used in law, business and medical school, it is unquestionably an art to use it effectively.<sup>39</sup> Many professors default to a lecture format because they believe that knowledge transfer best takes place this way. Unfortunately, this pedagogy does not maximize student learning or retention, and professors who rely solely on lectures ignore William Butler Yeats maxim: "Education is not the filling of a pail

---

<sup>39</sup> Garvin, *supra* note 1.



but the lighting of a fire.”<sup>40</sup> The Riga case has been field-tested in both undergraduate and graduate classes and helps to “light the fire”<sup>41</sup> in the classroom. Students rise to the challenge of the case-study method in general and this case in particular. Discussion of Riga promotes student involvement in learning by illustrating for students that their actual business transactions will be affected by the kind of decisions they make about initial transaction contracts. Students actually see how different wording in clauses might save them tens of thousands of dollars. They imagine how best to protect their risk. In short, this cases analysis exercise makes contract negotiation meaningful for students by encouraging discussion in a “real-world” context.

Professors also reap many benefits from use of this pedagogy. Discussing the Riga Case in class allows professors to review and apply the substantive concepts of contract law and the CISG. Concurrently professors may take advantage of Lemov’s “taxonomy” of teaching tips and improve their own course delivery.<sup>42</sup> Finally, use of this case in a course might well encourage professors to experiment by writing and testing their own exercises.<sup>43</sup>

In 2009, the winning Master Teacher presentation of the Academy of Legal Studies in Business (ALSB) focused on the basic question

---

<sup>40</sup> ROBERT I. FITZHENRY, *THE HARPER BOOK OF QUOTATIONS* 138 (1993) (attributing the quotation to William Butler Yeats). Compare Yeats’ statement with Benjamin Franklin’s quotation (“Tell me and I forget. Teach me and I remember. Involve me and I learn.”), see B. SALIM, *A COMPANION TO TEACHING ENGLISH* 89 (2001), and a similar quotation attributed to Confucius (“I hear and I forget. I see and I remember. I do and I understand.”), see JENS ORNBO ET AL., *EXPERIENCE BASED COMMUNICATION* 30 (2008).

<sup>41</sup> This is “light a fire” found in Yeats, *supra* note 40, which should be distinguished from Jim Morrison’s song. See *THE DOORS, Light My Fire* (Elektra 1966).

<sup>42</sup> LEMOV, *supra* note 6.

<sup>43</sup> For a recent illustration of case development, see sources cited *supra* note 5.

of whether a transaction was covered by the CISG.<sup>44</sup> This case goes beyond that level of difficulty and expects students to analyze multiple issues. Thus, the Riga Case could be used effectively as a complementary exercise to follow the award-winning exercise.

---

<sup>44</sup> Marcia Staff received the ALSB's Charles M. Hewitt Master Teacher Competition in 2009. See *Marcia Staff Wins Master Teacher Award*, UNIV. N. TEX. COLL. BUS., Aug. 19, 2009, <http://www.cob.unt.edu/news/view.php?/2009/08/19/marcia-staff-wins-master-teacher-award>.



EXPLORING ETHICAL ISSUES AND EXAMPLES BY USING  
SPORT<sup>^</sup>

By

*Adam Epstein\* & Bridget Niland\*\**

I. INTRODUCTION

The purpose of this article is to inspire instructors to expand the possible topics used when teaching ethics in the undergraduate or graduate business law, legal environment or sports law course. From our experience, the subjects covered in this article often lead to further exploration and inquiry and can be developed into valuable and interactive class discussions, research projects and presentations. We recognize that many of these subjects venture beyond the study of law. At the same time, law and its relationship to ethics is intertwined and often evolves into theoretical discussion and opinion with consideration of moral rather than legal issues. Our goal is simply to offer another avenue to connect to students when covering a general subject with no easy questions or answers.

In an economy that has revealed numerous Ponzi schemes and introduced the world to Bernard Madoff,<sup>1</sup> there are now other

---

<sup>^</sup>Preliminary drafts of this article were presented at the Tri-State Conference (Bloomington, Indiana, 2010 (Outstanding Paper Award)) and SALSBB Conference (San Antonio, 2011).

opportunities for teaching ethical issues beyond the 2001 collapse of *Enron* and its impact on corporate governance operations and accounting methods and laws.<sup>2</sup> We recommend, that in addition to corporate and commercial ethical issues, instructors consider the sport-related examples in this piece to further supplement their own stable of material, which likely includes white-collar criminals such as Kenneth Lay (Enron), Dennis Kozlowski (Tyco), Richard Scrushy (HealthSouth), John Rigas (Adelphia Communications) and Bernie Ebbers (WorldCom) to name a few.<sup>3</sup> Discussions involving Ivan Boesky, Michael Milken, and Charles Keating, former standard players in any business law course, merely elicit blank stares from most of today's students who are

---

\*Professor, Department of Finance and Law, Central Michigan University.

\*\* Assistant Professor, Business Administration Department, Daemen College.

<sup>1</sup> See Kevin McCoy, *Madoff Lawsuit: Mets Owners Owe Victims \$300M*, USA TODAY (Feb. 4, 2011), available at

[http://www.usatoday.com/money/industries/brokerage/2011-02-04-madoff-trustee-vs-mets-owners\\_N.htm](http://www.usatoday.com/money/industries/brokerage/2011-02-04-madoff-trustee-vs-mets-owners_N.htm) (noting that Madoff's Ponzi scheme has, in fact, impacted professional sports now as well).

<sup>2</sup> See Milton C. Reagan, Jr., *Ethics in Corporate Representation: Teaching Enron*, 74 *FORDHAM L. REV.* 1139 (2005) (noting that the word "Enron" has become a shorthand reference for corporate wrongdoing in the first years of the twenty-first century, and that though analyzing the complex transactions by the lawyers involved with Enron's downfall might actually raise more questions than provide answers, asking the right questions is an important aspect of effective teaching); see also Porcher L. Taylor, III, Fernando M. Pinguelo & Timothy D. Cedrone, *The Reverse-Morals Clause: The Unique Way to Save Talent's Reputation and Money in a New Era of Corporate Crimes and Scandals*, 28 *CARDOZO ARTS & ENT. L.J.* 65, 80-89 (2010) (discussing Enron, Madoff, and others which ultimately led to the enactment of Sarbanes-Oxley).

<sup>3</sup> See generally J. Scott Dutcher, *From the Boardroom to the Cellblock: The Justifications for Harsher Punishment of White-Collar and Corporate Crime*, 37 *ARIZ. ST. L.J.* 1295 (2005); see also generally Jayne W. Barnard, *The Dysfunctional Board: Causes and Cures: Narcissism, Over-Optimism, Fear, Anger, and Depression: The Interior Lives of Corporate Leaders*, 77 *U. CIN. L. REV.* 405 (2008); Frank B. Cross & Robert A. Prentice, *The Economic Value of Securities Regulation*, 28 *CARDOZO L. REV.* 333, 336 (2006).

separated from these men by decades.<sup>4</sup> Given the daily and ubiquitous media coverage of the ethical quandaries of professional athletes, student-athletes, fans, coaches and athletic administrators, sport can be a springboard from which instructors can leap into the more traditional and complex business and corporate dilemmas.<sup>5</sup>

We recommend addressing ethics after establishing a general foundation as well as its relationship to law, the American legal system, and the role of lawyers.<sup>6</sup> It also might be helpful to explain to students the practical nature of these examples as they may someday serve as a juror, manager, lawyer, coach or athletic administrator facing difficult choices and decisions. Rather than characterize decisions as *right* or *wrong* instructors should present the sport related ethical dilemmas in a balanced fashion so that students are encouraged to ponder and decide for themselves their stance on an issue. Rushing to judgment should be discouraged.<sup>7</sup> Considerable emphasis is placed in this article on the intercollegiate environment, the college-world in which we teach and our students have enrolled.

---

<sup>4</sup> See, e.g., Marianne M. Jennings, *A Primer on Enron: Lessons From A Perfect Storm of Financial Reporting, Corporate Governance and Ethical Culture Failures*, 39 CAL. W. L. REV. 163, 231-32 (2003) (noting prison terms and reforms following insider trading schemes and junk bonds); see also generally Jonathan G. Katz, *Reviewing the SEC, Reinvigorating the SEC*, 71 U. PITT. L. REV. 489 (2010).

<sup>5</sup> JOEL NATHAN ROSEN, *THE EROSION OF THE AMERICAN SPORTING ETHOS* (MCFARLAND & Co. 2007).

<sup>6</sup> See, e.g., Rakesh K. Anand, *Toward an Interpretive Theory of Legal Ethics*, 58 RUTGERS L. REV. 653 (2006) (organizing article around one simple question: "Where's the law in legal ethics?").

<sup>7</sup> See, e.g., Anita Bernstein, *Pitfalls Ahead: A Manifesto for the Training of Lawyers*, 94 CORNELL L. REV. 479, 505-6 (2009).

II. ETHICS

*“We may have broken rules...but we did not cheat.”*<sup>8</sup>

Before exploring issues and examples, we suggest asking students to define the term *ethics* in their own way.<sup>9</sup> A simple definition is, “The discipline dealing with what is good and bad with a moral duty and obligation.”<sup>10</sup> Ethics in sport might best be described by a quote initially applied to the medical profession, namely that “an ethic of service is at war with a craving for gain.”<sup>11</sup> That is, while most coaches, administrators and sport participants claim they subscribe to the principles of ethics and good sportsmanship, it is likely that they do so on the condition that such principles do not impede the likelihood of winning.<sup>12</sup> Thus, the struggle between playing by the rules and competing at-all-costs is often at the heart of the issue.<sup>13</sup>

---

<sup>8</sup> Jim Calhoun, *quoted in* SPORTS ILLUSTRATED, (Nov. 22, 2010), *available at* <http://sportsillustrated.cnn.com/vault/article/magazine/MAG1177590/index.htm> (quoting the University of Connecticut head basketball coach related to the NCAA investigation related to his university’s recruiting violations).

<sup>9</sup> It is worthwhile to note that the approach to teaching ethics in most business and sport law courses is through a discussion of ethical theories such as *Profit Maximization Theory*, *Ethical Fundamentalism*, *Kantian Theory*, *Utilitarianism*, *Social Justice Theory*, and *Ethical Relativism*. The connection to sport are not the subject of this article; however, from our experiences, sport examples connect well with these topics and could be used to supplement materials often included in the popular business law textbooks such as those published by Cengage Learning, McGraw-Hill, Pearson Education, and other companies.

<sup>10</sup> WEBSTER’S DICTIONARY OF LAW (1st ed. 1996).

<sup>11</sup> Gregg Easterbrook, *A Doctor’s Desire to Do Good-And Do Well*.

NEWSWEEK, Jan. 26, 1987 at p. 52.

<sup>12</sup> See Susan B. Shurden, Juan Santandreu & Michael C. Shurden, *How Student Perceptions of Ethics Can Lead to Future Business Behavior*, 12 J. LEGAL, ETHICAL & REG. 1 (2010); *see also* ANGELA LUMPKIN, MODERN SPORTS ETHICS (2009).

<sup>13</sup> See, e.g., Associated Press, *Bruce Pearl Says He Misdemean NCAA*, ESPN (Sept. 10, 2010), <http://sports.espn.go.com/ncb/news/story?id=5554682> (noting that as a preemptive strike during an NCAA investigation of rules violations, the

### III. BRIDGING THE GAP: STARTER TOPICS

*“The most important thing...is not winning but taking part...”*<sup>14</sup>

In using current sport-related examples, we have found that more students are willing to participate because they can relate to the context or are otherwise familiar with the ethical dilemma. As Millennials, most of today’s students are members of the *Google Generation*, and are quite attached to their smartphones.<sup>15</sup> The use of smartphones can create challenges for professors in the classroom, but such devices could also serve as a tool to engage students outside the classroom learning environment.<sup>16</sup> Using sport-related examples allows students to research and explore ethical dilemmas via the internet immediately after class available with just a just a few clicks.<sup>17</sup>

The following sections provide a set of *starter topics* coupled with examples to serve as a starting point to explore ethical and moral concerns in the context of sport. These topics cover subjects that business law professors should be accustomed to presenting. It is the authors’ hope that even if sports law is an area of only tangential interest for some, that consideration will still be given to its use as a matter of pedagogy. The sections below cover areas from youth sport to college sports to the professional ranks.

---

University of Tennessee athletics director self-imposed penalties to head and assistant coaches but all were still retained as employees).

<sup>14</sup> Pierre de Coubertin, *quoted in* James Ryan, *Rick Hawn Talks Recent Signing with Bellator and the Olympic Experience*, BLEACHER REPORT (Sept. 20, 2010), <http://bleacherreport.com/articles/468863-rick-hawn-talks-recent-signing-with-bellator-and-the-olympic-experience>.

<sup>15</sup> *See, e.g.*, Joan Catherine Bohl, *Generations X and Y in Law School: Practical Strategies for Teaching the “MTV/Google” Generation*, 54 LOY. L. REV. 775 (2008); *see also* Adam Epstein, *Teaching Torts with Sports*, 28 J. LEGAL STUD. EDUC. 117, 118 (2011).

<sup>16</sup> *See* Bohl, *supra* note 15.

<sup>17</sup> *Id.*; *see also* Benjamin V. Madison, III, *The Elephant in Law School Classrooms: Overuse of The Socratic Method as an Obstacle to Teaching Modern Law Students*, 85 U. DET. MERCY L. REV. 293 (2008).



### A. *Fraud and Sport*

A good starting point from which to explore ethics through sport is demonstrating examples of fraud in sport. Instructors should invite students to think of ways in which participants knowingly or intentionally break the rules of the game in order to win. Examples of fraud in sports occur at various levels and are characterized in many different ways including academic fraud,<sup>18</sup> résumé fraud,<sup>19</sup> participation fraud,<sup>20</sup> or even recruiting fraud.<sup>21</sup> Sadly, these examples reflect a culture of win at all costs and the lucrative reward systems that accompany victory.<sup>22</sup>

Perhaps the most infamous participation fraud occurred at the 1980 Boston Marathon when Rosie Ruiz used a subway train to win the women's race.<sup>23</sup> More recently, in 2010 West Texas high school

---

<sup>18</sup> See generally Glenn Wong, Kyle Skillman & Chris Deubert, *The NCAA's Infractions Appeals Committee: Recent Case History, Analysis and the Beginning of a New Chapter*, 9 VA. SPORTS & ENT. L.J. 47 (2009).

<sup>19</sup> See Brent C. Moberg, *Navigating the Public Relations Minefield: Mutual Protection Through Mandatory Arbitration Clauses in College Coaching Contracts*, 16 J. LEGAL ASPECTS OF SPORT 85 (2006) (referencing inaccuracies on Coach George O'Leary's resume resulting in only a five-day tenure as the head football coach).

<sup>20</sup> Associated Press, *Police Find Vikings' Smith with Kit to Circumvent Drug Tests*, ESPN (May 11, 2005), <http://sports.espn.go.com/espn/wire?section=nfl&id=2057658> (referencing Onterio Smith and his possession of "The Original Whizzinator" which is used to falsify a urine sample).

<sup>21</sup> See Gene Wojciechowski, *College "Recruit's" Lie a Tale Gone Horribly Wrong*, ESPN (Feb. 8, 2008), [http://sports.espn.go.com/espn/columns/story?columnist=wojciechowski\\_gene&id=3236039](http://sports.espn.go.com/espn/columns/story?columnist=wojciechowski_gene&id=3236039) (discussing Kevin Hart and his fraudulent scheme to convince others that he was actually being recruited for football in 2007).

<sup>22</sup> See C. Paul Rogers III, *The Quest for Number One in College Football: The Revised Bowl Championship Series, Antitrust, and the Winner Take All Syndrome*, 18 MARQ. SPORTS L. REV. 285, 303-4 (2008).

<sup>23</sup> *Rosie Ruiz Arrested*, N.Y. TIMES (Nov. 20, 1983), available at <http://query.nytimes.com/gst/fullpage.html?res=9A0CE2D91339F933A15752C1A965948260>; see also USA TODAY, *China Loses Olympic Medal over*

student Jerry Joseph misrepresented his name and age, and hid the fact that he had already graduated so he could play basketball at West Texas high school.<sup>24</sup> Joseph led his team to the state Texas playoffs before his real status (and name) was discovered.<sup>25</sup> Perhaps the most egregious example of age misrepresentation is the case involving Little League baseball star Danny Almonte.<sup>26</sup> Fraud could also include feigning an injury during a sports contest to gain a competitive advantage by a delay.<sup>27</sup>

Not all competitors are willing participants in an attempt to break the rules or otherwise implement a fraudulent scheme. In 2003, high school football player Nate Haasis set a state passing record as a result of an agreement (unbeknownst to him) between both teams' coaches to let his Springfield, Illinois high school team score a touchdown. Three days later, Haasis asked that the pass be removed from the record books and his request was granted.<sup>28</sup> Similarly, in 2008, golfer J.P. Hayes realized that he inadvertently

---

*Underage Gymnast* (Apr. 29, 2010), available at [http://www.usatoday.com/sports/olympics/2010-04-28-olympic-medal-underage-gymnast\\_N.htm](http://www.usatoday.com/sports/olympics/2010-04-28-olympic-medal-underage-gymnast_N.htm) (reporting the subsequent awarding of the bronze medal to the U.S. team as well).

<sup>24</sup> *Texas High Schooler Proven to be a 22-year-old with an Alias*, USA TODAY (May 12, 2010), available at [http://www.usatoday.com/sports/preps/basketball/2010-05-05-prep-imposter\\_N.htm](http://www.usatoday.com/sports/preps/basketball/2010-05-05-prep-imposter_N.htm). (he was really 22 years old, and his real name is Guerdwich Monimere).

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

<sup>26</sup> See Bruce W. Neckers, *Cheating*, 81 MICH. BAR J. 13 (2002) (noting that Almonte was well-over the twelve year-old age limit to participate in the Little League World Series, revealed long after he led his team to the title).

<sup>27</sup> See John Hunt, *Oregon Football: Fake Injuries were Part of Cal's Game Plan*, *Source Says*, OREGONIAN (Nov. 16, 2010), available at [http://blog.oregonlive.com/behindducksbeat/2010/11/oregon\\_football\\_fake\\_injuries.html](http://blog.oregonlive.com/behindducksbeat/2010/11/oregon_football_fake_injuries.html).

<sup>28</sup> Person of the Week: Nate Haasis, ABC NEWS (Nov. 7, 2003), available at <http://abcnews.go.com/WNT/PersonOfWeek/story?id=131846&page=1>; see also *2006 Sportsman of the Year, Honor Roll*, SI.COM (Dec. 1, 2006), <http://sportsillustrated.cnn.com/2006/magazine/specials/sportsman/2006/12/01/honor.roll.nate/>.

played with an unapproved ball, and reported the violation and his self-imposed penalty that ultimately disqualified himself from Q-school, and, thus any chance of reaching the PGA Tour that year.<sup>29</sup> Had Haasis not made the request, should the record stand? Would your students self-report a penalty detrimental to themselves?

### *B. Performance Enhancing Drugs*

The use of performance enhancing drugs (PEDs) is always a hot topic. Ingestible supplements and injectable drugs have caused considerable trouble over how to detect the presence of PEDs through drug testing.<sup>30</sup> At one time concerns had been so high that state high school associations instituted drug testing for steroids and other PEDs, though in recent years such programs have been discontinued due to lack funding.<sup>31</sup> Regulating the use of PEDs has become the ultimate game of cat-and-mouse between the users and the testers, with both sides pushing the boundaries of ethical or moral conduct.<sup>32</sup> As a result of increased numbers and the

---

<sup>29</sup> ESPN.com News Services, *Hayes Turns Himself in for Using Wrong Ball, DQ'd from PGA Qualifier*, ESPN (Nov. 23, 2008), <http://sports.espn.go.com/golf/news/story?id=3712372>.

<sup>30</sup> See Joshua H. Whitman, *Winning at All Costs: Using Law & Economics to Determine the Proper Role of Government in Regulating the Use of Performance-Enhancing Drugs in Professional Sports*, 2008 U. ILL. L. REV. 459 (2008); see also Steven M. Silverberg, *Safe at Home? Assessing U.S. Efforts to Protect Youths from the Effects of Performance Enhancing Drugs in Sports*, 35 BROOKLYN J. INT'L L. 271 (2010).

<sup>31</sup> See Jim Vertuno, *Texas May Halt Steroid-Testing of School Athletes to Save Money*, TENNESSEAN (Jan. 31, 2011), available at <http://www.tennessean.com/article/20110131/NEWS08/101310347/Texas-may-halt-steroid-testing-school-athletes-save-money> (noting that the state of Florida eliminated its program in 2009 as well).

<sup>32</sup> See, e.g., Rick Collins, *Changing the Game: The Congressional Response to Sports Doping via the Anabolic Steroid Control Act*, 40 NEW ENG. L. REV. 753, 762 (2006).

accuracy of testing methods, the number of positive tests fell significantly in 2008 in the Beijing Olympic Games.<sup>33</sup>

Athletes who admit to *knowingly* use a supplement or drug considered a *banned substance* is a relatively clear example of unethical behavior in sport. Simply put, this would involve an admission of a violation of a rule. Less clear, however, is how to deal with an athlete who claims to have *unknowingly* used a PED. For example, consider American elite swimmer Jessica Hardy who tested positive in 2008 for the drug clenbuterol, a prescription drug for asthma and breathing disorders. While maintaining her innocence, Hardy accepted a two-year ban from the sport on the heels of the 2008 Beijing Olympics.<sup>34</sup> Hardy attributed the positive test to a contaminated nutritional supplement, a claim she successfully proved in a lawsuit against the manufacturer.<sup>35</sup> Although she cleared her name from intentional wrong-doing, the damage had already been done to her reputation in the swimming community and her opportunity to compete evaporated.<sup>36</sup>

A more curious question for class discussion might be whether it is ethical to knowingly use a drug or supplement whose very existence has not yet been discovered and, therefore, not tested for by an independent regulatory body. Put differently, if there is no rule which bans its use by a team, league or other governing body, is it unethical to use the drug? Or, instead, should that be lauded as innovative training methods? This was at the heart of the BALCO

---

<sup>33</sup> See Christopher S. Groleau, *Weird Science: A Look at the World Anti-Doping Agency's Questionable Testing Methods and the Need for Change to Protect International Athletes*, 13 QUINNIPIAC HEALTH L.J. 85, 91-92 (2009).

PROCON.ORG, *How Many Athletes have Committed Doping Violations at the Olympics?* (Feb. 12, 2010),

<http://sportsanddrugs.procon.org/view.answers.php?questionID=001298>.

<sup>34</sup> Karen Crouse, *For Swimmer, Ban Ends, but Burden Could Last*, N.Y. TIMES (Aug. 7, 2010), available at

<http://www.nytimes.com/2010/08/08/sports/08hardy.html>.

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

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

(Bay Area Laboratory Cooperative) scandal involving owner Victor Conte and Patrick Arnold, a chemist, who developed the designer steroid now coined tetrahydrogestrinone, known to many as THG.<sup>37</sup> THG has been linked with use by disgraced Olympian Marion Jones and others after Coach Trevor Graham alerted United States Anti-Doping Agency (USADA) officials with evidence of a used syringe.<sup>38</sup>

### C. Performance Enhancing Technology

The extent to which athletic participants may use equipment or attire, as opposed to drugs, that enhances performance has also gained considerable attention. For example, in late 2010, the National Basketball Association (NBA) prohibited players from using sneakers that allegedly could increase their vertical leap.<sup>39</sup> Meanwhile, the use of the high-tech, full body swimsuits in the competitions leading up to and during the Beijing Olympics drew international discussion.<sup>40</sup> The suits were quite effective in improving performance by reducing the amount of drag in the water by using a water repellent fabric, creating a bubble effect between the suit and the swimmer.<sup>41</sup> This allowed swimmers to maneuver on top of rather than through the water thus getting more speed out of their effort. Swimmers wearing the suit proved it worked by breaking 62 world records between its debut in February 2008 and the close of the Beijing Olympic Games.<sup>42</sup> The avalanche of world records by those who wore the suit caused

---

<sup>37</sup> Silverberg, *supra* note 30, at 292.

<sup>38</sup> Associated Press, *Coach Linked to Marion Jones Sues USADA for \$30M*, ABC NEWS (May 12, 2010), <http://abclocal.go.com/wtvd/story?section=news/local&id=7436993>.

<sup>39</sup> ESPN.com News Services, *NBA: Players Can't Wear Concept Is*, ESPN (Oct. 20, 2010), <http://sports.espn.go.com/nba/news/story?id=5703947>.

<sup>40</sup> Roger Thurow & Christopher Roads, *Fast Times*, WALL ST. J. (Aug. 14, 2008), available at <http://online.wsj.com/article/SB121865005500237497.html>.

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

<sup>42</sup> *Id.*

former Olympians such as Janet Evans to refer to the use of the suits as *technical doping*.<sup>43</sup>

In addition to the outlandish swimming performances in Beijing and due to their extreme cost ranging from \$200 to \$700, many scholastic and local swim clubs subsequently decided to ban the suits.<sup>44</sup> Fears of permanently changing the dynamic of competitive swimming led to a complete ban of the suit in January 2010.<sup>45</sup> One way to approach the ethics challenge here is to query whether the suit defeated the *spirit of the sport*, though legal at the time.<sup>46</sup> Professors and students can ponder whether exploiting loopholes in rules is unethical or, instead, merely taking advantage of an unregulated opportunity.

#### D. Repeal of an Award Ex Post Facto

The importance of sports in American culture has caused many professional athletes and coaches to be heralded as role models even if former NBA player Charles Barkley believes otherwise.<sup>47</sup> Athletic achievements are often memorialized as permanent statues

---

<sup>43</sup> Craig Lord, *Evans: End The FINA Farce and Do It Fast*, SWIMNEWS.COM (July 30, 2009), <http://www.swimnews.com/news/view/7150>.

<sup>44</sup> Vicki Michaelis, *Michael Phelps Hits Reset with New Suit at U.S. Championships*, USA TODAY (Aug. 3, 2010), available at [http://www.usatoday.com/sports/olympics/2010-08-02-michael-phelps-swimming-suit-nationals-records\\_N.htm](http://www.usatoday.com/sports/olympics/2010-08-02-michael-phelps-swimming-suit-nationals-records_N.htm).

<sup>45</sup> Lisa Dillman, *Ban on Polyurethane Bodysuits Leaves Lingering Questions*, L.A. TIMES (Jan. 16, 2010), available at <http://articles.latimes.com/2010/jan/16/sports/la-sp-michael-phelps16-2010jan16>.

<sup>46</sup> See Vicki Michaelis, *As Times Plunge, New Suits Enhancing Effects Spur Debate*, USA TODAY (July 22, 2009) available at [http://www.usatoday.com/sports/olympics/2009-07-21-swimsuits-effects\\_N.htm](http://www.usatoday.com/sports/olympics/2009-07-21-swimsuits-effects_N.htm).

<sup>47</sup> See Michael M. O'Hear, *Blue-Collar Crimes/White Collar Criminals: Sentencing Elite Athletes Who Commit Violent Crimes*, 12 MARQ. SPORTS L. REV. 427, 439 (2001). Charles Barkley was featured in a 1993 Nike commercial in which he exclaimed, "I am not a role model..."

or on prominent trophies, banners and placards. However, when such an athlete or coach engages in on-the-field, off-the-field or post-career misconduct, the model status can certainly change even if they are merely allegations.<sup>48</sup> Thus, a query involves when former stars engage in such egregious misconduct among the rules of society, should their former athletic exploits be tainted as well? Should committing a crime unrelated to their sport prevent an athlete from being inducted into a sport hall of fame or to otherwise rescind recognition for their past athletic achievement?

National attention was given to Heisman Trophy winner Reggie Bush (University of Southern California) who was subsequently found to have violated National Collegiate Athletic Association (NCAA) amateurism rules.<sup>49</sup> Bush was then declared to have been ineligible by the NCAA five years *ex post facto*.<sup>50</sup> He ultimately forfeited his Heisman Trophy and the New York Athletic Club declared no winner for the 2005 year.<sup>51</sup> Given that his rule violations were unrelated to his performance, should Bush have relinquished the award? If so, should it have been given to second place finisher Vince Young?

Moreover, the *integrity clause* as a condition precedent to being eligible for the Heisman Trophy became a centerpiece of national

---

<sup>48</sup> See Michael O'Keefe, *Massage Therapist Stephanie Dusenberry Says Brett Favre Sent Her Inappropriate Text Messages: Report*, N.Y. DAILY NEWS (Jan. 19, 2011), available at [http://www.nydailynews.com/sports/football/2011/01/19/2011-01-19\\_message\\_therapist\\_stephanie\\_dusenberry\\_says\\_brett\\_favre\\_sent\\_her\\_inappropriate\\_t.html#ixzz1D7AaRizW](http://www.nydailynews.com/sports/football/2011/01/19/2011-01-19_message_therapist_stephanie_dusenberry_says_brett_favre_sent_her_inappropriate_t.html#ixzz1D7AaRizW).

<sup>49</sup> See Bill Pennington, *Heisman Trophy Left Vacant for 2005 After Bush's Forfeit*, N.Y. TIMES (Sept. 15, 2010), available at <http://www.nytimes.com/2010/09/16/sports/ncaafotball/16heisman.html>.

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

<sup>51</sup> *Id.*; see also LaVar Arrington, *Reggie Bush's Forfeited Heisman Shines Light on Unfair System*, WASH POST (Sept. 15, 2010), [http://voices.washingtonpost.com/hard-hits/2010/09/reggie\\_bushs\\_forfeited\\_heisman.html](http://voices.washingtonpost.com/hard-hits/2010/09/reggie_bushs_forfeited_heisman.html).

discussion in 2010 when Auburn University quarterback Cam Newton won the Heisman Trophy even though his father was involved in a pay-for-play scheme regarding his son's recruitment. The father violated both Southeastern Conference and NCAA rules pertaining to such activity.<sup>52</sup> It did not help matters that Cam Newton was also involved in previous criminal activity.<sup>53</sup> Would the outcome been the same if Newton was not the leading quarterback in the nation on a team headed for a national championship watched by millions on a broadcast that reaped millions for the schools involved?

Another example might be that involving one of the greatest running backs in the history of professional football: O.J. Simpson. Though he was never convicted for the murder of his ex-wife Nicole Brown Simpson and companion Ron Goldman, many felt that O.J. Simpson's name should be removed from the Buffalo Bills *Wall of Fame* at Ralph Wilson Stadium.<sup>54</sup> Such discussions

---

<sup>52</sup> See Associated Press, *Cam Newton Wins Heisman Trophy*, ESPN (Dec. 13, 2010), <http://sports.espn.go.com/ncf/news/story?id=5909569>; see also Heisman Trophy, *Heisman Trust Mission Statement*, [http://www.heisman.com/trust/mission\\_statement.php](http://www.heisman.com/trust/mission_statement.php) (last accessed Apr. 2, 2011) ("The Heisman Memorial Trophy annually recognizes the outstanding college football player whose performance best exhibits the pursuit of excellence with integrity. Winners epitomize great ability combined with diligence, perseverance and hard work. The Heisman Trophy Trust ensures the continuation and integrity of this award...").

<sup>53</sup> Tom Weir, *Cam Newton Left Off at Least 6 Heisman Ballots*, USA TODAY (Dec. 7, 2010), available at <http://content.usatoday.com/communities/gameon/post/2010/12/cam-newton-heisman-trophy-ballots/1>.

<sup>54</sup> Jeff Pencek, *Who Is the Demon Cursing the Buffalo Bills? None Other Than O.J. Simpson*, BLEACHER REPORT (Oct. 5, 2009), <http://bleacherreport.com/articles/266819-who-is-the-demon-cursing-the-buffalo-bills>.



resurfaced in 2009 when he was convicted for armed robbery and sentenced to prison.<sup>55</sup>

### *E. Perception of Women and Sport*

The perception of women in sport has made dramatic changes in the last century at all levels, and a semester-long course could focus on this subject alone. Whether as participants, coaches, referees, journalists or broadcasters, an exploration of the evolving change in respect of women in sport today is warranted. Although many debate the role that Title IX, the federal gender equity statute, should play today in creating more opportunities for women, there is little doubt that this law has shined light on the inequities for girls and women in sport in the United States.<sup>56</sup> From the triumphant United States women's World Cup soccer victory in 1999 to the comment made by prominent radio personality Don Imus who characterized the Rutgers University women's basketball team as, "nappy-headed hos," an exploration of changing (or non-changing) perceptions might be a worthwhile jaunt.<sup>57</sup>

A timeline of the role of women in the Olympic movement demonstrates the international and historical perceptions of women and sport as well. For example, it was not until the 1972 Munich Olympic Games that women were allowed to compete in the 1,500

---

<sup>55</sup> Associated Press, *Simpson's On-field Honors to Remain Despite Robbery Conviction*. ESPN (Dec. 13, 2008), <http://sports.espn.go.com/espn/news/story?id=3767513>.

<sup>56</sup> See, e.g., J. Brad Reich, *All the [Athletes] Are Equal, but Some Are More Equal than Others: An Objective Evaluation of Title IX's Past, Present, and Recommendations for Its Future*, 108 PENN ST. L. REV. 525 (2003); compare to Megan Ryther, *Swimming Upstream: Men's Olympic Swimming Sinks While Title IX Swims*, 17 MARQ. SPORTS L. REV. 679 (2007).

<sup>57</sup> See Judy Faber, *CBS Fires Don Imus Over Racial Slur*, CBS NEWS (Apr. 12, 2007), <http://www.cbsnews.com/stories/2007/04/12/national/main2675273.shtml>.

and 3,000 meters track races.<sup>58</sup> The 1984 Los Angeles Olympics allowed women to compete in the marathon.<sup>59</sup> The 5,000 and 10,000 did not make their appearance until 1992 in Barcelona, and women's steeplechase was added for the 2008 Beijing Olympics.<sup>60</sup> The International Olympic Committee (IOC) has women's boxing on the schedule for the 2012 London Olympics.<sup>61</sup> For the first time, all 26 summer Olympic sports will have male and female competitors.<sup>62</sup>

Women have made great strides in terms of participation in sports dominated for years by boys and men. Even the arena of sports broadcasting and journalism has created numerous opportunities for women, though not without an occasional controversy.<sup>63</sup> When it comes to discussion of women and sport generally, the ethical topics may appear limitless. Some will express concerns over Augusta National Golf Club's refusal to allow female membership.<sup>64</sup> Others might gasp at the continued use of female hostesses in the recruiting process of high school athletes.<sup>65</sup>

---

<sup>58</sup> See Jonathan Little, *Running Against the Wind: Sex Discrimination in High School Girl's Cross Country*, 76 UMKC L. REV. 711 (2008).

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

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

<sup>61</sup> Associated Press, *Women's Boxing on 2012 Slate*, ESPN (Aug. 13, 2009), <http://sports.espn.go.com/oly/news/story?id=4396098>.

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

<sup>63</sup> See Sam Westmoreland, *Ines Sainz and the Most Harassed Sports Reporters*, BLEACHER REPORT (Sept. 13, 2010), <http://bleacherreport.com/articles/461230-ines-sainz-and-the-most-harrassed-sports-reporters/page/1>; See also Paul Farhi, *ESPN Fires Ron Franklin for Calling Jeannine Edwards 'Sweet Baby'*, WASH. POST (Jan. 4, 2011), available at <http://www.washingtonpost.com/wp-dyn/content/article/2011/01/04/AR2011010404164.html>.

<sup>64</sup> See generally Barbara Osborne, *Gender, Employment, and Sexual Harassment Issues in the Golf Industry*, 16 J. LEGAL ASPECTS OF SPORT 25 (2006).

<sup>65</sup> Clay Travis, *NCAA Probes Tennessee Hostesses*, FANHOUSE (Dec. 9, 2009), <http://ncaafotball.fanhouse.com/2009/12/09/ncaa-probes-tennessee-hostesses/>; see also Alexander Wolff, *Persuasive Hostesses Help Colleges Lasso Top Prospects*, SPORTS ILLUSTRATED (Aug. 31, 1987), available at <http://sportsillustrated.cnn.com/vault/article/magazine/MAG1066350/index.htm>.

Discussion of girls and women as participants in sports across the board will likely generate a vibrant discussion of rights and wrongs.

#### IV. YOUTH AND INTERSCHOLASTIC SPORT

*“What? No one around here believes in comebacks?”*<sup>66</sup>

Unfortunately, some the best examples of unethical conduct in sport include inappropriate behavior by overly aggressive parents, spectators and coaches in youth sports. In fact, according to research presented in 2006 by the American College of Sports Medicine, too many youth sports coaches overemphasize winning and engage in abusive discipline.<sup>67</sup> Although many youth sport leagues now require parents to sign a code of conduct, the prevalent misbehavior by parents of young athletes can spark a discussion on whether enough is being done to curb poor sportsmanship at the early levels.<sup>68</sup> The following sections represent poignant examples of issues involving excessive parental involvement and the degree to which adults can affect or influence perceptions of sport and its relation to sportsmanship or what society deems right or wrong in general. Because of the nature of overzealous parents in youth sport, you will not be lacking in current material.

---

<sup>66</sup> Gordon Gekko, *WALL STREET: MONEY NEVER SLEEPS* (EDWARD R. PRESSMAN FILM 2010).

<sup>67</sup> Press Release, *Coaches' Behavior at Odds with Ethics, Parents' Expectations*, AM. COLLEGE OF SPORTS MED. (June 1, 2006), available at [http://www.acsm.org/AM/Template.cfm?Section=ACSM\\_News\\_Releases&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=5342](http://www.acsm.org/AM/Template.cfm?Section=ACSM_News_Releases&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=5342).

<sup>68</sup> See, e.g., Don Banks, *Running Up the Score is Not Governed by the Unwritten Rule in the NFL*, SPORTS ILLUSTRATED (Nov. 19, 2010), available at <http://dailycaller.com/2010/11/19/running-up-the-score-is-not-governed-by-unwritten-rule-in-nfl/print/>.

A. *Raging Parents and Sportsmanship*

An example of the *raging parent* involves Thomas Junta who was convicted by a Massachusetts jury of manslaughter after it rejected the assertion that the hockey dad acted in self-defense when he beat another father to death at a youth scrimmage in 2000.<sup>69</sup> Junta was convicted of manslaughter and was sentenced six to ten years in prison. He was released in 2010.<sup>70</sup> Other examples of out-of-control parents include the 2006 conviction of Jeff Doyal Robertson. A Texas jury found the father guilty of aggravated assault with a deadly weapon in the shooting of his son's freshman football coach.<sup>71</sup>

Not all examples involving youth parents or coaches involve physical violence or abuse. In 2010, a trick play by a middle school football team in Corpus Christi, Texas drew national attention and considerable criticism.<sup>72</sup> Driscoll Middle School's quarterback, in conjunction with and supported by a premeditated "trick" play in which defenders are deceived into thinking that the snap was illegitimate, began to walk forward as if the play had not yet begun.<sup>73</sup> Defenders, still mesmerized, stand and watch the

---

<sup>69</sup> CNN, *Junta Convicted of Lesser Charge in Hockey Death*, (Jan. 11, 2002), <http://archives.cnn.com/2002/LAW/01/11/hockey.dads.trial/>; see also Dianna K. Fiore, *Parental Rage and Violence in Youth Sports: How Can We Prevent "Soccer Moms" and "Hockey Dads" from Interfering in Youth Sports and Causing Games to End in Fistfights Rather than Handshakes*, 10 VILL. SPORTS & ENT. L.J. 103, 117-120 (2003).

<sup>70</sup> Ron Sanders, *Hockey Dad in Beating Death Released from Prison*, WBZTV.COM (Aug. 27, 2010), <http://wbztv.com/local/Thomas.Junta.released.2.1882513.html>.

<sup>71</sup> Associated Press, *Parent Guilty of Aggravated Assault with Deadly Weapon*, ESPN (Feb. 27, 2006), <http://sports.espn.go.com/sports/news/story?id=2347032>.

<sup>72</sup> See Frank Deford, *Middle School Trick Play is No Laughing Matter*, SI.COM (Nov. 17, 2010) [http://sportsillustrated.cnn.com/2010/writers/frank\\_deford/11/17/driscoll.middle.school/index.html?eref=sihp](http://sportsillustrated.cnn.com/2010/writers/frank_deford/11/17/driscoll.middle.school/index.html?eref=sihp).

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

quarterback then proceed to run 67 yards for a touchdown, outrunning a defensive back who realized too late what was happening.<sup>74</sup> On video, some parents laughed with glee and admiration for the legal, yet embarrassing, play.<sup>75</sup> One wonders if such conduct, though legal, sends the *right* message to the adults of tomorrow.

### B. Mercy Rules (Running Up the Score)

Examples of running up the score or clearly excessive margins of victory abound at all levels and all sports, including youth sport.<sup>76</sup> The question presented, however, is whether there is ever a time to show mercy on an opponent during a sports contest? Should rules be drafted to force the event to end due to a clear mismatch on that day? For example, in Riverdale, Utah, Christian Heritage High School's girls varsity basketball team beat West Ridge Academy 108-3 in 2011.<sup>77</sup> What's the point? School administrators did not take kindly when, in 2009, Micah Grimes was terminated as the basketball coach at the Covenant School girls basketball team (Texas) after beating Dallas Academy 100-0.<sup>78</sup> Grimes insisted that he did not run up the score and that he had nothing for which to apologize.<sup>79</sup> Examples at the collegiate level might include Lincoln University beating Ohio State Marion 201-78 in basketball

---

<sup>74</sup> *Id.* (video embedded in the article).

<sup>75</sup> *Id.*

<sup>76</sup> See e.g., Josh Butters, 'Pups Win by 100, HANFORD SENTINEL (Dec. 16, 2010), available at [http://www.hanfordsentinel.com/sports/local/article\\_68ad13b6-09ad-11e0-a30a-001cc4c002e0.html](http://www.hanfordsentinel.com/sports/local/article_68ad13b6-09ad-11e0-a30a-001cc4c002e0.html).

<sup>77</sup> See Rick Chandler, *Pouring it On? Girls HS hoops team beats opponent 108-3*, NBC SPORTS (Jan. 25, 2011), available at <http://offthebench.nbcsports.com/2011/01/25/pouring-it-on-girls-hs-hoops-team-beats-opponent-108-3/>.

<sup>78</sup> Barry Horn, *Covenant Coach Who Beat Dallas Academy 100-0 is Fired*, DALLAS MORNING NEWS (Jan. 26, 2009), available at <http://www.dallasnews.com/sharedcontent/dws/news/localnews/stories/012609d nspocovenantnu.2781526.html>.

<sup>79</sup> *Id.*

in 2006.<sup>80</sup> At the international level, in 2008 the Slovakia women's hockey team beat Bulgaria 82-0.<sup>81</sup> Reasonable minds should ponder what purpose it served to continue play on that day.

Running up the score with huge margins of victory has presented challenges for state high school athletic associations. In fact, the football committee of the Connecticut Interscholastic Athletic Conference (CIAA), which governs high school sports, adopted a *score management* policy that would suspend coaches whose teams win by more than 50 points.<sup>82</sup> It can be presented that in NCAA college baseball, a game is to end if a team is ahead by at least 10 runs after seven innings in a nine-inning game.<sup>83</sup> Additionally in NCAA softball, the rule is invoked if one team is ahead by at least eight runs after five innings.<sup>84</sup>

## V. INTERCOLLEGIATE SPORT

*"They're not professionals. And we're not going to pay them..."*<sup>85</sup>

As mentioned earlier in this article, we believe that an effective way to connect the relationship between law and ethics is to

---

<sup>80</sup> Dave Caldwell, *University on the Defensive for Scoring 201 Points*, N.Y. TIMES (Dec. 9, 2006), available at

<http://www.nytimes.com/2006/12/09/sports/ncaabasketball/09lincoln.html>.

<sup>81</sup> ESPN.com News Services, *Bulgaria Gives Up 139 Shots on Goal in 82-0 Women's Hockey Loss*, ESPN

(Sept. 10, 2008), <http://sports.espn.go.com/oly/news/story?id=3577150>.

<sup>82</sup> Associated Press, *Coaches Face Suspension for Wins of 50-plus Points*, ESPN (May 25, 2006), <http://sports.espn.go.com/sports/news/story?id=2457707>.

<sup>83</sup> NAT'L COLLEGIATE ATHLETIC ASS'N, BASEBALL, 2011-12 RULES, RULE 5§8(b)(4), (2010).

<sup>84</sup> NAT'L COLLEGIATE ATHLETIC ASS'N, SOFTBALL, 2010-11 RULES, RULE 6§ 6.13 (2010).

<sup>85</sup> Mark Emmert, *Changing Behaviors*, NCAA OFFICE OF THE PRESIDENT (Jan. 2011), available at

<http://www.ncaa.org/wps/wcm/connect/public/NCAA/NCAA+President/NCAA+President+Mark+Emmert> (last accessed Apr. 2, 2011) (referring to student-athletes at the annual convention in San Antonio).

present material in a context in which students can relate. One way to do this is to discuss the plethora of ethical issues involving college athletics. As many students may already know, the primary governing body of collegiate athletics in the United States is the NCAA.<sup>86</sup> The organization was formed in 1909 by a group of college presidents to ensure sportsmanship, protect amateurism and promote education.<sup>87</sup> These principles have been the core of the NCAA's existence. However, since its formation the NCAA has continually struggled to create an atmosphere that balances those three principles with an *arms race* focused on more on winning and less on teaching, subsidized by billion-dollar television contracts.<sup>88</sup>

Exploration might include the influence of athletic department boosters such as Bob Burton,<sup>89</sup> Ralph Engelstad,<sup>90</sup> and Phillip Knight,<sup>91</sup> and whether their financial influence is appropriate or

---

<sup>86</sup> This article utilizes the NCAA Division I Manual. NAT'L COLLEGIATE ATHLETIC ASS'N, 2010-2011 NCAA® Division I Manual (2010-11) (hereinafter "NCAA MANUAL" when referring to specific bylaw provisions), available at <http://www.ncaapublications.com/s-13-Manuals.aspx?pagenum=2&view=0> (last accessed Apr. 2, 2011).

<sup>87</sup> NAT'L COLLEGIATE ATHLETIC ASS'N, *About the NCAA*, <http://www.ncaa.org/wps/wcm/connect/public/ncaa/about+the+ncaa> (last accessed Apr. 2, 2011).

<sup>88</sup> See Brad Wolverton, *NCAA Agrees to \$10.8-Billion Deal to Broadcast Its Men's Basketball Tournament*, CHRON. OF HIGHER EDUC. (Apr. 22, 2010), available at <http://chronicle.com/article/NCAA-Signs-108-Billion-De/65219/> (confirming that the NCAA announced it had signed a 14-year, \$10.8-billion contract with CBS and Turner Broadcasting to televise its men's basketball tournament and would provide at least \$740-million annually to NCAA member colleges and likely include an expansion of the tournament field to 68 teams).

<sup>89</sup> ESPN.com News Services, *UConn Donor Unhappy with AD*, ESPN (Jan. 26, 2011), <http://sports.espn.go.com/ncf/news/story?id=6057094>.

<sup>90</sup> See Jason Finkelstein, *What the Sioux Should Do: Lanham Act Challenges in the Post-Harjo Era*, 26 CARDOZO ARTS & ENT. L.J. 301-04 (2008).

<sup>91</sup> See, e.g., Michael Rosenberg, *Nike's Phil Knight Has Branded Oregon into National Power*, SI.COM (Jan. 7, 2011) (discussing how Phil Knight of Nike has spent more than \$300 million on the Oregon athletic program exercising extreme influence and control over the athletic department).

crosses the line between being a loyal alumnus and overall college athletic supporter to a dominant and controlling influence over their athletic department beneficiaries. As a result, the NCAA principles and rules governing sportsmanship, amateurism and academics raise numerous issues for class discussion. The next sections focus on a few ethical considerations specifically related to the NCAA and its bylaws. This may serve as a useful segment since students will likely know someone on campus who is influenced by the NCAA bylaws either directly or indirectly. Interestingly, so much is on the line with regard to remaining in compliance with NCAA bylaws and rules that the hiring of institution compliance officers has now become big business in and of itself.<sup>92</sup>

#### A. NCAA and Sportsmanship

As a private, voluntary, non-profit association of over 1,000 member institutions, the NCAA has drafted and adopted regulations called *bylaws* designed to regulate its own membership and promote certain ideals, one being sportsmanship.<sup>93</sup> For example, NCAA Bylaw 2.2.4, *Student-Athlete/Coach Relationship* states, “It is the responsibility of each member institution to establish and maintain an environment that fosters a positive relationship between the student-athlete and coach.”<sup>94</sup> However, such ideals seem impotent as college coaches are captured on video lambasting their student-athletes or other coaches for errors

---

<sup>92</sup> Matt Baker, *OU Makes Moves to Strengthen Compliance Department*, TULSA WORLD (Dec. 13, 2010), available at (noting that in 2010 OU had eight full-time staff members and in 2008 the university spent more on compliance than recruiting).

<sup>93</sup> NCAA MANUAL, *supra* note 86. The word “sportsmanship” is found 27 times in the 2010-11 NCAA Manual.

<sup>94</sup> *Id.* at p. 3; see also ESPN.com News Services, *Leach Fired Short of Tech’s Bowl Game*, ESPN (Dec. 31, 2009), <http://sports.espn.go.com/ncf/bowls09/news/story?id=4781981>.



or improprieties on the field or court with impunity.<sup>95</sup> For example, University of Kentucky head basketball coach John Calipari launched into filthy-mouthed dress-down of his player, Terrence Jones, when his team lost to the University of Alabama which, of course, was uploaded to the internet causing considerable criticism for the outrage.<sup>96</sup> Does the NCAA (or its member institutions) create rules that establish some standard of ethical behavior but inconsistently enforce those rules, if at all? If so, why have a rule?

NCAA Bylaw 10.01.1, *Honesty and Sportsmanship*, has existed since the early 1950's, though it appears to be rarely cited by the NCAA enforcement staff particularly when prosecuting major violation cases.<sup>97</sup> One example includes the University of Colorado recruiting scandal that involved strippers and rape allegations but did not trigger a 10.01.1 citation.<sup>98</sup> Indeed, of the over 6,655 of *secondary* infractions cases that occurred between

---

<sup>95</sup> See Joshua D. Winneker, *Re-living "Goon-Gate" and its Potential Legal Consequences for Universities and Colleges*, CSBN (Feb. 1, 2011), <http://collegesportsbusinessnews.com/issue/february-2011/article/re-living-goon-gate-and-its-potential-legal-consequences-for-universities-and-colleges> (discussing the potential liability involved in the 2005 incident between Temple University and St. Joseph's University in which John Chaney sent in a goon player to intentionally foul).

<sup>96</sup> See Jeff Eisenberg, *Did John Calipari Go Too Far in Berating Terrence Jones*, RIVAL.COM (Jan. 19, 2011), [http://rivals.yahoo.com/ncaa/basketball/blog/the\\_dagger/post/Did-John-Calipari-go-too-far-berating-Terrence-J?urn=ncaab-309526](http://rivals.yahoo.com/ncaa/basketball/blog/the_dagger/post/Did-John-Calipari-go-too-far-berating-Terrence-J?urn=ncaab-309526).

<sup>97</sup> NCAA MANUAL, art. 10.01.1 ("Individuals employed by (or associated with) a member institution to administer, conduct or coach intercollegiate athletics and all participating student-athletes shall act with honesty and sportsmanship at all times so that intercollegiate athletics as a whole, their institutions and they, as individuals, shall represent the honor and dignity of fair play and the generally recognized high standards associated with wholesome competitive sports.").

<sup>98</sup> See NAT'L COLLEGIATE ATHLETIC ASS'N, Legislative Services Database (LSDBi), available at <https://web1.ncaa.org/LSDBi/exec/homepage> (last accessed Apr. 2, 2011).

2001 and 2006, only seven included a 10.01.1 violation.<sup>99</sup> Only 58 of the 590 *major* infractions cases that occurred between 1953 and 2006 include a citation of 10.01.1.<sup>100</sup>

Regulating the sportsmanship of student-athletes and coaches has certainly been difficult for the NCAA. For example, Kansas State University wide receiver Adrian Hilburn saluted the stadium crowd after a touchdown against Syracuse University in the 2010 Pinstripe Bowl.<sup>101</sup> He was penalized for excessive celebration. The penalty led to his team's failed attempt for a two-point conversion as it caused the football to be moved back to the 18 yard line.<sup>102</sup> Beginning in 2011, referees of NCAA football games have discretion to take away touchdowns for a taunting gesture, quite a radical rule change in the sport.<sup>103</sup> It will be interesting to see the degree to which this rule is enforced.

### B. NCAA and the Amateurism Ideal

According to the NCAA Division I Manual, Article 1.3.1, *Basic Purpose*, the NCAA's primary mission is "to maintain

---

<sup>99</sup> See NAT'L COLLEGIATE ATHLETIC ASS'N, Glossary of Terms, *available at* <http://www.ncaa.org/wps/wcm/connect/public/NCAA/Issues/Enforcement/Rules+Enforcement+glossary+of+terms> (last accessed Apr. 2, 2011). (A secondary violation is defined by the NCAA as "an isolated or inadvertent violation that provide or intends to provide" the school with "a minimal recruiting, competitive advantage." In contrast, a major infraction is defined as "any violation that is not considered secondary" and "usually provide an extensive recruiting or competitive advantage.")

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

<sup>101</sup> See Blair Kerkhoff, *Excessive Celebration Flag Curbs K-State's Enthusiasm*, KANSAS CITY STAR (Dec. 30, 2010), *available at* <http://www.kansascity.com/2010/12/30/2551992/excessive-celebration-flag-curbs.html>.

<sup>102</sup> *Id.*

<sup>103</sup> See Dennis Dodd, *Celebrating Too Much Before TDs? Players to Learn It's Pointless*, CBS SPORTS.COM (Jan. 17, 2011), <http://www.cbssports.com/collegefootball/story/14562841/celebrating-too-much-before-tds-players-to-learn-its-pointless>.

intercollegiate athletics as an integral part of the educational program and the athlete as an integral part of the student body and, by so doing, retain a clear line of demarcation between intercollegiate athletics and professional sports.”<sup>104</sup> The NCAA promotes education as one of its primary purposes, yet a few years ago the University of Oregon hired an athletic director who did not have a college degree.<sup>105</sup> Does that send the wrong message to student-athletes?

The NCAA also prohibits student-athletes from using his or her athletics skill (directly or indirectly) for pay in any form in that sport.<sup>106</sup> The NCAA has strictly applied this bylaw to include current NCAA student-athletes from selling or bartering awards for services or apparel received through their athletic participation. For example, the suspension of five Ohio State University football players who sold awards they received for their participation in bowl games and gave away team jerseys in exchange for free tattoos.<sup>107</sup> This incident, as well as others, could lead students into an interesting discussion as to the ethics behind the NCAA’s treatment of student-athletes and whether the non-profit organization is contriving the rules as it goes along or possibly applying the rules unevenly.<sup>108</sup> The discussion could include

---

<sup>104</sup> NCAA MANUAL, art. 1.3.1, at 1 (“Basic Purpose”).

<sup>105</sup> Joel Odom, *The Pat Kilkenny Era at Oregon: Big Bucks, Big Bills*, OREGONIAN (May 12, 2009) [http://blog.oregonlive.com/behindducksbeat/2009/05/the\\_pat\\_kilkenny\\_era\\_at\\_oregon.html](http://blog.oregonlive.com/behindducksbeat/2009/05/the_pat_kilkenny_era_at_oregon.html).

<sup>106</sup> NCAA MANUAL, art. 12.1.2, at 66 (“Amateur Status”).

<sup>107</sup> See Pete Thamel, *Ohio State Players, Including Pryor, Suspended for Five Games in 2011*, N. Y. TIMES (Dec. 23, 2010), available at <http://www.nytimes.com/2010/12/24/sports/ncaafootball/24buckeyes.html>.

<sup>108</sup> See Stewart Mandel, *Ohio State Mess Fuels Notion NCAA is Making Up Rules As It Goes Along*, SI.COM (Dec. 23, 2010), [http://sportsillustrated.cnn.com/2010/writers/stewart\\_mandel/12/23/ohio-state-suspensions-ncaa/index.html](http://sportsillustrated.cnn.com/2010/writers/stewart_mandel/12/23/ohio-state-suspensions-ncaa/index.html); see also Dan Wetzel, *Pryor’s Acts Expose Charade of College Athletics*, RIVALS.COM (Jan. 3, 2011), <http://rivals.yahoo.com/ncaa/football/news?slug=dw-pryor010311> (quoting NCAA as saying, “the notion that the NCAA is selective with its eligibility

whether student-athletes should be entitled to some type of compensation or freedom to market themselves given the amount of revenue that is generated in men's basketball and football. Should student-athletes be allowed to control the use of their images in commercial video games? Should they receive a percentage of the royalties earned from the sales of their jerseys, photos and video images?<sup>109</sup>

NCAA bylaws also state that student-athletes may not hire an agent to market them for athletics related purpose. If found doing so, a student-athlete is rendered a *professional* not an *amateur* and thus deemed permanently ineligible.<sup>110</sup> The NCAA does allow for an agent in one sport (and therefore be a professional) but remain an amateur in another sport. However, the agency contract must be sport specific. Otherwise, the NCAA's position is that the agency contract automatically applies to all sports.<sup>111</sup> Does the NCAA's agency rule deny student-athletes their constitutional right to counsel?<sup>112</sup>

---

decisions and rules enforcement is another myth with no basis in fact...Money is not a motivator or factor.”).

<sup>109</sup> See AP Wire, *Basketball Star Ed O'Bannon*, CRESCENT-NEWS (Sept. 20, 2010), available at <http://www.crescent-news.com/news/article/4897744>.

<sup>110</sup> NCAA MANUAL, art. 12.3.1, at 73 (“Use of Agents, General Rule”) (“An individual shall be ineligible for participation in an intercollegiate sport if or she ever has agreed (orally or in writing) to be represented by an agent for the purpose of marketing his or her athletics ability or reputation in that sport. Further, an agency contract not specifically limited in writing to a sport or particular sports shall be deemed applicable to all sports, and the individual shall be ineligible to participate in any sport.”).

<sup>111</sup> *Id.*

<sup>112</sup> See *Oliver v. Nat'l Collegiate Athletic Ass'n*, 920 N.E.2d 203, 214 (Ohio Com.Pl. 2009) (finding “[t]he process advanced by the NCAA hinders the representation provided by legal counsel creating an atmosphere fraught with ethical dilemmas and pitfalls that an attorney consulting a student-athlete must encounter.”).

## C. NCAA and Hostile or Abusive Imagery

Though reluctant to use its unethical conduct bylaws to address sportsmanship and other behavioral concerns, the NCAA has played an active role in redefining ethics in terms of team mascots. The use of Native American imagery, in particular, has been at the forefront of discussion and debate among NCAA members. In 2005, the NCAA required 31 schools to explain the necessity of the use of American Indian tribes as mascots or nicknames.<sup>113</sup> The NCAA desired to eliminate those mascots or nicknames that were *hostile or abusive*. Stanford University and Dartmouth College (among many others including Marquette, Miami (Ohio), and St. Johns) had previously retired their *Indians* team nicknames but only after bitter fights with alumni.<sup>114</sup> Some colleges have nicknames, but not mascots (such as the Central Michigan University *Chippewas*). In May, 2006, the NCAA issued a press release, stating, "...the NCAA remains committed to ensuring an atmosphere of respect and sensitivity for all who participate in and attend our championships."<sup>115</sup>

The University of Illinois at Urbana-Champaign abandoned its use of *Chief Illiniwek* after the NCAA rejected its 2006 appeal that the mascot was neither *hostile* nor *abusive*.<sup>116</sup> The Chief was officially retired in 2007, though the *Fighting Illini* remains.<sup>117</sup> For more

---

<sup>113</sup> Staff and Wire Reports, *Native American Nicknames Still Under Fire*, USA TODAY (June 14, 2006), available at [http://www.usatoday.com/sports/college/other/2006-06-14-nicknames\\_x.htm](http://www.usatoday.com/sports/college/other/2006-06-14-nicknames_x.htm).

<sup>114</sup> Milan Simonich, *Students, Others Want IUP Indians Team Names Changed*, PG NEWS (Mar. 4, 2001), <http://www.post-gazette.com/regionstate/20010304indians3.asp>.

<sup>115</sup> Associated Press, *NCAA Takes Utah Off Banned Mascots List*, ESPN (Sept. 3, 2005), <http://sports.espn.go.com/ncaa/news/story?id=2149907>.

<sup>116</sup> Doug Lederman, *Is NCAA Using the Bully Pulpit-or Bullying?*, INSIDE HIGHER ED (May 1, 2006), <http://www.insidehighered.com/news/2006/05/01/mascot>.

<sup>117</sup> Associated Press, *University of Illinois' Controversial Mascot is Retired*, FOX NEWS (Feb. 22, 2007), <http://www.foxnews.com/story/0,2933,253520,00.html>.

than 25 years, Florida State University (FSU) students have portrayed *Chief Osceola* planting a flaming spear at midfield before every Seminoles home football game. In its report to the NCAA, FSU uses a common defense of such imagery, saying that it is respectful and a celebration of the culture. The NCAA has allowed FSU to continue to use the Chief.<sup>118</sup> In 2007, the University of North Dakota (UND) and the NCAA reached a settlement in which UND either got approval from the Spirit Lake Sioux and Standing Rock Sioux or would change their nickname. UND ultimately voted to drop the name and logo, though part of the reason was, apparently, so it could join the Summit League (Conference).<sup>119</sup> College of William and Mary's *Tribe* was not okay as long as it had feathers, so it now uses the *Tribe* though their actual mascot is a griffin.<sup>120</sup> The University of Toledo and Bowling Green University play for the *Peace Pip* in football and no one seems to be bothered by that.<sup>121</sup>

Instructors can discuss with students the extent to which college mascots, images, and logos create or promote stereotypes, and whether the NCAA's role is appropriate in this regard. Should colleges and universities with nicknames such as Vikings, Mongols, Aztecs, Warriors, Fighting Irish, Trojans, Highlanders be terminated as well? Is this consistent with the tax-exempt purpose of the NCAA and its post-season bowl games? Could all of this be

---

<sup>118</sup> See Robert Andrew Powell, *Florida State Can Keep its Seminoles*, N.Y. TIMES (Aug. 24, 2005), available at <http://www.nytimes.com/2005/08/24/sports/24mascot.html>.

<sup>119</sup> See Joe Barrett, *University Loses Sioux Mascot War*, WALL ST. J. (Apr. 10, 2010), available at <http://online.wsj.com/article/SB10001424052702304703104575174233219665968.html>.

<sup>120</sup> Associated Press, *William and Mary Adopts Griffin*, ESPN (Apr. 7, 2010), <http://sports.espn.go.com/ncaa/news/story?id=5063198>.

<sup>121</sup> See Graham Watson, *Top 5 Non-BCS In-Conference Rivalries*, COLLEGE FOOTBALL NATION BLOG (Aug. 22, 2008), [http://espn.go.com/blog/ncfnation/post/\\_/id/223/top-5-non-bcs-in-conference-rivalries](http://espn.go.com/blog/ncfnation/post/_/id/223/top-5-non-bcs-in-conference-rivalries).

a smokescreen to avoid dealing with other issues such as those previously mentioned or its multi-billion dollar tax-exempt television contract?

#### *D. NCAA Transfer Rules*

Although the NCAA does not prohibit a coach from leaving one institution for another, its general rules do prevent student-athletes from having the same freedom. Indeed, the NCAA permits coaches to transfer immediately while student-athletes have to complete one full year at their transfer school before being eligible to compete on a varsity athletics team.<sup>122</sup> Exceptions to the general rule exist for student-athletes in every sport but football, baseball, basketball and men's ice hockey, but only if the student-athlete obtains permission from his or her current institution to transfer and compete at the new school.<sup>123</sup> If the school denies permission and the appeal process unsuccessful, then the student-athlete must miss a season of competition and correspondingly lose a year of eligibility.<sup>124</sup>

In 2006, upon pressure for college athletic reform groups and others concerned about student-athlete well-being, the NCAA broadened its initial transfer exception rules.<sup>125</sup> Under the current rule, football and other revenue sport student-athletes can only use the exception if the institution that granted the undergraduate

---

<sup>122</sup> NCAA MANUAL, art. 14.5.1, at 175 (“Residence Requirement-General Rule”).

<sup>123</sup> NCAA MANUAL, art. 14.5.5.2 (“Exceptions”), 14.5.5.2.10 (“One-Time Transfer”).

<sup>124</sup> *Id.* at bylaw 14.5.5.1 (“General Rule-Four Year College Transfers”).

<sup>125</sup> See Dennis Dodd, *Football Coaches Start Pushback Against New Transfer Rule*, CBSSPORTS (May 26, 2006), <http://www.cbssports.com/collegefootball/story/9463380>.

degree does not offer the desired graduate degree.<sup>126</sup> In 2010, University of Mississippi quarterback Jeremiah Masoli had earned his bachelor's degree from the University of Oregon but was kicked off the football team after legal problems.<sup>127</sup> He attempted to transfer to the University of Mississippi but was denied his eligibility by the NCAA which claimed that his primary purpose for the transfer was for an athletic, rather than educational, purpose.<sup>128</sup> The NCAA, however, reversed itself after an appeal and decided that as the bylaw read, there was a loophole in the way the bylaw was written, and that Masoli should not be denied his opportunity to compete.<sup>129</sup>

NCAA student-athletes must receive permission from their current coach or athletic director before speaking with another institution about transferring to that school.<sup>130</sup> If this permission to speak is not granted, the student-athlete can transfer but may not receive any athletic related aid during their first year of enrollment.<sup>131</sup> To further complicate the transfer process for student-athletes, many Division I institutions only grant permission to do so if the student-athlete first agrees to not attend any school within the same

---

<sup>126</sup> *Id.*; see also John Wagner, *Switching Teams: Falcons Kicker Had Been a Wolverine*, TOLEDO BLADE (Sept. 22, 2010), available at <http://toledoblade.com/article/20100922/SPORTS03/100929909/-1/SPORTS>.

<sup>127</sup> See ESPN.com News Services, *NCAA Denies Jeremiah Masoli's Waiver*, ESPN (Aug. 31, 2010), <http://sports.espn.com/ncf/news/story?id=5516909>.

<sup>128</sup> See ESPN.com News Services, *Jeremiah Masoli Eligible at Ole Miss*, ESPN (Sept. 4, 2010), <http://sports.espn.com/ncf/news/story?id=5528636>.

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

<sup>130</sup> NCAA MANUAL, art. 13.1.1 ("Contactable Individuals"); 13.1.1.3 ("Four-Year College Prospective Student-Athletes")

<sup>131</sup> *Id.*



conference.<sup>132</sup> This further deters student-athletes from transferring to another school.<sup>133</sup>

### *E. Recruitment of High School Athletes*

The area of college recruiting provides a host of ethical issues for students and professors to discuss. NCAA bylaws have been put in place to level the playing field and include a limit on the number of official paid visits to campus by prospective student-athletes to only five institutions.<sup>134</sup> The bylaws are so specific they even outline the types and volumes of food that can be served during the visit itself.<sup>135</sup> They also prohibit helicopter and limousine transportation for prospects, and when students are presented with such information it usually draws immense laughter and discussion as to why such provisions had to be included in the first place.<sup>136</sup>

Since the number of recruits and roster members is limited per year, coaches often make extremely difficult decisions as to who receives (or retains) an athletic scholarship on an annual basis. This might cause a coach to push out current scholarship players

---

<sup>132</sup> See e.g., Bob Condotta, *Pac-10 Rules that USC Players Cannot Transfer Inside the Conference*, SEATTLETIMES.COM (June 11, 2010), [http://seattletimes.nwsourc.com/html/huskyfootballblog/2012090135\\_pac-10\\_rules\\_that\\_usc\\_players.html](http://seattletimes.nwsourc.com/html/huskyfootballblog/2012090135_pac-10_rules_that_usc_players.html).

<sup>133</sup> See e.g., Joe Schad, *Brown Wants to Transfer to K-State*, ESPN (July 31, 2010), <http://sports.espn.go.com/nfc/news/story?id=5424622> (noting that University of Tennessee head football coach Derek Dooley refused to outright release for football player from his athletic scholarship claiming he had an obligation to protect the program).

<sup>134</sup> NCAA MANUAL, art. 13.6.2.2, at 110 (“Number of Official Visits-Prospective Student-Athlete Limitations”).

<sup>135</sup> *Id.* art. 13.6.7.7, at 115 (“Meals on Official Visit”).

<sup>136</sup> *Id.* art. 13.5.2.1, at 108 (“General Restrictions”); see also generally Adam Epstein and Paul Anderson, *Utilization of the NCAA Manual as a Teaching Tool*, 26 J. OF LEGAL STUD. EDUC. 100-35 (2009).

for more talented or motivated ones.<sup>137</sup> This might include *over-signing* the number of players, in violation of NCAA rules, but to rescind those agreements if a first choice student-athlete becomes available.<sup>138</sup> The practice became so problematic in the major football programs that both the SEC and the NCAA passed legislation essentially prohibiting it in that sport.<sup>139</sup> The new rule is limited to major college football programs and addresses only the practice of signing first time students to scholarships; it does not address coaches pushing out players to make room for those with more talent.<sup>140</sup> Students may enjoy discussing the ethical implications of such practices.

In addition to the practice of over-signing student-athletes to athletic scholarships, college coaches in all of the NCAA divisions have been cited for making illusory promises regarding playing time and positions during the recruiting process that go unfulfilled once the student-athlete gets to the institution. One such case

---

<sup>137</sup> See, e.g., ESPN.com News Services, *OTL: Over The Limit*, ESPN (Dec. 19, 2010) <http://espn.go.com/video/clip?id=5935634&categoryid=2564308>; but see Gregg Doyel, *Bad Guys Utilize Over-Signing, and It Has to Stop*, CBS Sports.com (Aug. 8, 2010), <http://www.cbssports.com/collegefootball/story/13727507/bad-guys-utilize-oversigning-and-it-has-to-stop>.

<sup>138</sup> See James Kennedy Ornstein, *Broken Promises and Broken Dreams: Should We Hold College Athletic Programs Accountable for Breaching Representations Made in Recruiting Student-Athletes?*, 6 SETON HALL J. SPORTS L. 641(1996); Katherine Sulentic, *Running Backs, Recruiting, and Remedies: College Football Coaches, Recruits, and the Torts of Negligent and Fraudulent Misrepresentation*, 14 ROGER WILLIAMS U. L. REV. 127 (2009).

<sup>139</sup> See Ivan Maisel, *Coaches Work Around Signing Day Limits*, ESPN (Feb. 9, 2010), [http://sports.espn.go.com/nfl/columns/story?columnist=maisel\\_ivan&id=4899549](http://sports.espn.go.com/nfl/columns/story?columnist=maisel_ivan&id=4899549).

<sup>140</sup> See Andy Staples, *Oversigning Offenders Won't Be Curbed by NCAA's Toothless Rule*, SL.COM (Jan. 24, 2011), [http://sportsillustrated.cnn.com/2011/writers/andy\\_staples/01/24/oversigning/index.html?eref=sihp](http://sportsillustrated.cnn.com/2011/writers/andy_staples/01/24/oversigning/index.html?eref=sihp) (noting that when Football Bowl Subdivision schools begin signing football players on Feb. 2, for the first time to an NCAA bylaw that limits them to 28 signees between Signing Day and May 31).

resulted in litigation. In 1996, Brian Fortay sued the University of Miami after its former coach Jimmy Johnson promised Fortay the starting quarterback provision if he signed with the school.<sup>141</sup> One year into his career at Miami Johnson left for the NFL and Fortay did not fit into Johnson's successor's vision for the Hurricanes offense.<sup>142</sup> Fortay ultimately transferred to Rutgers, but his bitterness remained at being left with an empty promise.<sup>143</sup> The recruiting process is ultra-competitive, and students can be asked their opinion about the process itself, generally.

#### F. *Clustering and Academic Integrity*

In an attempt to raise graduation rates and stem the rising tide of criticism as to whether student-athletes are actually *athlete-students*, the NCAA adopted stricter academic and eligibility rules.<sup>144</sup> For example, as part of its major academic reform legislation of 2002, the NCAA adopted a graduation success rate (GSR) that it claimed more accurately measured that rate at which Division I student-athletes graduate.<sup>145</sup> Though critics claim that the GSR skews the data in that it does not properly measure the number of student-athletes that graduate, especially in football, the debate highlights a number of ethical issues from the accuracy of research performed with a specific goal in mind to why such an arguably skewed measuring is needed.<sup>146</sup> Similarly, the NCAA

---

<sup>141</sup> *Fortay v. Univ. of Miami*, 1994 U.S. Dist. LEXIS 1865 (D.N.J. 1994).

<sup>142</sup> *Id.*

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

<sup>144</sup> See e.g., *Ross v. Creighton Univ.*, 957 F.2d 410 (7th Cir. 1992) (affirming in part, reversing in part, and remanding the claim by former student-athlete who sought to prove university was negligent and breached its contract arising from alleged failure to educate him).

<sup>145</sup> See Welch Suggs, *Graduation Rates Rise for Athletes*, CHRON. OF HIGHER EDUC. (Nov. 5, 2008), <http://chronicle.com/article/Graduation-Rates-Rise-for/19998/>.

<sup>146</sup> Press Release, *College Sport Research Institute Releases Initial Adjusted Graduation*

compiles Academic Progress Rates (APRs) for individual teams for the previous six years. The APR awards one point per semester for those student-athletes who remain in school or graduating and another for maintaining academic eligibility.

Starting in August 2010, the NCAA affixed APR score to coaches shining a spotlight on them and the role they play in their athletes' academic success, coaches have voiced reservations about the plan, arguing that they are being singled out when, in fact, faculty, tutors and others on campus also might be held accountable. Essentially, the new NCAA rules have caused its members to create a certain set of academic degrees that student-athletes might choose so to allow them an allegedly easier path to academic eligibility and graduation.<sup>147</sup> What ethical implications arise from such measurements? Students could consider the academic/athletic environment in which would make such a measurement necessary in the first place?<sup>148</sup> Although the rules have resulted in a greater number of NCAA student-athletes graduating within a desired five-year window, some critics, including the media, assert that student-athletes are limited to pursuing a certain course of study of "easy" majors under this system.<sup>149</sup> *Clustering* is the term used to describe such tactics.<sup>150</sup>

---

*Gap (AGG) Results* (Apr. 20, 2010), available at [http://www.unc.edu/depts/exercise/csri/PDF/AGG%20Embargoed%20Press%20Release\\_1.0.pdf](http://www.unc.edu/depts/exercise/csri/PDF/AGG%20Embargoed%20Press%20Release_1.0.pdf) (last accessed Apr. 2, 2011).

<sup>147</sup> See Brad Wolverton, *Athletics Participation Prevents Many Players from Choosing Majors They Want*. CHRON. OF HIGHER EDUC. (Jan. 8, 2007), <http://chronicle.com/article/Athletics-Participation-Pre/122712/>.

<sup>148</sup> See David Moltz, *NCAA Grades Coaches*, INSIDE HIGHER ED (Aug. 6, 2010), <http://www.insidehighered.com/news/2010/08/06/coaches>.

<sup>149</sup> See e.g., Glenn Dickey, *Harbaugh Can Resurrect the Cardinal*. SAN FRANCISCO EXAM'R (May 3, 2007), available at <http://www.sfoxaminer.com/sports/dickey-harbaugh-can-resurrect-cardinal> (noting that Stanford University coach and former University of Michigan quarterback stated that UM steered him toward a less rigorous major); see also J. J. Fountain & P. S. Finley, *Academic Majors of Upperclassmen Football Players in the Atlantic Coast Conference: An Analysis of Academic Clustering Comparing White and Minority Players*, 2 J. ISSUES IN INTERCOLLEGIATE

In addition to clustering, instances academic fraud involving prospective student-athletes and current student-athletes have been well reported. Some situations demonstrate a lack of institutional control causing an inquiry and evaluation by the NCAA Committee on Infractions.<sup>151</sup> Recent changes to NCAA academic standards have resulted in a new set of ethical dilemmas in which some claim that student-athletes with poor academic performance fraudulently seek disability status in order to obtain greater accommodation under NCAA bylaws.<sup>152</sup>

---

ATHLETICS, 1 (2009) [http://csri-jiia.org/documents/puclications/research\\_articles/2009/Jiia\\_2009\\_1\\_Fountain\\_Publish%20Copy\\_1.0.pdf](http://csri-jiia.org/documents/puclications/research_articles/2009/Jiia_2009_1_Fountain_Publish%20Copy_1.0.pdf) (noting that while academic clustering occurred for football student-athletes in the Atlantic Coast Conference, it occurs at a much higher rate for African-American players). ()

<sup>150</sup> See Brad Wolverton, *NCAA Committee to Explore Concerns Over Athletes' Clustering in Certain Major*, CHRON. OF HIGHER EDUC. (Jan. 14, 2008), available at <http://chronicle.com/article/NCAA-to-Explore-Concerns-Over/396/>; see also Erik Brady, *Advisers Face a 'Burn-out Field': Competing Interests Make Guiding Athletes Thorny*, USA TODAY, (Nov. 20, 2008) available at [http://www.usatoday.com/printedition/sports/20081120/majors20\\_cv.art.htm](http://www.usatoday.com/printedition/sports/20081120/majors20_cv.art.htm).

<sup>151</sup> See Gene A. Marsh, *A Call for Dissent and Further Independence in the NCAA Infractions Process*, 26 CARDOZO ARTS & ENT. L.J. 695 (2009); Frank J. Ferraro, *When Athletics Engulfs Academics: Violations Committed by University of Minnesota Basketball*, 1 DEPAUL J. SPORTS L. CONTEMP. PROBS. 13 (2003); see also M. Tae Phillips, *Un-Equal Protection: Preferential Admissions Treatment for Student Athletes*, 60 ALA. L. REV. 751 (2009); Cliff Potter, *Expanding UNC Football Investigation: Lack of Institutional Control?*, BLEACHER REPORT (Aug. 27, 2010), <http://bleacherreport.com/articles/444312-expanding-unc-football-investigation-lack-of-institutional-control>.

<sup>152</sup> Josh Barr, *Fraudulent Disabilities A Concern to NCAA*, WASH. POST (June 30, 2007), available at <http://www.washingtonpost.com/wp-dyn/content/article/2007/06/29/AR2007062902235.html>.

### G. Religious Issues

The NCAA is a private organization and not considered a state actor.<sup>153</sup> Still, situations among its state-supported member colleges and universities have given considerable pause as to the possible excessive governmental entanglement with religion.<sup>154</sup> For example, consider the 2004 incident at the federally funded United States Air Force Academy which briefly had a banner hung in the locker room by head football coach Fisher DeBerry.<sup>155</sup> This banner was known as the *Competitors Creed*, a four-paragraph poem from the Fellowship of Christian Athletes (FCA) which begins, “I am a Christian First and Last.” The banner stayed up for one day before the coach was asked to remove it by Academy officials.<sup>156</sup> Students might be called upon to review the poem and then explain whether they feel DeBerry may have crossed the line.<sup>157</sup>

---

<sup>153</sup> See Alain Lapter, *Bloom v. NCAA: A Procedural Due Process Analysis and the Need for Reform*, 12 SPORTS LAW. J. 255 (2005) (referencing the seminal case *NCAA v. Tarkanian*, 488 U.S. 179 (1988)).

<sup>154</sup> See generally Adam Epstein, *Religion and Sports in the Undergraduate Classroom: A Surefire Way to Spark Student Interest*, 21 SOUTHERN LAW J. 1, 133-49 (2011).

<sup>155</sup> See Heather Cook, *Service Before Self? Evangelicals Flying High at the U.S. Air Force Academy*, 36 J.L. & EDUC. 1, 8 (2007) (noting that two weeks after the Academy initiated a program of religious tolerance, football coach Fisher DeBerry hung a banner in the football locker room declaring, “I am a Christian first and last, I am a member of Team Jesus Christ.” Despite an official reprimand from Academy officials, DeBerry allegedly continued to advise players to attend church the day after games and stating that “religion is what we’re all about at the Academy.”)

<sup>156</sup> Michael Bradley, *Separation of Church and Football*, SPORTS ILLUSTRATED (May 26, 2005), available at <http://sportsillustrated.cnn.com/vault/article/web/COM1045050/index.htm> (noting that DeBerry’s actions were “dangerous” due to the tremendous influence he has over his impressionable student-athletes).

<sup>157</sup> FELLOWSHIP OF CHRISTIAN ATHLETES, <http://www.fca.org/aboutfca/> (last accessed Apr. 2, 2011).

Brigham Young University (BYU), a Mormon institution, maintains a policy against Sunday competition in accordance with religious beliefs.<sup>158</sup> BYU takes this competition principle very seriously, and remains a holdout in NCAA's Division I, remaining true to its roots.<sup>159</sup> Often referred to as the *BYU Rule*, this rule meant that NCAA Division I schools were not required to participate in athletic competitions held on Sundays.<sup>160</sup> The rule has been modified now and calls for teams to formally register their refusal to play on certain days with the NCAA before the beginning of the academic year.<sup>161</sup>

Similarly, recent National Football League (NFL) first-round draft choice Tim Tebow, a Heisman Trophy winner from the University of Florida, who also regularly wore eye black containing Biblical verses for years as a student-athlete.<sup>162</sup> After his departure, the NCAA changed its playing rules to prevent eye black messages which some now refer to as the *Tim Tebow Rule*.<sup>163</sup>

---

<sup>158</sup> See Epstein, *supra* note 154, at 137-41; see also Lee Benson, *BYU is Lone Holdout for Not Playing on Sundays*, DESERET NEWS, Jul. 6, 2010, available at <http://www.deseretnews.com/article/700046058/BYU-is-lone-holdout-for-not-playing-on-Sundays.html> (noting that other private institutions run by Christian churches such as Southern Methodist, Texas Christian, St. Joseph's, and Notre Dame do not have a similar policy). Brigham Young University is sponsored by the Church of Jesus Christ of Latter-Day Saints (LDS).

<sup>159</sup> *Id.*; see also History of BYU, BRIGHAM YOUNG UNIV., <http://yfacts.byu.edu/viewarticle.aspx?id=137> (last accessed Apr. 2, 2011).

<sup>160</sup> See Scott C. Idleman, *Religious Freedom and the Interscholastic Athlete*, 12 MARQ. SPORTS L. REV. 295 (2001).

<sup>161</sup> See NCAA MANUAL, art. 31.1.4.1 ("Institutional Policy"). This provision requires advance notice for the NCAA to accommodate possible scheduling conflicts during the academic year for its championships.

<sup>162</sup> Josh Wiley, *Tim Tebow Bible Verses-Game by Game*, ASSOCIATED CONTENT (Jan. 1, 2010), [http://www.associatedcontent.com/article/2546065/tim\\_tebow\\_bible\\_verses\\_game\\_by\\_game.html](http://www.associatedcontent.com/article/2546065/tim_tebow_bible_verses_game_by_game.html).

<sup>163</sup> Michael DiRocco, *The Message is Out on Eye Black in College Football and the NFL*, JACKSONVILLE.COM (Apr. 17, 2010), <http://jacksonville.com/sports/college/florida-gators/2010-04-17/story/message-out-eye-black-college-football-and-nfl>.

## VI. PROFESSIONAL SPORT

*“I am not a role model.”*<sup>164</sup>

The professional sport environment is remarkably different than the intercollegiate, interscholastic and youth sport environments, primarily due to the nature of the participants. That is, the athletes are paid professionals. Much attention is given to the big four major professional sports leagues in North America, the National Football League (NFL), National Basketball Association (NBA), Major League Baseball (MLB) and the National Hockey League (NHL).<sup>165</sup> Understanding ethics in the professional sport context certainly requires an appreciation of the nature of collective bargaining in general and its influence on the sometimes tenuous nature of the relationship between players, coaches and owners.<sup>166</sup> This section focuses only on two brief sections.

### A. *Role of the Commissioner*

Much deference is given to the power of league commissioners in determining punishment for on-the-field misbehavior (during the

---

<sup>164</sup> Charles Barkley, *quoted in* “I am not a Role Model” Nike Air Commercial, YOUTUBE.COM (1993), *available at* <http://www.youtube.com/watch?v=R8vh2MwXZ6o> (last accessed Apr. 2, 2011).

<sup>165</sup> The *big four* is a phrase commonly used to describe the four major North American professional sports leagues: the National Basketball Association, the National Football League, Major League Baseball and the National Hockey League. *See, e.g.,* Marc Edelman, *How to Curb Professional Sports’ Bargaining Power Vis-à-vis the American City*, 2 VA. SPORTS & ENT. L.J. 280, 291 (2003); *see also* Tim Chapin, *Sports Facilities and Development: The Political Economy of Sports Facility Location: An End-of-the-Century Review and Assessment*, 10 MARQ. SPORTS L.J. 361 (2000).

<sup>166</sup> *See* Vittorio Tafur, *Tom Cable Files Grievance Against Raiders*, SFGATE.COM (Jan. 17 2011), [http://articles.sfgate.com/2011-01-17/sports/27033235\\_1\\_al-davis-raiders-senior-executive-lane-kiffin](http://articles.sfgate.com/2011-01-17/sports/27033235_1_al-davis-raiders-senior-executive-lane-kiffin).



course of the game) and unethical conduct off-the-field as well.<sup>167</sup> Exploring the role of the commissioner in the big four sports leagues, which has become much more proactive in handing down punishment for off-the-field incidents, might inspire students to consider the importance of a contract, codes of conduct, and consequences for actions.

For example, current NFL commissioner Roger Goodell has not been bashful in exercising his right to issue penalties under the league's personal conduct policy. In 2010, the NFL commissioner suspended Pittsburgh Steelers quarterback Ben Roethlisberger for six games for violating the policy. Goodell handed down the punishment one week *after* prosecutors decided not to charge Roethlisberger in a case involving a college student who accused him of sexually assaulting her in a Georgia nightclub in March, 2010.<sup>168</sup> Roethlisberger became the first player suspended by Goodell under the personal conduct policy who had not been arrested or charged with a crime.<sup>169</sup>

A similar debate regarding the breadth of powers of the MLB commissioner occurred as far back as 1964 when Major League Baseball enhanced the commissioner's powers.<sup>170</sup> One specific power found in the MLB constitution is a clause called the "best

---

<sup>167</sup> See, e.g., Taylor, III, Pinguelo & Cedron, *supra* note 2, at 102-4 (referencing quarterback Michael Vick's involvement in a dog-fighting conspiracy and the manner in which Commissioner Goodell reinstated him to the Philadelphia Eagles).

<sup>168</sup> Alan Robinson, *A Slimmer Roethlisberger Back in Steelers Practice*, NEWS-HERALD (June 1, 2010), <http://www.havasunews.com/articles/2010/09/22/sports/doc4c05e44ebb082276363672.txt>.

<sup>169</sup> ESPN.com News Services, *Roethlisberger Suspended by NFL*, ESPN (Apr. 22, 2010), <http://sports.espn.go.com/nfl/news/story?id=5121614>.

<sup>170</sup> *The Commissionership: A Historical Perspective*, MLB.COM, [http://mlb.mlb.com/mlb/history/mlb\\_history\\_people.jsp?story=com](http://mlb.mlb.com/mlb/history/mlb_history_people.jsp?story=com) (last accessed Apr. 2, 2011).

interests of baseball” clause.<sup>171</sup> Allen “Bud” Selig’s interpretation of “best interests” has largely expanded. For example, in 2010, some suggested that Selig missed an opportunity to invoke the best interests of baseball clause to override the clearly erroneous call made by MLB first-base umpire Jim Joyce, which forfeited the chance for Detroit Tigers pitcher Armando Galarraga to become only the 21<sup>st</sup> pitcher in MLB history to pitch a perfect game.<sup>172</sup>

### B. Retiring (Un-Retiring) From Competition

Brett Favre is the most recent example of professional athletes in the spotlight who seem to be unable to walk away from their sport though he has taken the indecision to a higher level.<sup>173</sup> Favre’s consistent and annual display of uncertainty with regard to retirement has cause heated debate for years.<sup>174</sup> Could fans sue for various contract law theories including intentional interference with contractual relations, breach of contract, promissory estoppel (i.e., *detrimental reliance*) if, for example, the fans relied on the decision by the athlete or coach, bought (or relinquished) their

---

<sup>171</sup> MAJOR LEAGUE CONSTITUTION, <http://www.bizofbaseball.com/docs/MLConstitutionJune2005Update.pdf> (last accessed Apr. 2, 2011).

<sup>172</sup> Associated Press, *Joyce, Armando Galarraga Have a Low-Key Reunion*, NBC SPORTS (Sept. 10, 2010), <http://nbcsports.msnbc.com/id/39105339/ns/sports-baseball/>.

<sup>173</sup> See Doug Farrar, *The Brett Favre Retirement Story: A ‘Mad Libs’ Version*, YAHOO! SPORTS (Jan. 17, 2011), [http://sports.yahoo.com/nfl/blog/shutdown\\_corner/post/The-Brett-Favre-retirement-story-A-Mad-Libs-v?urn=nfl-308637](http://sports.yahoo.com/nfl/blog/shutdown_corner/post/The-Brett-Favre-retirement-story-A-Mad-Libs-v?urn=nfl-308637); see also Martin S. Bell, *Saved by the Bell: Going Away Often*, HARVARD CRIMSON (Feb. 14, 2001), available at (noting the frustration in dealing with that other high-profile athletes such as Mario Lemieux, Dominik Hasek and even Michael Jordan retiring from a sport, having a formal retirement ceremony, and then un-retiring thereafter including coaches such as Dick Vermeil).

<sup>174</sup> Farrar, *supra* note 173; see also Mark J. Miller, *Cashman to Pettite: ‘Don’t Brett Favre Us’*, YAHOO! SPORTS (Jan. 19, 2010), <http://sports.yahoo.com/mlb/rumors/post/Cashman-to-Pettite-Don-t-Brett-Favre-us?urn=mlb-309474> (referring to uncertainty in the decision-making process of star pitcher Andy Pettitte).

season tickets because a player then changed their mind? Could fans sue for the intentional (or negligent) infliction of emotional distress?

## VII. CONCLUSION

The purpose of this article is to encourage professors to explore ethics in the context familiar to many of their students: the ubiquitous discussion of sports at all levels of participation and across a variety of environments. Many, if not all, of the ethical concerns or issues above involve legal issues as well and could certainly be utilized in a fundamental business law course at the appropriate time. As shown, the NCAA is riddled with examples ripe for discussion. It will be interesting to see if any referees actually take away a touchdown due to excessive celebration and, if so, what real impact that would have for the referees themselves. In the professional sport context, the Ben Roethlisberger example demonstrates that sometimes mistakes might lead to other opportunities and second chances. In youth sport, concerns over raging parents will continue to present ethical and legal challenges for local communities. In college sport, ethical breaches, challenges and other considerations might be part of the reason for the continued evolution and growth of the NCAA Manual and its bylaws.

We believe that it is vitally important for the educator to remain as neutral as possible when presenting the material so as to appear as a mediator of sorts rather than promoting an agenda. Regardless of how neutral students appear to be, no doubt some of these issues can provoke even the most introverted students into the debate. Discussion of classic business law cases such as Enron are certainly worthwhile, but we believe that as a supplement or introduction to the standard material, consideration can be given to the use of sports examples as that is a context that many students can relate. Participation in such discussions enhances the active-learning environment and challenges the students and professors

alike. While the study of Enron's demise and Madoff's Ponzi scheme is important, we believe that using sport to teach ethics is equally effective and get students to close their laptops, turn their smartphones to "buzz," and actually engage in discussion and debate, even if just for the moment.

A FOCUS ON THE FOREIGN CORRUPT PRACTICES ACT  
(FCPA):  
*SIEMENS AND HALLIBURTON* REVISITED AS INDICATORS  
OF CORPORATE CULTURE

by

*Richard J. Hunter, Jr.,\* David Mest,\*\* & John Shannon\*\*\**

I. INTRODUCTION

The February 12, 2010 *Economist* reported: “The Obama administration is enforcing the Foreign Corrupt Practices Act [FCPA] with evangelical zeal—and employing techniques once reserved for fighting organized crime.”<sup>1</sup> In a similar fashion, attorneys Stephen J. Haedicke and W. Richard Schroeder, commenting on events of September of 2008, noted that “This recent flurry of activity confirms that the DOJ [Department of Justice] is holding steady on its promise to go after individuals

---

\* Professor of Legal Studies, Seton Hall University; Adjunct Professor of Law, Rutgers University School of Law-Camden and Newark.

\*\* Faculty Associate, Department of Accounting and Taxation, Seton Hall University.

\*\*\* Associate Professor of Legal Studies, Seton Hall University.

<sup>1</sup> *Businesspeople Need to Think Harder About Political Risk*, *ECONOMIST*, Feb. 12, 2011, at 75.

involved in FCPA violations, and not just companies.”<sup>2</sup> These assertions prompt a reexamination of one of the most important—and controversial—pieces of legislation impacting on international business that Congress has enacted in the past thirty-five years: *The Foreign Corrupt Practices Act of 1977*.<sup>3</sup>

In the mid-1970s, the United States Congress found through a series of hearings that many American companies were not just *lobbying* foreign governments and politicians in order to secure business but were actually *bribing* foreign governmental officials in order to procure lucrative business contracts. Congress found the instances of bribery to be both “pervasive and troubling.”

Congress conducted these hearing at a result of information gathered from a series of investigations undertaken by the U.S. Securities and Exchange Commission [SEC]. The investigations uncovered the fact that over 400 U.S. companies *admitted* making questionable or illegal payments in excess of \$300 million to foreign government officials, politicians, and political parties in order to secure business.<sup>4</sup> The hearings uncovered abuses that ranged from outright bribery of high foreign officials to secure some type of favorable action by a foreign government to the making of more normal or routine “*facilitating payments*” in order to ensure that government officials discharged certain ministerial or clerical duties. A major example was the Lockheed bribery scandal,<sup>5</sup> in which officials of one of the scions of American

---

<sup>2</sup> Stephen J. Haedicke & M. Richard Schroeder, *Active Foreign Corrupt Practices Act Enforcement Focuses on Individuals in September 2008*, <http://www.joneswalker.com/news-publications-586.html>, Nov. 6, 2008 (last visited Feb. 28, 2011).

<sup>3</sup> 15 U.S.C. §§ 78dd-1, et seq. (1977).

<sup>4</sup> Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct*, 78 GEO. L.J. 1559, 1583 (1990). Mr. Pitt was Chairman of the SEC from 2001-2003.

<sup>5</sup> Lockheed would eventually pay a fine of \$24.8 million—then the largest DOJ corporate fine in its history. See *United States v. Lockheed Corp.*, No. CR. A. 194 Cr 226MHS, 1995 WL 17064259 (N.D. Ga. Jan. 9, 1995) (discussing the

industry, the giant aerospace company Lockheed, paid foreign officials in order to favor their company's products.<sup>6</sup>

Another was the 1975 affair termed as the *Bananagate scandal* in which Chiquita Brands, again, a major U.S. exporter of agricultural products, had bribed the President of Honduras in order to lower its taxes.<sup>7</sup> A federal grand jury accused United Brands [the parent company] of bribing Honduran President Osvaldo Lopez Arellano with \$1.25 million, with the promise of another \$1.25 million later, in exchange for a reduction in the export taxes. Lopez Arellano was eventually removed from power, but later investigations revealed repeated bribes carried out by the company.<sup>8</sup>

Professor John Coffee observed:

The dramatic exposure of United Brands misconduct occurred after the suicide of its prominent chief executive officer, Eli Black, whose death followed the commencement of an SEC investigation into a \$ 1.25 million payment,

---

indictment against Lockheed Corporation). See also Wesley Cragg, *Ethics, Globalization and the Phenomenon of Self-Regulation: An Introduction*, in ETHICS CODES, CORPORATIONS AND THE CHALLENGES OF GLOBALIZATION 10 (Wesley Cragg ed., 2005).

<sup>6</sup> See BEN R. RICH & LEO JANOS, SKUNK WORKS: A PERSONAL MEMOIR OF MY YEARS AT LOCKHEED 10 (1994).

<sup>7</sup> See, e.g., Arthur F. Mathews, *Current Issues in Corporate Governance: International Corporate Investigations*, 45 OHIO ST. L.J. 655, 664 n.42.

<sup>8</sup> See April Howard, *Chiquita in Columbia: Bananas Gone Wild*, <http://www.upsidedownworld.org/main/content/view/684/1>, April 3, 2007 (last visited Feb. 21, 2011). See also *United States v. Kay*, 359 F.3d 738, 743-56 (5<sup>th</sup> Cir. 2004) (holding that making improper payments to a foreign official to lower corporate taxes and custom duties could satisfy the "obtain or retain business" element of an FCPA anti-bribery violation by providing an unfair advantage to the payor over competitors and concluding that there was "little difference" between this type of improper payment and an improper payment to a foreign official to award a government contract).

authorized by Black, to the President of Honduras, apparently to avoid the imposition of a confiscatory export duty on bananas. "Bananagate" shifted the focus of both SEC and popular attention from illegal domestic political contributions to the broader issues arising out of foreign and commercial bribery. It thus set the stage for the unfolding of the incredible saga of Lockheed Corporation and its worldwide efforts to bribe senior ministers of friendly foreign governments. Other notable instances of such payments, such as those of Gulf in South Korea, Exxon in Italy, and Northrop and Grumman in the Middle East, have been described in detail elsewhere, and in the aggregate suggest a level of corporate hubris and unchecked ambition reminiscent of Commodore Vanderbilt and the nineteenth century robber barons.<sup>9</sup>

---

<sup>9</sup> John C. Coffee, Jr., *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 VA. L. REV. 1099, 1115-16 (1977). Included in this "illustrious" group are: John Jacob Astor (real estate, fur)—New York City; Jay Cooke (finance)—Philadelphia, Pennsylvania; Charles Crocker (railroads)—California; Daniel Drew (finance)—New York state; James Buchanan Duke (tobacco)—near Durham, North Carolina; Brian James Dwyer (coal)—Parma, Ohio; James Fisk (finance)—New York state; Henry Morrison Flagler (railroads, oil, the Standard Oil company)—New York City and Palm Beach, Florida; Henry Clay Frick (steel)—Pittsburgh and New York City; John Warne Gates (steel, oil)—Chicago and Texas; Jay Gould (finance, railroads)—New York (both state and city); Edward Henry Harriman (railroads)—New York state; Milton S. Hershey (chocolate)—Hershey, Pa.; Mark Hopkins (railroads)—California; J. P. Morgan (banking, finance, steel, industrial consolidation)—New York City; John D. Rockefeller (oil, Standard Oil)—New York; John D. Spreckels (transportation, water, media)—San Diego, California; Leland Stanford (railroads)—Sacramento, California and San Francisco, California; Cornelius Vanderbilt (railroads)—Staten Island, N.Y.; Andrew Carnegie (steel)—Pittsburgh and New York; and Bryan P. Kroetsch (importer/exporter)—Buffalo, N.Y. See generally MATTHEW JOSEPHSON, *THE ROBBER BARONS: THE GREAT AMERICAN CAPITALISTS, 1861-1901* (1934).



## II. SPECIFIC ELEMENTS OF THE FCPA

There are two key elements of the FCPA:

1. The Act requires corporations to *keep accurate books and records* of all foreign transactions and *install internal accounting controls* in order to assure that all transactions and payments are both lawful and accurate;<sup>10</sup>
2. The Act makes it *illegal* for an American company [a domestic concern] or their officers, directors, agents or employees either *directly or through any intermediaries to bribe or attempt to bribe a foreign official, a foreign political party official, or a candidate for foreign political office*<sup>11</sup> *for the purpose of obtaining or retaining business, or directing business to another party.*

---

<sup>10</sup> The FCPA's *Books and Records and Internal Control* provisions require: (i) that books, records and accounts are kept in reasonable detail to accurately and fairly reflect transactions and dispositions of assets, and (ii) that a system of internal accounting controls is devised (a) to provide reasonable assurances that transactions are executed in accordance with management's authorization; (b) to ensure that assets are recorded as necessary to permit preparation of financial statements and to maintain accountability for assets; (c) to limit access to assets to management's authorization; and (d) to make certain that recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

<sup>11</sup> The FCPA defines the term foreign official to include "any officer or employee of a foreign government or any department, agency, or instrumentality thereof [...] or any person acting in an official capacity for or on behalf of any such government or department, agency or instrumentality...."

As noted by the law firm of Foley and Lardener:

Generally, a foreign national can be classified as a foreign official under the FCPA in one of two ways. First, an employee of a foreign company can be deemed a foreign official directly in his or her own right by virtue of a parallel position or appointment he or she may have with a

*Issuers* are the main “persons” covered by provisions of the Act. Issuers include any U.S. or foreign corporation that has a class of securities registered, or that is required to file reports under the Securities and Exchange Act of 1934.<sup>12</sup> A *domestic concern* refers to any individual who is a citizen, national, or resident of the United States and any corporation and other business entity organized under the laws of the United States or having its principal place of business in the United States. The term “any person” covers both enterprises and individuals. The FCPA is jointly enforced by the Department of Justice (“DOJ”) and the SEC. Most courts have held that individuals cannot bring private actions under the FCPA. The DOJ is responsible for all criminal enforcement under the FCPA and has the sole responsibility for the criminal investigation and enforcement of domestic concerns. The SEC is responsible for civil investigations of issuers, but may refer a case to the DOJ for prosecution if criminal matters arise during the course of the investigation. Both the DOJ and the SEC have worked together in “parallel investigations” of suspected violations in many cases.<sup>13</sup>

---

government entity. Second, and much more a risk for the unwary, an employee of a foreign company can be deemed a foreign official under the FCPA when his or her employer is an “instrumentality” of a foreign government (a term not defined in the FCPA or delineated in the FCPA’s legislative history). Once a foreign company is deemed an “instrumentality” of a foreign government, every single employee, from the lowest ranking employee to the chairman of the board, will be considered a foreign official for purposes of the FCPA.

*See FCPA Enforcement: FCPA Explained*, <http://www.Foley.com> (last visited Feb. 18, 2011).

<sup>12</sup> Any stock issuer who has more than five hundred shareholders, whose assets exceed \$1,000,000, and who engages in interstate commerce or whose securities are traded on a national stock exchange, is required to register its securities with the SEC. *See* 15 U.S.C. § 781(g) (2006).

<sup>13</sup> *See, e.g., SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1379 (D.C. Cir. 1980).

The Act specifically applies where a payment involves “*anything of value*.” Interestingly, the term “anything of value” is not specifically defined in the FCPA nor is the statute’s legislative history<sup>14</sup> dispositive or illuminating as to intention of Congress in this regard. The term, however, has been broadly construed by courts and the Department of Justice and has been interpreted to include not only cash or a cash equivalent, but also, among other things: discounts; gifts; use of materials, facilities or equipment; entertainment; drinks; meals; transportation; lodging; insurance benefits; and a promise of future employment.<sup>15</sup> There is no *de minimis* value associated with the “anything of value” element.<sup>16</sup> The perception of the recipient and the subjective valuation of the thing conveyed are often seen as the key factors considered by the SEC or DOJ in determining whether “anything of value” has been given to a foreign official.<sup>17</sup>

What are some of the key “red flags” that may require a higher level of inquiry on the part of the firm making a payment to a foreign official? Marcia Staff, a Professor of Business Law at the University of North Texas, identifies the following as just such “red flags”:<sup>18</sup>

---

<sup>14</sup> H.R. Rep. No. 95-640 (1977); S. Rep. No. 95-114 (1977); H. Con. Rep. No. 94-831 (1977).

<sup>15</sup> See *FCPA Enforcement: FCPA Explained*, <http://www.Foley.com> (last visited Feb. 18, 2011) [hereinafter *FCPA Enforcement*].

<sup>16</sup> See, e.g., In re The Dow Chem. Co., Exchange Act Release No. 55281 (2007), SEC LEXIS 286, at \*7 (Feb. 13, 2007) (noting that although certain improper payments “were in small amounts—well under \$100 per payment—the payments were numerous and frequent”). For an interesting contrary approach, see Marie M. Dalton, *Efficiency v. Morality: The Codification of Cultural Norms in the Foreign Corrupt Practices Act*, 2 N.Y.U.J.L. & BUS. 583 (2006) (arguing that the FCPA must be altered to incorporate a more “economically based, as opposed to morally based,” prohibition on bribery).

<sup>17</sup> *FCPA Enforcement*, *supra* note 15.

<sup>18</sup> Marcia Staff, *Reflection on Global Compliance: Intersection of FCPA, Sanctions and Export Controls*, 17 CURRENTS: INT’L TRADE L.J. 72, 72 (2008) (citing Cherie O. Taylor, *The Foreign Corrupt Practices Act: A Primer*, CURRENTS: INT’L TRADE L.J. 3 (2008)).

- Lack of experience or "track record" with the product field or industry;
- Reputation for unethical behavior;
- Unwillingness to enter into written agreement to abide by anti-corruption laws;
- Close relationship to government officials;
- Representative or consultant recommended by governmental official or close relative of an official;
- Violation of local law or policy;
- Country where transaction is taking place has a reputation for corruption;<sup>19</sup>
- Incomplete, inconsistent or inaccurate information in required disclosures;
- Request that payment be made to a third party or in some other county;
- Request for payment in cash;
- Request for an unusually large fee in relation to the service provided;
- Request for reimbursement for a poorly documented or questionable expense;
- Evidence of political contributions;
- Family or business ties to high level government official;
- Only qualification [of recipient] is influence with or closeness to government official;
- Inconsistencies in "due diligence" information obtained for a third party;
- Written contract is missing;
- Payments made do not match contract terms;

---

<sup>19</sup> See, e.g., The Corruption Perception Index, at <http://www.transparency.org> (last visited May 3, 2011).

- Split payment or payments to parties not named in contract; and
- Payments to banks or entities in countries known for bank secrecy laws.

There is an important affirmative defense to a charge that a company or an individual has violated the FCPA: *payments to secure routine, ministerial, or clerical actions are not illegal under the major amendment to the FCPA, the 1988 Omnibus Foreign Trade and Competitiveness Act [Trade Act]*.<sup>20</sup>

The following are examples of what may be classified as “*routine actions*” and thus, not illegal: obtaining permits, licenses or other official government documents; processing governmental payments, such as visas or work orders; providing police protection, and mail pick-up and delivery; providing phone service, power or water supplies; loading or unloading of cargo; protecting perishable products; and scheduling inspections associated with contract performance or transit of goods. Most importantly, however, routine governmental action does *not* include the core

---

<sup>20</sup> P.L. 100-418 (Aug. 23, 1988). See generally the comments prepared by the Department of Commerce, at [www.lectlaw.com/files/bur21.htm](http://www.lectlaw.com/files/bur21.htm) (last visited May 3, 2011). The following quotation is taken from the guidance offered by the U.S. Department of Commerce, dated May 10, 1994:

The 1988 Trade Act directed the Attorney General to provide guidance concerning the Department of Justice's enforcement policy with respect to the Foreign Corrupt Practices Act of 1977 ("FCPA"), to potential exporters and small businesses that are unable to obtain specialized counsel on issues related to the FCPA. The guidance is limited to responses to requests under the Department of Justice's Foreign Corrupt Practices Act Opinion Procedure (...) and to general explanations of compliance responsibilities and potential liabilities under the FCPA.

decision by a foreign official to award business to, or to continue business with a company covered by the Act.<sup>21</sup>

Payments for these and other related routine services are sometimes called facilitation or “grease payments” as opposed to bribes.

The original Act was signed into law by President Jimmy Carter on December 19, 1977, barely one year into his Administration. In 1978, the SEC brought its first enforcement action under the FCPA. The SEC found that Katy Industries, Inc., violated the Act when an Indonesian official and his associates were bribed in order to obtain a thirty-year contract with the country's state-owned oil and gas company. According to the complaint, a Katy director, an Indonesian official, and a representative of Indonesia agreed that the official would help the company obtain an oil production agreement with Pertamina, Indonesia's state-owned oil corporation. Katy would make payments to the representative, who in turn would pass them on to the foreign official. By 1974, the SEC reported, the two had received over \$65,000. As a result of their interventions, in January of 1974, Katy entered into a \$10 million contract with Pertamina, which ultimately gave Katy "the exclusive right to explore and develop oil and gas within a designated area of Indonesia."<sup>22</sup>

As noted above, the Act was amended in 1988. Under the 1988 amendments, there is a second major defense: if the payment is lawful under the written law of a foreign country or the money was

---

<sup>21</sup> 15 U.S.C. § 78dd-1(f)(3)(B) (for issuers); § 78dd-2(h)(4)(B) (for domestic concerns); § 78dd-3(f)(4)(B) (for "any person"). See also Rebecca Koch, *The Foreign Corrupt Practices Act: It's Time to Cut Back the Grease and Add Some Guidance*, 28 B.C. INT'L & COMP. L. REV. 379, 385 (2005); Jennifer Dawn Taylor, *Ambiguities in the Foreign Corrupt Practices Act: Unnecessary Costs of Fighting Corruption?* 61 LA. L. REV. 861 (2001).

<sup>22</sup> *SEC v. Katy Indus.*, No. C78-3476 (N.D. Ill. filed Aug. 30, 1978).

spent as part of demonstrating a product or a bona fide expenditure relating to performing a contractual obligation, it is normally not illegal.<sup>23</sup>

The Act was further amended in 1998 by the *International Anti-Bribery and Fair Competition Act of 1998*<sup>24</sup> which was designed to implement the anti-bribery conventions of the Organization for Economic Co-operation and Development, of which the United States is a Member.<sup>25</sup>

---

<sup>23</sup> A second affirmative defense is more intriguing and nuanced. The FCPA recognizes an affirmative defense to liability where "the payment, gift, offer, or promise of anything of value that was made was lawful under the written laws and regulations of the [foreign official's] country." 15 U.S.C. § 78dd-1(c)(1). As a practical matter, this defense may offer little shelter. Notes William Athanas: "'Lawful under written law' is fundamentally different from 'consistent with local custom and practice,' and no country in the world—even those with the most pervasive cultures of corruption—authorizes bribery under its written laws." See William C. Athanas, *When Doing Business Internationally Becomes a Crime: Assisting Clients in Understanding and Complying with the Foreign Corrupt Practices Act*, 71 ALA. LAW. 382, 386 (2010).

<sup>24</sup> Pub. L. 105-366, 112 Stat. 3302, enacted November 10, 1998. See also Organization for Economic Cooperation and Development [OECD], Convention on Combating Bribery to Enter into Force on 15 February 1999, at <http://www.oecd.org/media/release/nw98-124a.htm> (Dec. 17, 1998) (last visited May 3, 2011).

<sup>25</sup> See Arg.-Braz.-Bulg.-Chile-Slovak Republic, Organization for Economic Cooperation and Development, Convention on Combating Bribery of Foreign Public Officials in International Business Transactions Dec. 18, 1997, 37 I.L.M. 1 (1998). OECD membership includes the following "high income" countries: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States.

According to the website of the organization, "The OECD brings together the governments of countries committed to democracy and the market economy from around the world to: support sustainable economic growth; boost

There are both *criminal and civil implications* to the FCPA. A violation of the FCPA can result in significant fines and penalties. For example, a company can face a criminal fine up to \$2 million per violation of the anti-bribery provisions and individuals found culpable can be subject to a criminal fine of up to \$250,000 per violation, as well as imprisonment for up to five years. In addition, willful violations of the “Books and Records and Internal Control” provisions can result in criminal fine of up to \$25 million for a

---

employment; raise living standards; maintain financial stability; assist other countries' economic development; and contribute to growth in world trade.” See <http://www.oecd.org> (the website of the OECD) (last visited May 3, 2011). Combating corruption is considered as an important adjunct to the stated objectives. As noted by the OECD on its website, “The keystone to its efforts is the OECD Anti-Bribery Convention and the Convention's 2009 Anti-Bribery Recommendation.” *Id.* See also H. Lowell Brown, *Extraterritorial Jurisdiction Under the 1998 Amendments to the Foreign Corrupt Practices Act: Does the Government's Reach Now Exceed its Grasp?* 26 N.C.J. INT’L L. & COM. REG. 239, 239-240 nn.6-8 (2001). Brown comments:

The OECD Convention was the culmination of over a decade of effort by the United States government and others to build an international consensus for the criminalization of transnational bribery. The Convention established the following: (1) bribery of a foreign official as a criminal offense; (2) requirements for corporate accounting and for internal corporate financial controls; and (3) a basis for mutual assistance among the signatories for the investigation and prosecution of offenses arising from the bribery of foreign officials. The Convention required, among other things, that signatory countries adopt implementing legislation to conform their domestic laws to the provisions of the Convention, as a prerequisite to ratification. The 1998 amendments to the FCPA accomplished this implementation by the United States, and following the deposit of instruments of ratification by Canada, Finland, Germany, Hungary, Iceland, Japan, and the United Kingdom, as well as by the United States, the OECD Convention entered into force on February 15, 1999.



company and a criminal fine up to \$5 million as well as imprisonment for up to 20 years for culpable individuals.<sup>26</sup>

---

<sup>26</sup> As to penalties, see generally Veronica Foley & Catina Haynes, *The FCPA and Its Impact in Latin America*, 17 CURRENTS: INT'L TRADE L.J. 27, 30-31 (2009).

In general, as noted by Tarun and Tomczak, the range of any fine is a product of the "seriousness of the offense and the culpability of the corporation." A corporate fine is based on a five-step process. "First, the seriousness of the offense . . . is computed and reflected in a number called the 'Base Fine.'" This amount will be "the greatest of: (1) the amount from a table corresponding to a calculation under the individual Guidelines; (2) the pecuniary gain to the [corporation] from the offense; or (3) the pecuniary loss from the offense caused by the [corporation], to the extent" caused intentionally, knowingly or recklessly. "Second, the culpability of the [corporation] is assessed by adding up the [corporation's] 'Culpability Score.' One begins the computation with a score of five." Points may be added to the Culpability Score depending upon a number of factors, including: "the size of the corporation; the level and degree of discretionary authority of individuals who participated in or tolerated the criminal activity; whether the corporation had a fairly recent history of similar misconduct; whether the offense violated a judicial order, injunction, or condition of probation; or whether the corporation willfully obstructed or attempted to obstruct justice during the investigation, prosecution or sentencing of the offense. Points may be subtracted if: (1) the offense occurred even though the corporation had in place a compliance and ethics program; or (2) the corporation self-reports, cooperates, and accepts responsibility." See Robert W. Tarun & Peter Tomczak, *A Proposal for a United States Department of Justice Foreign Corrupt Practices Act Leniency Policy*, 47 AM. CRIM. L. REV. 157, 161-163 nn.55-62.

The Sentencing Guidelines are rather *proactive* in that they establish criteria for a compliance and ethics program that includes:

- (1) The organization shall establish standards and procedures to prevent and detect criminal conduct.
- (2) (A) The organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program. (B) High-level personnel

These fines and penalties are levied in addition to what are termed as “collateral sanctions” that can result from an FCPA violation. These “collateral sanctions” include termination of government

---

of the organization shall ensure that the organization has an effective compliance and ethics program, as described in this guideline.

(3) The organization shall use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.

(4) (A) The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program, [throughout the organization and as appropriate, the organization's agents] by conducting effective training programs and otherwise disseminating information appropriate to such individuals' respective roles and responsibilities. . . .

(5) The organization shall take reasonable steps (A) to ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct; (B) to evaluate periodically the effectiveness of the organization's compliance and ethics program; and (C) to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.

(6) The organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.

(7) After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program.

licenses and for the most egregious violators, debarment from government contracting programs. In addition, as indicated in both *Siemans* and the *KBR* cases, discussed below, the SEC is able to seek disgorgement of a company's profits<sup>27</sup> on contracts secured with improper payments. Further, enforcement agencies are able to seek the appointment of an "independent compliance monitor" in cases of corporate violators for multi-year periods, which might result in violators incurring significant expense and governmental intrusion into corporate matters.

As might be expected, enforcement under the FCPA is one of the murkiest areas of international business and international business law! Many American corporate executive grumble (in private) that the FCPA is a significant impediment to conducting business overseas and that the FCPA is a not too veiled attempt by the United States to apply its moral principles to other societies to other cultures in which bribery and corruption are endemic and pervasive. Noted Mark Murphy:

Today, the FCPA remains the only piece of legislation in the world that criminalizes the bribery of foreign officials. From its inception, the FCPA has received a great deal of criticism for isolating U.S. corporations from their competitors and

---

*Id.*

<sup>27</sup> Disgorgement is defined as the "forced giving up of profits obtained by illegal or unethical acts. A court may order wrongdoers to pay back illegal profits, with interest, to prevent unjust enrichment. Disgorgement is a remedy and not a punishment." *See, e.g.,* Disgorgement, <http://www.kosmix.com/topic/Disgorgement> (last visited May 3, 2011). *Black's Law Dictionary* defines disgorgement as "the act of giving up something (such as profits illegally obtained) on demand or by legal compulsion." The key to disgorgement under the FCPA is the acquiring of profits. In the context of the United States, see *In re Gleeson's Will*, where disgorgement was used as a remedy when the trustee remained as a holdover on the testator's land and acquired a profit. 124 N.E.2d 624 (Ill. App. 1955).

placing them on an uneven playing field because they were forced to play by a different set of rules in competing for international business. The 1988 amendments to the FCPA did little to win any additional international support for the U.S. anti-bribery position and thus, the playing field remains slanted against U.S. businesses.<sup>28</sup>

But one fact remains: The FCPA is now an important part of the calculus of international business and must be considered before engaging in making *any* payments to a foreign official.

### III. CASE STUDIES IN ENFORCEMENT

Two enforcement actions are especially instructive concerning the seriousness with which violations are dealt with by both the DOJ and SEC.<sup>29</sup> These cases at the time set records for penalties for violations of the Act. In the first case, *Siemens Aktiengesellschaft* ("Siemens"/Siemens AG) and three of its subsidiaries agreed to pay a total of \$800 million in criminal fines and civil penalties in the form of disgorgements related to the companies' world-wide practice of bribing foreign officials in pursuit of business.<sup>30</sup> In the

---

<sup>28</sup> Mark J. Murphy, *International Bribery: An Example of an Unfair trade Practice*, 21 BROOKLYN J. INT'L L. 385, 387 nn.9-12 (1995).

<sup>29</sup> A comprehensive updating of current enforcement actions may be found in "International Trade Law News," *at*

<http://www.jjacobsonlaw.com/labels/FCPA.html> (last visited Feb. 21, 2011).

<sup>30</sup> In all, in December 2008, the Fraud Section of the Department of Justice, in conjunction with German authorities and the SEC, obtained anti-corruption penalties totaling approximately \$1.6 billion from Siemens AG and three of its foreign subsidiaries. Seven months later, the World Bank entered the controversy and sanctioned Siemens AG and obtained an additional \$100 million fine—resulting in a total fine of \$1.7 billion. See Vanessa Fuhrmans, *Siemens Settles with World Bank on Bribes*, WALL ST. J., July 3, 2009, at B1. See also Press Release, Department of Justice, Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations and Agree to Pay \$ 450 Million in Combined Criminal Fines (Dec. 15, 2008), *at* <http://www.justice.gov/opa/pr/2008/December/08-crm-1105.html> (last visited

second case, the former Halliburton subsidiary, *Kellogg, Brown & Root, Inc.* ("KBR"), agreed to pay a total of \$579 million in criminal fines and civil disgorgements for its corrupt actions in securing a series of lucrative construction contracts in Nigeria.<sup>31</sup> The penalties imposed in each of these cases are many times greater than any penalty previously imposed under the FCPA. M. Richard Schroeder and Stephen Haedicke comment that "Together, they demonstrate the seriousness with which U.S. enforcement authorities continue to pursue corporate bribery worldwide."<sup>32</sup>

### A. *The Siemens Case*

In December 2008, Siemens pleaded guilty to a two-count bill of information charging it with knowingly violating the FCPA's reporting mandate that companies (1) maintain internal controls sufficient to detect and deter bribery and (2) make and keep

---

May 3, 2011); Press Release, Securities Exchange Commission, Engaging in Worldwide Bribery (Dec. 15, 2008), *at*

<http://www.sec.gov/news/press/2008/2008-294.htm> (last visited May 3, 2011).

*See* Press Release, Department of Justice, Kellogg Brown & Root LLC Pleads Guilty to Foreign Bribery Charges and Agrees to Pay \$ 402 Million Criminal Fine (Feb. 11, 2009), *available at*

<http://www.justice.gov/opa/pr/2009/February/09-crm-112.html>; Press Release, Securities Exchange Commission, SEC Charges KBR and Halliburton for FCPA Violations (Feb. 11, 2009), *at* <http://www.sec.gov/news/press/2009/2009-23.htm> (last visited May 3, 2011).

<sup>32</sup> M. Richard Schroeder & Stephen Haedicke, *United States: The Foreign Corrupt Practices Act: Two Recent Cases Set New Records, Teach Old Lessons*, *at* [www.Mondaq.com](http://www.Mondaq.com) (June 19, 2009) (last visited May 3, 2011). *Mondaq* was launched in August 1994. It is a comprehensive electronic resource, providing legal, regulatory and financial commentary and information supplied by some of the world's leading professional advisors from over 80 countries. As noted by *Mondaq*, the purpose of the service "is to facilitate better online communication and contact between leading advisory firms and organizations or individuals in need of specialist professional expertise." *See*

<http://www.aboutus.org/Mondaq.com> (last visited May 3, 2011). The authors gratefully acknowledge the summary commentary provided by Schroeder and Haedicke concerning both *Siemens* and *Halliburton* in the formulation of this research paper.

accurate books and records. These are sometimes referred to as the Act's "accounting provisions." The *Siemens* case marked the first time that the United States charged a company with criminal violations of these "accounting provisions." At the same time, three Siemens subsidiaries each pleaded guilty to conspiring to violate the FCPA's anti-bribery provisions, its internal controls provisions, and its book-and-records provisions. Additionally, the Securities and Exchange Commission ("SEC") filed a settled enforcement action against the company on December 12, 2008.

Schroeder and Haedicke provide interesting factual commentary concerning this case and the one that follows involving *Halliburton*. They note that the *Siemens* case indicated strongly that Siemens suffered from a pervasive "culture of corruption." According to the United States government, Siemens' project cost calculation sheets frequently reflected what is known as "*nutzliche aufwendungen*," a term that literally translates as "useful money"—but which many Siemens employees clearly understood to mean bribes.<sup>33</sup> Additionally, evidence indicated that many Siemens offices maintained "cash desks" from which employees could withdraw up to one million euros at a time; employees would often visit these desks with suitcases that they would fill up with money. There were few internal controls to assure that the money would be used for lawful purposes.<sup>34</sup>

According to the United States government, Siemens and its subsidiaries engaged in widespread corrupt practices which included the following:

---

<sup>33</sup> For a discussion of this concept, also referred to as "N/A," see Lynn Hermann, *Daimler to settle charges of international bribery*, <http://www.digitaljournal.com/print/article/289531> (March 24, 2010) (last visited May 3, 2011).

<sup>34</sup> Schroeder & Haedicke, *supra* note 32.

1. using “*off-book*” accounts for corrupt payments, even after compliance risks associated with these accounts were raised at the highest level of management;
2. entering into purported *business consulting agreements*, sometimes *after* Siemens had won the relevant project as a way to hide corrupt payments;
3. *engaging former Siemens employees to funnel bribes* to foreign officials on the Company's behalf;
4. justifying payments to purported business consultants based on *false invoices*;
5. *mischaracterizing corrupt payments* on the corporate books and records as consulting fees;
6. *limiting the quantity and scope of audits* of payments to purported business consultants;
7. *accumulating profit reserves as liabilities on internal balance sheets and then using them to make corrupt payments*;
8. *concealing the identities of employees approving payments* by using removable “Post-It” notes to affix signatures on approval forms;
9. *allowing third-party payments* to be made based on a single signature, contrary to company policy requiring dual authorization;
10. *drafting and backdating sham business consulting agreements* to justify third party payments; and
11. *changing the titles of documents* to avoid their review by company lawyers.<sup>35</sup>

The United States government asserted that these practices had resulted in payments totaling over \$1.4 billion over the course of six years (between 2001 and 2007). Of this amount, over \$800 million was known to have been used to bribe foreign officials on the behalf of Siemens. The remainder went primarily to business consultants for unknown purposes.

---

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

How did these schemes come to light and as the subject of scrutiny by the Department of Justice and the SEC? In November 2006, the public prosecutor's office in Munich, Germany raided the Siemens office and arrested a number of high-level members of management. Shortly thereafter, the Company disclosed to the U.S. Department of Justice and SEC the possibility that it had violated the FCPA and initiated a global internal investigation of its practices. The Siemens investigation—which the DOJ termed "exceptional"—eventually involved over *1.5 million billable hours* by attorneys and forensic accountants, the collection and preservation of over 100 million documents, and over 1700 in-person interviews conducted in 34 countries.<sup>36</sup>

In addition, Siemens incurred major expenses of over \$150 million developing an FCPA compliance program in tandem with the investigation. Ultimately, the issues were resolved without the necessity of a formal criminal prosecution.<sup>37</sup> Siemens and three of

---

<sup>36</sup> See Miller Chevalier, *Siemens Agrees to Landmark \$800 Million Settlement*, Dec. 15, 2008, <http://www.millerchevalier.com/Publications/MillerChevalierPublications?find=4935> (last visited May 3, 2011).

<sup>37</sup> The Department of Justice has wide discretion in the area of bringing criminal charges against a business. These are set forth in what are termed the "Principles of Prosecution." See Mike Koehler, *The Façade of FCPA Enforcement*, 41 GEO. J. INT'L L. 907, 925 nn.58-62 (2010). The "Principles of Prosecution," found in the U.S. Attorneys' Manual, set forth the factors prosecutors "should consider" in determining whether to bring criminal charges against a business organization or negotiate a plea or other agreement. Relevant factors include: "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents," and the corporation's willingness to "cooperate with relevant government agencies." The Principles of Prosecution specifically state that "[c]ooperation is a potential mitigating factor, by which a corporation . . . can gain credit in a case that otherwise is appropriate for indictment and prosecution." Under the Principles of Prosecution, a corporation's failure to cooperate "does not mean the corporation will be indicted;" rather it "simply means that the corporation will not be entitled to mitigating credit for that cooperation"—a statement which appears, both in writing and in practice, to be a distinction without a difference. See Department of Justice, *U.S. Attorney's Manual* § 9-28.000 (2008),



its subsidiaries agreed to a settlement of issues consisting of (a) a \$450 million fine; (b) a promise by Siemens to cooperate with domestic and foreign enforcement authorities; (c) the implementation of a "rigorous" FCPA compliance program; and (d) retention of an independent compliance monitor for a term of four years. These penalties were in addition to a \$350 million civil disgorgement agreed upon with the SEC and fines and disgorgements imposed by the Munich Public Prosecutor's Office. All told, Siemens was obligated to pay over \$1.6 billion in fines and penalties in connection with the cases brought by the DOJ, the SEC, and the Munich Public Prosecutor's Office.

### *B. The KBR Case*

On February 11, 2009, a former Halliburton subsidiary, KBR, pleaded guilty to a five-count indictment charging it with a near decade-long conspiracy to violate the anti-bribery provisions of the FCPA and four substantive FCPA bribery violations. The Company agreed to pay a \$402 million criminal fine. Concurrently, KBR and Halliburton settled with the SEC and agreed to disgorge \$177 million in corruptly obtained profits. It is expected that Halliburton is likely to pay the full amount of both these penalties pursuant to indemnification clauses contained in the separation agreement between it and KBR.<sup>38</sup>

The KBR case arose from four contracts entered into by various Nigerian government entities between 1995 and 2004 which were designed to construct a liquefied natural gas production facility on Bonny Island, Nigeria. KBR was part of a joint venture with three international companies that bid on these contracts, which the

---

<http://www.justice.gov/opa/documents/corp-charging-guidelines.pdf> (last visited March 7, 2011).

<sup>38</sup> Concerning the general issue of parent-subsidiary liability under the FCPA, see H. Lowell Brown, *Parent-Subsidiary Liability Under the Foreign Corrupt Practices Act*, 51 BAYLOR L. REV. 1 (1998).

Nigerian government valued at approximately \$6 billion upon completion.<sup>39</sup>

According to U.S. enforcement authorities, KBR and the other joint venture partners paid \$182 million in bribes to a range of Nigerian officials to secure the four Bonny Island contracts. These bribes were arranged through the efforts of representatives of high-level Nigerian officials and then funneled through two international business consultants—one based in Gibraltar, and other in Japan. The joint venture entered into contracts with these two consultants through a wholly owned Portuguese “shell company” that KBR had specifically created in an attempt to insulate itself from FCPA liability. KBR refrained from placing any American nationals on the board of directors of these Portuguese entities in order to further shield itself from potential liability under the FCPA.

After the charges had been brought, the resolution of this case followed quickly. On September of 2008, a guilty plea of Albert "Jack" Stanley, a former KBR vice-president and confidant of former Vice President Dick Cheney, who helped manage and execute the bribery scheme, was entered. Stanley's final sentencing [Stanley was originally sentenced to 84 months in prison and a restitution payment of \$10.8 million] has been postponed eight times is scheduled once again for March of 2011.<sup>40</sup>

---

<sup>39</sup> This operation was designed as a method of project financing organized under the BOO (“Build-Operate-Own”) or BOT (“Build-Operate-Transfer”) models. *See, e.g.,* Kojo Yelapaala, *Rethinking the Foreign Direct Investment Process and Incentives in Post-Conflict Transition Countries*, 30 NW. J. INT’L L. & BUS. 23, 29 (2010).

<sup>40</sup> *See* Plea Agreement, *United States v. Stanley*, No. H-08-597, P 19 (S.D. Tex. Sept. 3, 2008). *See also* FCPA Blog, *Another Sentencing Delay for KBR’s Ex Boss*, <http://www.fcpcbog.com/blog/tag/albert-jack-stanley> (last visited March 3, 2011).

In addition to the fine, KBR's plea agreement with the government requires that it hire an independent compliance monitor for a period of three-years to review specifically its FCPA compliance program. Documents filed with the plea agreement reveal that KBR faced criminal fines as high as \$763.6 million—no doubt in part because tolerance of the corrupt conduct was pervasive throughout the company. The Company's full cooperation, however, during the investigation mitigated the final penalty imposed as a result of the proceedings.<sup>41</sup>

---

<sup>41</sup> Lisa Harriman Randall commented:

Because of the magnitude of the SEC's investigatory caseload, the agency added a program of voluntary disclosure to its regular disclosure enforcement efforts. Corporations that suspected they might come under SEC scrutiny could gain a measure of immunity from prosecution by admitting and rectifying improper behavior they had not previously disclosed. To qualify for this deferential treatment, a corporation was first required to stop making questionable foreign payments and institute unimpeachable accounting procedures—steps designed to prevent ongoing bribery. Next, a participating corporation was to designate an independent special counsel to investigate the matter and make a report to the corporation's board of directors. The special counsel's findings would then be released to the public in an 8-K filing. The corporation was also required to give consent for the SEC to use the disclosed information as the agency saw fit. For a corporation that had made bribe payments, the alternative was to risk subjecting itself to a formal SEC enforcement action. Voluntary disclosure was preferable to a formal action because it was less public and more subject to the corporation's control.

Lisa Harriman Randall, *Multilateralization of the Foreign Corrupt Practices Act*, 6 MINN. J. GLOBAL TRADE 657, 661-664 nn.17-24 (1997). See also Beth S.

IV. LESSONS THAT MAY BE LEARNED... OR ARE THERE?

The notoriety of these two cases may indicate that they are unique. However, while this may be true, there are several lessons concerning FCPA compliance that may be applicable to any company doing business internationally. Schroeder and Haedicke provide an interesting construct and list these lessons as follows:

- (1) Innovative corporate structures and the use of third parties cannot insulate a company from liability where its employees know or have reason to know bribes are being paid on its behalf;
- (2) A company's culture matters—where management ignores or condones bribery, the practice will thrive;
- (3) An effective FCPA compliance program must be an on-going, meaningful effort, not simply a "paper program"; and
- (4) Regardless of the underlying conduct, a company can reap real rewards if it responds effectively and appropriately to signs that one or more of its employees may have paid or authorized a bribe.<sup>42</sup>

In both *Siemens* case and *KBR*, the companies used a variety of consultants to funnel bribes to foreign officials in the hopes of shielding their parent corporations from potential liability. Specifically, *KBR* had even set up a foreign shell company—with no Americans serving on the corporate board—that it and its co-conspirators then used to enter into contracts with the consultants. In the end, these efforts were seen to be exactly what they were—not so veiled (or successful) attempts to circumvent the reaches of the FCPA. Why did these efforts fail? First, the FCPA contains a broad “knowledge standard,” which criminalizes *paying or authorizing payment of anything of value to a third party where the*

---

Dorris, *The Limited Waiver Rule: Creation of an SEC-Corporation Privilege*, 36 STAN. L. REV. 789, 793-794 nn.20-24 (1984).

<sup>42</sup> Schroeder & Haedicke, *supra* note 32.

payor knows or has reason to know that the thing of value will be used to bribe a foreign official.<sup>43</sup> "Knowledge is established if a person is aware of a high probability of the existence of such circumstance, unless the person actually believes that such circumstance does not exist."<sup>44</sup> Likewise, if a company consciously disregards the actions of its agents, representatives, partners or employees, the "knowledge standard" is satisfied.<sup>45</sup> The Act does not distinguish whether the thing of value flows through one or more other entities before it reaches the foreign official. Simply stated, if the original payor knew or had reason to know that a bribe would be paid on its behalf, then the payor incurs liability for the FCPA violation.

Secondly, both Siemens and KBR are publicly traded companies, subject to the FCPA's "books-and-records and internal control provisions," described above. Under these provisions, public companies have an affirmative duty to make and keep books and records which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company. Perhaps more importantly, a publicly traded company must affirmatively devise and implement a system of internal controls sufficient to provide reasonable assurance that transactions are

---

<sup>43</sup> See James Parkinson, *United States: FCPA Grillo Verdict Underscores Enforcement Priority: Individuals*, MONDAQ BUSINESS BRIEFING, Aug. 3, 2009 (noting that "[i]f you suspect a fact (for example, that a party has made or may in the future make an improper payment on your behalf) and realize the fact is highly probable, there may be a consequence in not obtaining the final confirmation").

<sup>44</sup> See 15 U.S.C. § 78dd-1(f)(2)(B) (issuers); *id.* § 78dd-2(h)(3)(B) (domestic concerns); *id.* § 78dd-3(f)(3)(B) (any person).

<sup>45</sup> See, e.g., *United States v. Baker Hughes Servs. Int'l, Inc.*, Case No. 4:07CR129 (S.D. Tex. Apr. 11, 2007). See also 15 U.S.C. § 78dd-1(f)(2)(A) (reasoning that a person's state of mind is "knowing" if: (1) such person is aware that such person is engaging in such conduct, that such circumstances exists, or that such result is substantially certain to occur; or (2) such person has a company belief that such circumstance exists or that such result is substantially certain to occur).

occurring only pursuant to appropriate authorization and that they are recorded accurately.

As a result, a public company is not free simply to distribute money to outside consultants (third parties) and then hope or assume these monies will be used properly. What is clear is that the company must take reasonable *affirmative steps* to assure that it knows the purposes for which the money is being spent.

## V. THE ROLE OF CULTURE IN INTERNATIONAL BUSINESS IN THE CONTEXT OF THE FCPA

Kenichi Ohmae, the Japanese management guru, coined the phrase “borderless world.” Much of our understanding about globalization comes from the writings and research of Professor Ohmae. His formulation, termed the *Five Stages of Globalization*, indicate the strong correlation between international trade and globalization. Each of the five stages involves significant issues relating to issues of corporate culture in the conduct of international business and trade. According to Professor Ohmae, an international business enters the international business environment through a progression of activities that can generally be described as:

1. Exporting, using the distribution system of a business found in the host country;
2. Exporting, setting up a distribution system in the host country;
3. Manufacturing and distributing products in the host country — but maintaining a company’s ties with its “home” country, perhaps by acting as a subsidiary corporation or entity of the *parent* company;
4. Insiderization, becoming like any other manufacturing concern located in the host country — acquiring the identity of a national company or entity;

5. Becoming a fully globalized company — operating in many host countries simultaneously; where it may be difficult to ascertain the country to which a fully globalized company is attached.<sup>46</sup>

Findings by the SEC and the Department of Justice are quite expositive from this point of view of the existence of a corrupt corporate culture which may permeate the various forms of market penetration. In both *Siemens* and *KBR*, the government specifically noted the companies' pervasive tolerance for bribery. In *Siemens*, the SEC noted that the company's internal corporate culture "had long been at odds with the FCPA" and was one in which bribery "was tolerated and even rewarded at the highest levels."<sup>47</sup> As the government pointed out, in 2000 and 2001, Siemens began to develop anti-corruption policies, but this "paper program" did little or nothing to stop on-going and pervasive corrupt practices. Siemens' supposed "compliance officer" worked only part-time on his considerable compliance duties and his staff consisted of only two lawyers. Furthermore, Siemens had specifically rejected a recommendation that a company-wide list of agents and consultants be prepared that a central committee of management could have reviewed in order to ascertain the true nature of any questionable relationships. Likewise, in *KBR*, the government noted that "tolerance of the offense by substantial authority personnel was pervasive" throughout the organization.<sup>48</sup>

What are the lessons of these two case studies? What can a company seeking to expand its business internationally do to

---

<sup>46</sup> See, e.g., KENICHE OHMAE, *THE NEXT GLOBAL STAGE: THE CHALLENGES AND OPPORTUNITIES IN OUR BORDERLESS WORLD* (2005).

<sup>47</sup> SEC Litigation Release No. 20829, Dec. 15, 2008, at [www.sec.gov/litigation/litreleases/2008/lr20829.htm](http://www.sec.gov/litigation/litreleases/2008/lr20829.htm) (last visited May 3, 2011).

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

promote a corporate culture free from the taint of the worst abuses found to have been committed under the FCPA?

According to Schroeder and Haedicke, the following are some practical suggestions that should be considered at the highest levels of corporate governance:

1. “All employees should be specifically aware of corporate policies relating to the payment of bribes or other corrupt practices and to the general outline of the FCPA.
2. Corporate leadership—starting with the CEO—must reinforce the clear message of “zero tolerance” to corporate corruption by emphasizing the company's commitment to full compliance with the FCPA.<sup>49</sup>
3. All communications should be simple and direct in the form of an annual update or through the use of corporate newsletters, e-mails, or websites.
4. A company must create a “compliance team” with specific responsibilities and authorities in the area of compliance with the FCPA;
5. The corporation must then assure that efforts of the compliance team will be supported by an adequate staff, sufficient research capabilities, and that it is adequately funded.
6. A company’s compliance team must have and has a clear mandate to prevent and report corruption.
7. A company must institute internal procedures that assure that corrupt practices are rooted out and punished and, perhaps more importantly, that positive ethical practices are publicized and rewarded.”<sup>50</sup>

---

<sup>49</sup> See, e.g., Inter-American Development Bank (“IADB”) Website, <http://www.iadb.org/news/articledetail.cfm?Language=En&parid=3&artType=AN&artid=2834> (last visited March 2, 2011) (discussing its policy of zero tolerance towards corruption).

<sup>50</sup> See Schroeder & Haedicke, *supra* note 32. Many of the compliance program



One of the major consultants in the field of FCPA compliance, *Jones Walker*, suggests mandating FCPA compliance training for "key personnel" who are expected to *interface* with foreign officials on the company's behalf or who themselves

---

components included in these FCPA settlements, however, reflect elements of the guidance set forth in the Attorneys' Manual and serve to highlight some of the DOJ's more general compliance expectations, including:

- (1) a system of financial and accounting procedures, that include a system of internal accounting controls, designed to ensure the maintenance of accurate books, records, and accounts;
- (2) the assignment to one or more independent senior corporate officials--who shall report directly to the audit, ethics or compliance committee of the board of directors--the responsibility for the implementation and oversight of compliance with policies, standards, and procedures;
- (3) a reporting system, including a "helpline" for company directors, officers, employees, agents and business partners to report suspected violations of the compliance code or suspected criminal conduct;
- (4) clearly articulated corporate procedures designed to ensure that substantial discretionary authority is not delegated to individuals who the corporation knows, or should know through the exercise of due diligence, have a propensity to engage in illegal or improper activities; and
- (5) the creation and implementation of appropriate disciplinary mechanisms, including as appropriate, the discipline of individuals responsible for the failure to detect a violation of the law or of compliance policies, standards, and procedures.

*See United States v. AGA Med. Corp.*, Press Release, U.S. Dep't of Justice, 08-491 (June 3, 2008), at <http://www.usdoj.gov/opa/pr/2008/June/08-crm-491.html> (last accessed May 3, 2011); *United States v. Baker Hughes Servs. Int'l., Inc.*, No. 07-cr-00129 (S.D. Tex. Apr. 11, 2007) (requiring implementation of corporate compliance program as condition of plea agreement); and *United States v. Titan Corp.*, No. 05-cr-0314 (S.D. Cal. Mar. 1, 2005) (cited in Barry J. Pollack, *Time to Stop Living Vicariously: A Better Approach to Corporate Criminal Liability*, 46 AM. CRIM. L. REV. 1393, 1399 n.19 (2009)).

*supervise* third parties who interface with foreign officials on the company's behalf. This training should include:

- “Conduct risk-based due diligence for all third-party agents and consultants, and centralize those efforts within the legal or compliance departments;
- Provide FCPA compliance training to any "high-risk" agents;
- Require agents to sign annual certifications attesting that they have not and will not violate anti-corruption laws;
- Involve multiple company departments in compliance efforts, for example, legal, internal audit, and accounting;
- Conduct periodic reviews and audits of the company's compliance systems to ensure that they are functioning and to look for ways to improve.”<sup>51</sup>

It is certainly true that businessmen and women must understand the significance of culture—and bribery—in conducting international business and especially in attempting to *penetrate* a foreign market. Culture is one of the most challenging elements that managers will face in the international arena. Ultimately, to be successful in international activities and ventures, businessmen and women must be *knowledgeable about world cultures, must develop a cultural literacy—that is, a detailed knowledge about a culture that enables people to live and work together—and a keen cultural sensitivity*. This cultural sensitivity must certainly extend to understanding the culture of a host country that might indicate that the payment of bribes—no matter how they are characterized—must be paid. Just as important is a clear understanding of the internal corporate culture that would

---

<sup>51</sup> Schroeder & Haedicke, *supra* note 32.

encourage, condone, or turn a deaf ear to corporate bribery under the FCPA.

Is the FCPA still relevant? Have American corporations learned the lessons of the FCPA? Despite so much publicity and attention, companies seem still to be engaged in illegal, questionable, and unethical behavior. In fact, just in the last year, one individual received the longest prison sentence imposed to date for a violation of the Act. On April 20 of 2010, United States District Court Judge Henry Hudson imposed an 87 month prison sentence on Charles Jumet after Jumet pleaded guilty to violating the FCPA and to making false statements to federal prosecutors in connection with a conspiracy to pay money (more than \$200,000) secretly to Panamanian government officials in exchange for the awarding of contracts to Ports Engineering Consulting Corporation (PEEC) to maintain a series of lighthouses and buoys along Panama's waterway. The government of Panama ultimately awarded PEEC with a no-bid 20-year concession. In addition, Jumet was ordered to pay a \$15,000 fine and serve three years of supervised probation following his release from prison.

Maybe it is in fact hard to teach the "old dogs" of international business the "new tricks" of compliance with the FCPA!



BALANCING CUSTOMER SERVICE, SAFETY ISSUES, AND  
LEGAL REQUIREMENTS: IT'S ALL ABOUT SAFETY

by

*Gregory P. Tapis, \* Kathryn Kisska-Schulze, \*\*  
Kanu Priya, \*\*\* & Jeanne Haser\*\*\*\**

I. INTRODUCTION

On Monday August 9, 2010, thirty-eight year-old Steven Slater, a flight attendant for JetBlue Airways, grabbed a beer from a beverage cart, activated the emergency-evacuation chute, slid down onto the ground and headed towards the employee parking lot.<sup>1</sup> Such an event occurred after Mr. Slater had an unfriendly interaction with a passenger on the aircraft. According to Federal Aviation Administration (“FAA”) and JetBlue officials:

---

\*Assistant Professor, Augustana College, Business Administration Department.

\*\* Assistant Professor, North Carolina Agricultural and Technical State University, Department of Management.

\*\*\*Assistant Professor, Arkansas State University, Department of Management and Marketing.

\*\*\*\*Assistant Professor, Rhode Island College, Department of Accounting & Information Systems.

<sup>1</sup> A. Newman and Ray Rivera, *Fed-Up Flight Attendant Makes Sliding Exit*, N.Y. Times, August 10, 2010, at A1.

“One passenger stood up to retrieve belongings from the overhead compartment before the crew had given permission. Mr. Slater instructed the person to remain seated. The passenger defied him.<sup>2</sup> Mr. Slater reached the passenger just as the person was pulling down the luggage, which struck Mr. Slater in the head.<sup>3</sup> Mr. Slater asked for an apology. The passenger instead cursed at him.”<sup>4</sup>

While millions of passengers are carried on United States airlines each year,<sup>5</sup> little research exists in business law literature related to legal issues in such a complex industry. The airline industry is heavily regulated<sup>6</sup> yet highly sensitive to costs<sup>7</sup> and customer opinions when it comes to competition for customers.<sup>8</sup>

---

<sup>2</sup> Such defiance is in violation of Federal Aviation Regulations. See FAR §121.571(a)(1)(i) stating, “...Federal Aviation Regulations require passenger compliance with the lighted passenger information signs (if such signs are required), posted placards..., and crewmember instructions...” Additionally, FAR §121.580 states, “No person may assault, threaten, intimidate, or interfere with a crewmember in performance of the crewmember’s duties aboard an aircraft being operated under this part.”

<sup>3</sup> *Id.*

<sup>4</sup> A. Newman and Ray Rivera, *Fed-Up Flight Attendant Makes Sliding Exit*, N.Y. Times, August 10, 2010, at A1.

<sup>5</sup> See December 2009 Airline Traffic Data, [http://www.bts.gov/press\\_releases/2010/bts012\\_10/html/bts012\\_10.html](http://www.bts.gov/press_releases/2010/bts012_10/html/bts012_10.html), (last accessed May 10, 2011), stating U.S. airlines carried 703,900,000 passengers during calendar year 2009.

<sup>6</sup> The airline industry is regulated by the Federal Aviation Administration, the National Transportation Safety Board and the Department of Transportation.

<sup>7</sup> See Cost Allocation Studies, [http://www.faa.gov/library/reports/cost\\_allocation](http://www.faa.gov/library/reports/cost_allocation), (last visited December 2, 2010).

<sup>8</sup> See 2010 North American Airline Satisfaction Study, <http://businesscenter.jdpower.com/news/pressrelease.aspx?ID=2010092>, (last accessed May 10, 2011).

With such an increasing number of passengers flying<sup>9</sup>, there is growing concern among pilots and airline officials between balancing safety within the commercial aviation industry and customer service.<sup>10</sup> Such concern has resulted in passengers threatening boycotts,<sup>11</sup> the Department of Homeland Security (“DHS”) opining on security procedures conducted by the Transportation and Safety Administration (“TSA”),<sup>12</sup> and TSA defending its current safety procedures.<sup>13</sup> Such disconnect between customer satisfaction and the agencies involved in keeping our skies safe beckons the question: Can there be a balance between customer service and safety in the airline industry?

The remainder of this paper proceeds as follows. First, specific Federal Aviation Regulations (“FARs”) are discussed to give context to the issues raised in this paper. Second, specific customer service issues are discussed. This is followed by a

---

<sup>9</sup> See Bureau of Transportation Statistics, <http://www.bts.gov/> (last accessed May 10, 2011) where most months United State’s airline carry in excess of 60 million passengers.

<sup>10</sup> See e.g., Oceanside man ejected from airport for refusing security check, <http://www.signonsandiego.com/news/2010/nov/14/tsa-ejects-oceanside-man-airport-refusing-security.html> (last accessed May 10, 2011) where John Tyner refused to subject himself to the new full-body scanners or enhanced pat-down procedures at the San Diego International Airport stating it was an invasion of his privacy.

<sup>11</sup> See e.g., Holiday travel: National Opt-Out Day, <http://www.washingtonpost.com/wp-dyn/content/discussion/2010/11/24/DI2010112401939.html> (last accessed May 10, 2011) where an organized effort was conducted asking passengers to refuse full-body scanners and elect for the full-body pat-down thereby attempting to create a “bottleneck” at Airport Security Checkpoints.

<sup>12</sup> See e.g., Napolitano stands firm on airline security needs, [http://www.forbes.com/feeds/ap/2010/11/22/general-us-holiday-security\\_8157308.html](http://www.forbes.com/feeds/ap/2010/11/22/general-us-holiday-security_8157308.html) (last accessed May 10, 2011).

<sup>13</sup> See e.g., TSA: TSA Statement from Administrator John S. Pistole, [http://www.tsa.gov/press/happenings/112110\\_right\\_balance.shtm](http://www.tsa.gov/press/happenings/112110_right_balance.shtm) (last accessed May 10, 2011).

discussion of balancing the right to privacy with customer safety. Third, safety issues are reviewed detailing that many potentially perceived “luxuries” or “conveniences” are required to be trumped by safety. Fourth, implications for practice arising from the review of safety and customer service issues are discussed. Finally, limitations of this paper as well as avenues for future research are discussed.

## II. FEDERAL AVIATION REGULATIONS

Four major FARs pertain to aircraft operation. These include FAR Parts 91, 119, 121 and 135. For purposes of clarification, it is important to briefly discuss these and how they relate to this paper. First, FAR Part 91 governs the operation of aircraft within the United States, including the waters within three nautical miles of the U.S. coast.<sup>14</sup> Second, Part 119 applies to each person operating or intending to operate civil aircraft.<sup>15</sup> Third, FAR Part 121 governs “the domestic, flag, and supplemental operations of each person who holds or is required to hold an Air Carrier Certificate or Operating Certificate under Part 119 of this Chapter.”<sup>16</sup> Part 121 is the regulation pertaining to commercial aircraft operations and applies to all flight crew members. Finally, FAR Part 135 governs commuter or on-demand operations of each person who holds or is required to hold an Air Carrier Certificate or Operating

---

<sup>14</sup> FAR §91.1(a). It is important to note that this section of the FAR specifically excludes moored balloons, kites, unmanned rockets, unmanned balloons, and ultralight vehicles.

<sup>15</sup> FAR §119.1(a). Furthermore, FAR §119.1(a)(1) states “as an air carrier or commercial operator, or both, in air commerce and FAR §119.1(a)(2) states “when common carriage is not involved, in operations of U.S.-registered civil airplanes with a seat configuration of 20 or more passengers, or a maximum payload capacity of 6,000 pounds or more.

<sup>16</sup> FAR §121.1(a). FAR §121.1(b) governs “each person employed or used by a certificate holder conducting operations under this part including maintenance, preventative maintenance, and alteration of aircraft.



Certificate under FAR Part 119.<sup>17</sup> For purposes of this review, Part 91 and Part 121 are the primary foci.

### III. CUSTOMER SERVICE

Several of the major airlines discuss their dedication to customer service on their websites.<sup>18</sup> However while these airlines all state customer service and/or relations as a top priority, many of these airlines specifically include a reference to safety in these customer service statements.<sup>19</sup> However, recent polls suggest the airline industry has not followed through with such commitments to service. For example, a 2010 Gallup Poll found that forty-one percent of Americans carry a negative view of the airline industry.<sup>20</sup> Furthermore, seventy-six percent of Americans who have flown at least twice in the past year state they were highly dissatisfied with ticket costs and fees charged for checked baggage

---

<sup>17</sup> See FAR §135.1(a)(1-3) which states this regulation applies to operators giving flight tours (for a fee) or aircraft operations transporting mail which are governed by the United States Postal Service.

<sup>18</sup> See e.g., American Airlines Customer Service Plan, <http://www.aa.com/i18n/customerService/customerCommitment/customerServicePlan.jsp> (last accessed May 10, 2011), Continental Airlines Customer First Commitments, [http://www.continental.com/web/en-us/content/co\\_customer\\_first.2010051001.pdf](http://www.continental.com/web/en-us/content/co_customer_first.2010051001.pdf) (last accessed May 10, 2011), Delta Customer Service Commitment, [http://www.delta.com/legal.delta\\_customer\\_commitment/index.jsp](http://www.delta.com/legal.delta_customer_commitment/index.jsp) (last accessed May 10, 2011), and U.S. Airways Customer Service Plan, <http://http://www2.usairways.com/en-US/aboutus/customersfirst/customerserviceplan.html> (last accessed May 10, 2011).

<sup>19</sup> See *id.* where the first statement of American Airlines Customer Service Plan is, “American Airlines and American Eagle are in business to provide safe...” Continental Airlines Customer First Commitments contains the statement, “Our goal is to make every flight a safe and pleasant experience for our customers.” Delta Airlines and U.S. Airways do not specifically mention safety in their customer service statements.

<sup>20</sup> See Airline Industry Image Grounded in Negative Territory, <http://www.gallup.com/poll/142691/airline-industry-image-grounded-negative-territory.aspx> (last accessed May 10, 2011, 2011).

and rebooking flights.<sup>21</sup> However, an in-depth examination into airline pricing structures shows a different scenario - one in which airline companies constantly struggle with.

While data shows that many Americans are dissatisfied with airline ticket prices and fees,<sup>22</sup> research indicates that historically airline ticket prices have remained relatively stable. As seen in Table 1, in 1993 the average annual airline domestic fare was \$318.62 while in 2009 the average fare was \$309.79.<sup>23</sup> Conversely, in 1993 the U.S. Kerosene-Type jet fuel retail sales by refiners were fifty-eight cents per gallon while in 2009 this amount was \$1.70 per gallon.<sup>24</sup> Thus while, the average fare decreased by approximately nine dollars over a sixteen year period, the average price of fuel increased by approximately three times over the same time period. Such discrepancy in pricing creates a conflict between how commercial airline companies cover the cost of fuel price increases and how such price increases might impact airline industry safety.

TABLE 1 – AVERAGE ANNUAL AIRLINE DOMESTIC FARES AND U.S. KEROSENE-TYPE JET FUEL COST

<i>Year</i>	<i>Average Annual Airline Domestic Itinerary Fares USD</i>	<i>U.S. Kerosene-Type Jet Fuel Retail Sales by Refiners (Cents per Gallon)</i>
1993	318.62	58.0
1994	291.86	53.4
1995	292.19	54.0
1996	276.63	65.1

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

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

<sup>23</sup> See U.S. Kerosene-Type Jet Fuel Retail Sales by Refiners (Cents per Gallon), <http://www.eia.doe.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=A503600002&f=A> (last accessed May 10, 2011).

<sup>24</sup> See Average Domestic Airline Itinerary Fares, <http://www.transtats.bts.gov/AverageFare/Default.aspx> (last accessed May 1, 2011).

1997	287.22	61.3
1998	309.17	45.2
1999	323.83	54.3
2000	339.00	89.9
2001	320.62	77.5
2002	312.33	72.1
2003	315.36	87.2
2004	305.41	120.7
2005	307.31	173.5
2006	328.55	199.8
2007	325.26	216.5
2008	345.73	305.2
2009	309.79	170.4

One possible avenue for airlines to lower their costs is reducing pilot salaries. Because sixty-two percent<sup>25</sup> of all flights are flown by regional carriers,<sup>26</sup> the pilot pay rates for the first five years of employment with an airline are reported in Table 2.<sup>27</sup> When calculating potential annual salaries for pilots, it is important to note that the maximum number of hours a pilot may fly in a calendar year is one thousand.<sup>28</sup> However not all commercial airlines guarantee pilots a full one thousand hours of flying time.<sup>29</sup> For example, for a first year First Officer employed by Colgan Air,

---

<sup>25</sup> Regional Carriers Shoulder Big Load, HOUSTON CHRONICLE, (August 15, 2011).

<sup>26</sup> See Airline Glossary, <http://www.avjobs.com/history/airline-glossary.asp> (last accessed May 10, 2011) where a regional carrier is defined as, “an airline with annual revenues of less than \$100 million whose service is generally limited to a particular region.

<sup>27</sup> See Airline Pilot Salary and Pay Rates, <http://www.willflyforfood.com/airline-pilot-salary/> (last accessed May 10, 2011).

<sup>28</sup> See FAR §121.471(a)(1).

<sup>29</sup> See e.g., Airline Pilot Salary and Pay Rates, <http://www.willflyforfood.com/airline-pilot-salary/> (last accessed May 10, 2011) where Colgan Air guarantees 75 hours per month, translating into 900 hours per year.

Inc. (“Colgan Air”)<sup>30</sup> who flies the maximum number of guaranteed hours<sup>31</sup> of seventy-five per month (900 per year), the salary would be \$18,900 (e.g. 900 hours \* \$21 per hour).<sup>32</sup>

TABLE 2 – PILOT PAY FOR REGIONAL AIRLINES<sup>33</sup>

<i>Airline</i>	<i>Major Affiliation</i>	<i>Year 1 Hourly Rate</i>	<i>Year 2 Hourly Rate</i>	<i>Year 3 Hourly Rate</i>	<i>Year 4 Hourly Rate</i>	<i>Year 5 Hourly Rate</i>
American Eagle	American Airlines	\$25.46	\$34.39	\$37.34	\$39.19	\$40.19
Atlantic Southeast Air	Delta	\$23.00	\$35.42	\$37.83	\$39.01	\$40.20
Colgan Air	Continental	\$21.00	\$26.00	\$27.00	\$28.00	\$29.00
Express Jet	United Airlines	\$23.00	\$34.00	\$37.00	\$39.00	\$40.00
Mesaba Airlines	Delta	\$24.00	\$29.00	\$32.00	\$35.00	\$36.00
Piedmont Airlines	U.S. Airways	\$27.00	\$31.00	\$33.00	\$34.00	\$35.00
Pinnacle Airlines	Delta	\$21.00	\$24.00	\$30.00	\$33.00	\$34.00
Skywest Airlines	Delta	\$22.00	\$35.00	\$37.00	\$39.00	\$40.00

The issue of pilot salary was indirectly raised while investigating the crash of Colgan Airways Flight 3407 (a regional flight

<sup>30</sup> Colgan Air, Inc. operates as Continental Connection, United Express and US Airways Express, offering daily scheduled service to fifty three U.S. cities in fifteen states & Canada. See <http://www.colganair.com/>.

<sup>31</sup> Colgan Air, Inc. allows for a maximum number of monthly hours of seventy five which equates to a maximum yearly number of flying hours of nine hundred. See Pilot Job Resources, <http://www.willflyforfood.com>, (last accessed May 10, 2011).

<sup>32</sup> Note that this salary does not include the per diem rate of \$1.40 per hour. Commercial pilots are only paid their hourly rate for actual flight time. All other “duty time” is paid at the per diem rate.

<sup>33</sup> Pilot Job Resources, <http://www.willflyforfood.com>, (last accessed May 10, 2011).

operating as Continental Connection Flight 3407) on February 12, 2009. The cockpit voice recorder (“CVR”) recorded several instances when the Captain and First Officer were discussing dissatisfaction with pay<sup>34</sup> as well as the commuting time required to reach the airport they were stationed at in order to maintain an acceptable quality of life.<sup>35</sup> Therefore, it appears the low pay for pilots may create a distraction since it is recorded they are discussing it during flight.

#### IV. BALANCING THE RIGHT TO PRIVACY WITH CUSTOMER SAFETY

While the U.S. Constitution does not explicitly provide citizens with a right to privacy, certain amendments in the Bill of Rights are interpreted as intending to offer persons the privilege of privacy.<sup>36</sup> Of these amendments, none appears more controversial in the commercial airline industry today as does the Fourth

---

<sup>34</sup> Cockpit Voice Recorder Group Chairman Factual Report Docket No. SA-531 Exhibit No. 12-A, 21:46:13.6, where the First Officer (FO) states, “exactly if I hold off— you know if it’s a matter of holding on a few months well then I’ll be making a substantial amount more money in the— in the Q than I would in the Saab.” and 21:46:22.9 when the FO states, depending you know how— how long would it be to make that worth my while. Would it— would I make more money upgrading into the Saab right away or would I make more money if I waited for the Q for a little while.” and the Captain responds, “well think of it this way uh if you— if you stayed on the on the Q obviously you’re gonna— you’re not making the captain rate.”

<sup>35</sup> See *id.* at 21:45:55.6 where the FO states, “Yeah I don’t know what I want to do with the upgrade. I’m not entirely in like a big rush to upgrade. Um it would depend on where I’m based. Just because having to commute to be the bottom of the list is gonna suck. and—.” and 21:46:42.5 where the Captain states, “but you may have a better quality of life to begin with uhh with regards to buying a house and having a schedule to where you you know you could work around and you could be—.”

<sup>36</sup> See U.S. CONST. Amend. I, III IV, V, and IX. The First Amendment protects the freedom of religion, speech and the press; the Third Amendment prevents against the forced quartering of troops in one’s home; the Fourth Amendment protects against unreasonable search and seizure; the Fifth Amendments protects the right to Due Process; and the Ninth Amendment acts as a “catch all”, asserting the existence of unenumerated rights retained by the people.

Amendment and its promise of protection against unreasonable search and seizure.<sup>37</sup>

With the inception by TSA of its Advanced Imaging Technology (“AIT”) in 2007<sup>38</sup>, the question beckons whether customers’ right to privacy is being violated. AIT provides a method of screening airline passengers for metallic and nonmetallic threats including weapons, explosives and other objects concealed under layers of clothing without physical contact.<sup>39</sup> At an airport security checkpoint, passengers walk into the AIT imaging portal, where they stand in a prone position and remain still for a few seconds while an X-Ray likened image is made.<sup>40</sup> Such passenger image is a full body image which produces naked pictures of passengers, though such passengers’ faces are blurred to the viewer in order to protect their identities.<sup>41</sup>

Once a TSA officer reviews the image, the passenger is free to exit the opposite side of the portal.<sup>42</sup> TSA notes that the officer viewing the processed passenger image is remotely located in a secure resolution room and never sees the passenger; and the officer assisting the passenger during the screening process never

---

<sup>37</sup> U.S. CONST. Amend. IV provides in full, “The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by oath of affirmation, and particularly describing the place to be searched, and the persons or things to be seized.”

<sup>38</sup> See <http://www.tsa.gov/approach/tech/ait/index.shtm>, (last accessed May 10, 2011).

<sup>39</sup> See [http://www.tsa.gov/approach/tech/ait/how\\_it\\_works.shtm](http://www.tsa.gov/approach/tech/ait/how_it_works.shtm), (last accessed May 10, 2011).

<sup>40</sup> See <http://www.tsa.gov/approach/tech/ait/faqs.shtm>, (last accessed May 10, 2011).

<sup>41</sup> See [http://www.tsa.gov/approach/tech/ait/how\\_it\\_works.shtm](http://www.tsa.gov/approach/tech/ait/how_it_works.shtm), (last accessed May 10, 2011).

<sup>42</sup> See <http://www.tsa.gov/approach/tech/ait/faqs.shtm>, (last accessed May 10, 2011).

sees the actual image.<sup>43</sup> Passengers have the right to opt out of the AIT imaging portal at airport security screening stations; however, those passengers must submit to alternative screening, including a physical pat-down.<sup>44</sup>

TSA's stance on instituting the AIT screening process is purely one of safety – "Imaging technology is an integral part of TSA's effort to continually look for new technologies that help ensure travel remains safe and secure by staying ahead of evolving threats."<sup>45</sup> And such stance runs in direct correlation with the FAA's number one roll – the regulation of civil aviation to promote safety.<sup>46</sup> So in a country where aircraft safety is a number one priority, can the United States balance personal imaging and opt-out physical pat-downs with aircraft safety regulations?

A 2010 CBS News Poll found that eighty-one percent of Americans approve of the use of full-body digital X-ray machines.<sup>47</sup> However, a journalist for the Boston Globe wrote of his less-than-private security experience at Logan International Airport.<sup>48</sup> After opting out of the AIS screening procedure, the gentleman-journalist painted the following picture of his physical pat-down experience:

"The agent firmly ran his hands over my entire body, head to toe, front and back. He rubbed

---

<sup>43</sup> See <http://www.tsa.gov/approach/tech/ait/privacy.shtm>, (last accessed May 10, 2011).

<sup>44</sup> See <http://www.tsa.gov/approach/tech/ait/privacy.shtm>, (last accessed May 10, 2011).

<sup>45</sup> <http://www.tsa.gov/approach/tech/ait/index.shtm>, (last accessed May 10, 2011).

<sup>46</sup> See [http://www.faa.gov/about/safety\\_efficiency/](http://www.faa.gov/about/safety_efficiency/), (last accessed May 10, 2011).

<sup>47</sup> See [http://www.cbsnews.com/8301-503544\\_162-20022876-503544.html](http://www.cbsnews.com/8301-503544_162-20022876-503544.html), (last accessed May 10, 2011).

<sup>48</sup> Tom Keane, *Invasion of Privacy*, BOSTON GLOBE, Nov. 19, 2010.

his hands over my buttocks and in between. He put his hands in my pants and ran them all around my waist. From behind, he ran his hands along my legs, all the way up my thigh as high as he could go and onto my genitals.”<sup>49</sup>

The United States Supreme Court has stated:

"[The Fourth] Amendment protects individual privacy against certain kinds of governmental intrusion, but its protections go further, and often have nothing to do with privacy at all. Other provisions of the Constitution protect personal privacy from other forms of governmental invasion. But the protection of a person's *general* right to privacy -- his right to be let alone by other people -- is, like the protection of his property and of his very life, left largely to the law of the individual States.”<sup>50</sup>

The United States Supreme Court has further conceded that the Fourth Amendment right to privacy is diminished in airports:<sup>51</sup>

“Certain constraints on personal liberty that constitute "seizures" for purposes of the Fourth Amendment may nonetheless be justified even though there is no showing of "probable cause" if ‘there is articulable suspicion that a person has committed or is about to commit a

---

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

<sup>50</sup> *Katz v. United States*, 389 U.S. 347, 350 – 351 (1967).

<sup>51</sup> *Florida v. J.L.*, 529 U.S. 266, 274; 120 S. Ct. 1375; 146 L. Ed. 2d 254 (2000); *See, e.g., Florida v. Rodriguez*, 469 U.S. 1, 83 L. Ed. 2d 165, 105 S. Ct. 308 (1984) (*per curiam*).



crime.<sup>52</sup> Such a temporary detention for questioning in the case of an airport search is reviewed under the lesser standard...<sup>53</sup>, and is permissible because of the ‘public interest involved in the suppression of illegal transactions in drugs or of any other serious crime.’<sup>54,55</sup>

The crux in balancing safety with privacy rights thus falls within the parameter of whether there is articulable suspicion to search airport passengers.<sup>56</sup> “Once an encounter ceases to be consensual, reasonable articulable suspicion that an individual is engaged in criminal activity is required before law enforcement officers may continue to question or to detain him.”<sup>57</sup> To satisfy the Fourth Amendment, law enforcement officers must have more than a mere suspicion or hunch that a crime may occur.<sup>58</sup> However, articulable suspicion is flexible in nature and is not set by “hard-and-fast rules”.<sup>59</sup> Further, in airport settings the U.S. Supreme Court has recognized that even when law enforcement officers have no basis for suspecting an individual of a crime, such officers may still question him or her, particularly because of the safety issues resonating within the aircraft industry.<sup>60</sup>

At the close of 2010, three hundred and eighty five AIT imaging technology machines were being used at sixty- eight airports

---

<sup>52</sup> Florida v. Royer, 460 U.S. 491, 498 (1983).

<sup>53</sup> As enunciated in Terry v. Ohio, 392 U.S. 1 (1968).

<sup>54</sup> Royer, *supra*, at 498-499.

<sup>55</sup> Rodriguez, *supra*, at 310.

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

<sup>57</sup> United States v. Kolawole Adebajo, U.S. App. LEXIS 11850, 13 (1995). *See also* United States v. Sokolow, 490 U.S. 1, 7, 104 L. Ed. 2d 1, 109 S. Ct. 1581 (1989).

<sup>58</sup> Kolawole, *supra*, at 13. *See also* Terry v. Ohio, 392 U.S. 1 at 27 (1968).

<sup>59</sup> Kolawole, *supra*, at 13. *See also* INS v. Delgado, 466 U.S. 210, 217, 80 L. Ed. 2d 247, 104 S. Ct. 1758 (1984).

<sup>60</sup> Kolawole, *supra*, at 13. *See also* Rodriguez, *supra*, at 5-6.

nationwide.<sup>61</sup> As such, it is clear that states have chosen to follow the safety directives of the TSA and the FAA as well as implementing the Constitutional standards required by the Fourth Amendment as interpreted in international airports by the U.S. Supreme Court. Thus, where airline and passenger safety is measured against an individual's right to privacy, safety appears to prevail.

## V. SAFETY ISSUES

There are several safety issues and regulations which are important to discuss in relation to this paper. The first issue is Pilot in Command which holds the pilot ultimately responsible for all accidents or failure to comply with safety regulations. Second, there are several safety issues which often inconvenience passengers. These include regulations related to alcoholic beverages, rest requirements for crews, restrictions on carry-on baggage and the use of portable hand-held electronic devices. Finally, there are legal issues which apply to many industries, but in the interest of safety certain exemptions are granted to the airline industry.

### A. *Pilot in Command*

FAR Section 91.3 grants responsibility and authority of the aircraft to the pilot in command. Specifically, FAR Section 91.3(a) states, "The pilot in command of an aircraft is directly responsible for, and is the final authority as to, the operation of that aircraft." This specific regulation grants the pilot in command of commercial aircraft ultimate responsibility for safety issues related to the aircraft as well as passengers and their behavior on board.

---

<sup>61</sup> <http://www.tsa.gov/approach/tech/ait/faqs.shtm>.

While such pilot responsibility comes with severe penalties for failure to adhere to the FAA regulations,<sup>62</sup> in certain instances pilots have been terminated from their airlines for adhering to such regulations.<sup>63</sup>

FAR Section 91.3 is the primary basis for our argument that it is difficult to maintain a healthy balance between safety and customer service and that safety must supersede customer service. While FAR Section 91.3 appears straightforward in its requirements and standards, other FAA regulations are not drafted as clearly. Such discrepancy in language may result in pilots interpreting regulations differently, thus resulting in frustration among airline passengers as well as potential inconveniences.

*B. Alcoholic Beverages:*

FAR Section 121.575 addresses the consumption of alcoholic beverages aboard commercial aircraft with all three sections trumping customer service in lieu of safety. FAR Section 121.575(a) states, “No person may drink any alcoholic beverage aboard an aircraft unless the certificate holder operating the aircraft has served that beverage to him.” In this case the certificate holder is the aircraft carrier.<sup>64</sup> As such, the FAA prohibits passengers from bringing their own personal alcoholic beverages on board commercial aircraft, perhaps in an attempt to avoid paying the fees associated with the purchase of on-board alcoholic beverages.

---

<sup>62</sup> See e.g., Hinson v. Krauchun, 1993 NTSB Order No. EA-4002 where the NTSB suspended a pilot’s license for not complying with FAR §91.3.

<sup>63</sup> See e.g., Ex-Gulfstream International Airline pilot files complaint with FAA, <http://www.eturbonews.com/2376/ex-gulfstream-international-airline-pilot-fil>, (last accessed May 10, 2011) where Captain Kenny Edwards was fired for refusing to operate an aircraft he deemed unsafe but the airline disagreed.

<sup>64</sup> Federal Aviation Administration – Airline Certificate Information – Applicable Definitions, <http://av-info.faa.gov/Definitions.asp>, (last accessed May 10, 2011).

Such regulation has infuriated some airline passengers and filled up online discussion forums.<sup>65</sup>

Second, FAR Section 121.575(b)(2) states “No certificate holder may serve any alcoholic beverage to any person aboard its aircraft who appears to be intoxicated while FAR Section 121.575(c) states, “no certificate holder may allow any person to board any of its aircraft if that person appears to be intoxicated.”

FAR Section 121.575(b)(2) and FAR Section 121.575(c) raise two examples of the vagueness of regulations which ultimately require the pilot in charge to make the final determination of the actual meaning. The primary word creating such vagueness is ‘intoxicated’ which has several different meanings.<sup>66</sup>

### C. Rest Requirements:

Airline pilots and flight attendants<sup>67</sup> are both subject to stringent guidelines pertaining to duty periods<sup>68</sup> and rest periods<sup>69</sup> for safety

---

<sup>65</sup> See e.g., Drinking on Planes? Allowed?, <http://forums.whirlpool.net.au/archive/1188230>, (last accessed May 10, 2011) and Has Anyone Snuck Alcohol on a Plane?, <http://answers.yahoo.com/question/index?qid=20080222150129AAKmw2k>, (last accessed May 10, 2011).

<sup>66</sup> See e.g., “affected by a substance that intoxicates; drunk; inebriated,” Define intoxicated at Dictionary.com, <http://dictionary.reference.com/browse/intoxicated> (last accessed May 10, 2011) and “a diminished ability to act with full mental and physical capabilities because of alcohol or drug consumption; drunkenness” BLACK’S LAW DICTIONARY 841 (8th ed. 2009).

<sup>67</sup> See FAR §121.467(a) defining a flight attendant as “an individual, other than a flight crew member, who is assigned by the certificate holder, flag, or supplemental operations, in accordance with the required minimum crew complement under the certificate holder’s operations specifications or in addition to that minimum complement, to duty in an aircraft during flight time and whose duties include but are not necessarily limited to cabin-safety-related responsibilities.”

purposes. Flight crewmembers have restrictions on the number of in-flight hours scheduled based on calendar year,<sup>70</sup> calendar month,<sup>71</sup> consecutive days,<sup>72</sup> and consecutive hours.<sup>73</sup> For example, pilots flying the majority of U.S. commercial aircraft cannot be scheduled for a duty period of more than sixteen hours during any twenty-four consecutive hours.<sup>74</sup> The sixteen hour duty day is firm and if a situation arises where a pilot would need to perform longer than these sixteen hours, the flight must be cancelled if no alternate crew is available.<sup>75</sup>

D. *Exit Row Requirements:*

Many passengers prefer exit row seating due to the additional room provided in these rows, and airlines are responding to this preference by charging extra fees for exit row seating.<sup>76</sup> However, the assignment of which passengers may be seated in exit rows is

---

<sup>68</sup> FAR §121.467 defines a duty period as “the period of elapsed time between reporting for an assignment involving flight time and release from that assignment by the certificate holder conducting domestic, flag, or supplemental operations. The time is calculated using either Coordinated Universal Time or local time to reflect the total elapsed time.”

<sup>69</sup> See *id.* defining a rest period as “the period free of all responsibility for work or duty should the occasion arise.”

<sup>70</sup> See FAR §121.471(a)(1) restricting crews to a maximum of 1,000 hours in any calendar year.

<sup>71</sup> See FAR §121.471(a)(2) restricting crews to a maximum of 100 hours in any calendar month.

<sup>72</sup> See FAR §121.471(a)(3) restricting crews to a maximum of 30 hours in any 7 consecutive days. FAR §121.467 states a “calendar day means the period of elapsed time, using Coordinated Universal Time or local time, that begins at midnight and ends 24 hours later at the next midnight.

<sup>73</sup> See FAR §121.471(b)(1-3) requiring 9 consecutive hours of rest for less than 8 hours of scheduled flight time; 10 consecutive hours of rest for 8 or more but less than 9 hours of scheduled flight time; 11 consecutive hours of rest for 9 or more hours of scheduled flight time.

<sup>74</sup> See FAR §121.505(b).

<sup>75</sup> *Id.*

<sup>76</sup> See e.g., AirTran Airways.

dictated by the FAA.<sup>77</sup> Such seating assignments are determined solely for safety reasons and the ability of such passengers seated in the exit row to perform key functions in the event of an aircraft emergency.<sup>78</sup>

Every passenger seated in a commercial aircraft exit row must comply with the FAA regulations for sitting in these assigned seats. Each passenger seated in an exit row must be at least fifteen years of age, be able to locate the emergency exit, recognize the emergency exit opening, comprehend the instructions for operating the emergency exit, operate the emergency exit, assess whether opening the emergency exit will increase the hazards to which passengers may be exposed, follow oral directions and hand signals given by a crew member, stow or secure the emergency exit door so that it will not impede use of the exit, assess the condition of an escape slide, activate the slide, and stabilize the slide after deployment to assist others in getting off the slide, pass expeditiously through the emergency exit and assess, select and follow a safe path away from the emergency exit as well as a number of other functions.<sup>79</sup>

While it is intuitive for many that flight attendants are available for customer service, such attendants are often in charge with ensuring airlines are in compliance with key FARs. Pertaining to exit row requirements, no aircraft may taxi or pushback unless at least one required crewmember has verified that no exit seat is occupied by a person the crewmember determines is likely to be unable to perform the applicable functions.<sup>80</sup> Perhaps one of the most infamous images associated with passengers performing the functions required by sitting in the exit row and thus saving the lives of fellow passengers occurred on January 15, 2009. On January 15, 2009, U.S. Airways flight (also known as Cactus) 1549

---

<sup>77</sup> FAR §121.585 outlines the requirements for sitting in an emergency exit row.

<sup>78</sup> *Id.*

<sup>79</sup> FAR §121.585(d)(1-10).

<sup>80</sup> FAR §121.585(g).

crashed into the Hudson River after a bird strike.<sup>81</sup> After Cactus 1549, Captained by Chesley B. Sullenberger and Assisted by First Officer Jeffrey Skiles, crash landed the emergency exits were immediately opened and escape slides deployed.<sup>82</sup> Passengers exited the Airbus A320, N106US and took safety on one of the deployed escape slides or on one of the wings.<sup>83</sup>

*E. Carry-on Baggage:*

With the recent evolution of U.S. airlines charging fees for checked baggage,<sup>84</sup> many passengers are now electing to bring their items aboard the aircraft as carry-on baggage.<sup>85</sup> Such an increase in airline carry-on baggage creates additional safety issues requiring attention from certificate holders, pilots, and flight attendants.

Specifically, “no certificate holder may allow all passenger entry doors of an airplane to be closed in preparation for taxi or pushback unless at east one required crewmember has verified that each article of baggage is stowed...”<sup>86</sup> Furthermore, “no certificate holder may allow an airplane to take off or land unless each article of baggage is stowed in a suitable closet...and in a manner that does not hinder the possible use of any emergency equipment; or”<sup>87</sup> “under a passenger seat.”<sup>88</sup> With such an increase in carry-on

---

<sup>81</sup> NTSB Docket ID 47230.

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

<sup>83</sup> *Id.*

<sup>84</sup>For example, Delta Airlines, American Airlines, and United Airlines all charge \$25 for the first checked bag and \$35 for the second checked bag for domestic travel.

<sup>85</sup> The Transportation Safety Administration’s restrictions regarding carrying liquids, gels, and aerosols onboard an aircraft in carry-on baggage are recognized by the authors but an in-depth discussion is beyond the scope of this paper.

<sup>86</sup> FAR §121.589(b).

<sup>87</sup> FAR §121.589(c)(1).

<sup>88</sup> FAR §121.589(c)(3).

baggage and the specificities of FAR Section 121.589, the potential for flight delays increases in an industry where the turnaround of commercial aircraft averages thirty-four minutes.<sup>89</sup>

*F. Use of Portable Electronic Devices: FAR Section 91.3 v. Customer Service:*

While the case of JetBlue flight attendant Steven Slater appears extreme, instances constantly arise when FAR Section 91.3 trumps customer service. In many instances, this results in passengers being removed from aircraft.

The use of portable hand-held electronic devices has resulted in passengers being removed from aircraft and flights being delayed. For example, on December 3, 2010, actor Josh Duhamel was escorted off a plane for refusing a flight attendant's instructions for refusing to turn off his Blackberry before the aircraft took off, resulting in the flight being delayed.<sup>90</sup> In this situation, the flight attendant called for back-up and in accordance with FAR Section 91.3 and the pilot approved the removal of Mr. Duhamel.<sup>91</sup> In refusing to turn off his Blackberry, Mr. Duhamel violated several FARs.<sup>92</sup>

## VI. LEGAL ISSUES AND SAFETY: CUSTOMERS AND EMPLOYEE HIRING

---

<sup>89</sup> Aircraft Turnaround Times, <http://www.airliners.net> (last accessed May 10, 2011).

<sup>90</sup> Police Reportedly Escort Actor Josh Duhamel Off New York-Bound Flight for 'Taunting Attendant,' <http://www.foxnews.com/entertainment/2010/12/03/josh-duhamel-kicked-plane-nyc/?test=latestnews>, (last accessed May 10, 2011).

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

<sup>92</sup> Josh Duhamel violated FAR §121.571(a)(1)(i) for failure to comply with crewmember instructions and FAR §121.580 for interfering and intimidating a crewmember during the performance of required duties.



While many businesses and public facilities are required to accommodate customers with disabilities,<sup>93</sup> certain exemptions specific to the airline industry trump not only customer service but common legal requirements such as the Americans with Disabilities Act.<sup>94</sup> For example, airlines are permitted to deny transportation to passengers if “the only seat that will physically accommodate the person’s handicap is an exit seat.”<sup>95</sup>

Additionally, the airline industry often uses discriminatory practices in employment and hiring practices in the interests of safety and these practices are protected by law.<sup>96</sup> Specifically, pilots are required to retire at the age of sixty-five in the interests of safety.<sup>97</sup> Furthermore, when hiring flight attendants airlines place greater restrictions in the hiring process in the interest of safety.<sup>98</sup>

## VII. IMPLICATIONS FOR PRACTICE

Several implications for the airline industry arise from this review. These include the need for increased communication by airline companies regarding the importance of safety, an increase in pilot pay, and a reduction in the duty day for pilots. First, as discussed, there are several safety requirements dictated by law which

---

<sup>93</sup> See e.g., Americans with Disabilities Act of 1990.

<sup>94</sup> *Id.*

<sup>95</sup> FAR §121.585(m)(2).

<sup>96</sup> See generally bona fide occupational qualifications.

<sup>97</sup> On December 13, 2007, President Bush signed the Fair Treatment for Experienced Pilots Act which increased the mandatory age for Pilots and Co-Pilots from 60 to 65 years of age. However, the Act still requires that at least one pilot be under 60 years of age for international flights.

<sup>98</sup> See e.g., Flight Attendant Career Guide,

<http://www.skywest.com/careers/flight-attendant/flight-attendant-jobs.php> (last accessed May10, 2011), where Skywest states, “To become a Flight Attendant at SkyWest, your height must be between 5’0” and 5’8” without shoes due to the internal size of the aircraft. For your safety, there are no exceptions to this requirement.”

passengers are not aware of the purpose. One of the safety requirements dominating the news is the use of the AIT and balancing it with the right to privacy. The airline industry along with the TSA has determined that the use of this technology is necessary in order to reduce the risk of explosives entering aircraft. Additionally, the reasons for restricting the service of alcoholic beverages and portable handheld electronic devices should be communicated to passengers in the context of safety as alcoholic beverages can result in passenger belligerence. Further, as discussed in this paper the use of handheld electronic devices often creates conflict between passengers and crew. Also, the airline industry should consider explaining better the primary purpose of exit row seating being for assisting in the event of an emergency rather than comfort.

Second, it is important to consider an increase in pilot pay. As indicated in Table 2, it is possible that a first officer's salary can be \$18,000 for the year. One potential reason for this is the reduced average passenger fare and a corresponding increase in fuel prices. As seen in Table 1, in 1993 the average airfare and fuel price (cents per gallon) were \$318.62 and fifty-eight respectively. In 2009, the average airfare and fuel price (cents per gallon) were \$309.79 and 170.40. Thus, the industry should maintain a consistency between the increase in fuel price and the corresponding average airfare.

Finally, the airline industry should consider a reduction in the sixteen hour duty day for pilots. Since pilots are only paid for actual flight time, and this flight time is limited to eight hours in these sixteen hours, reducing the duty day not only has the potential for increasing pilot morale and decreasing the possibility of pilot fatigue.

## VIII. LIMITATIONS AND FUTURE RESEARCH

As with all papers, this paper is not without limitations. However, these limitations do provide fruitful avenues for future research. First, the airline industry is extremely complex and it is important to note that this paper merely scratches the surface regarding many of the safety and customer service issues. Other issues which should be addressed in future studies are traveling with infants and small children as well as traveling with pets.

Second, this paper is a review piece of many issues unique to the airline industry. Future studies should collect qualitative and quantitative data from both crew members and passengers to try and reconcile some of the differences in perception regarding the industry. The primary purpose of this paper is to raise some of these issues in the hope that it raises awareness among scholars and promotes the need for further legal research in this industry (perhaps in the area of patient rights).

Finally, this paper reviews two accident reports. These are the reports associated with United Airlines Flight 1549 (the crash in the Hudson River) and Colgan Flight 3407 (the Buffalo crash). Future studies should examine additional commercial aircraft accident reports to determine if pilot fatigue and/or the duty day are mentioned, as was the case in the Colgan Flight 3407 cockpit voice recorder transcript.

## IX. CONCLUSION

The United States commercial airline industry is a complex and highly regulated industry. These complexities and regulations often result in the difficult task of determining how to balance customer service and safety regulations. Often, this creates a disconnection and frustration between crew and passengers. While the majority of major carriers have a customer service statement detailing their dedication to passengers, many contain the term

“safety” in these customer service statements. Customer service is an important issue in any service industry, however in respect to the airline industry it is imperative that customers and airlines alike realize it is all about safety.



INTERNATIONAL AUDIT COMMITTEE INDEPENDENCE  
REQUIREMENTS: ARE POLICYMAKERS PUTTING THE  
ACADEMIC RESEARCH TO USE?

by

*J. Royce Fichtner*\*

I. INTRODUCTION

The audit committee concept was born in the early 1940s when the New York Stock Exchange Board of Governors, in response to a major accounting scandal involving the firm of McKesson & Robbins, first recommended that listed companies utilize a committee of external directors to select the company's external auditor.<sup>1</sup> This recommendation centered on fixing one of the inherent conflicts of interest in the financial reporting process. Namely that corporate management, the entity responsible for preparing the company's financial statements and simultaneously incentivized to produce positive financial results, was also heavily

---

\* Assistant Professor of Business Law, Drake University. The author would like to thank Tyler Moulton, Master of Accounting graduate student, for his research assistance. The author would also like to thank Roger Brooks for creating the Roger Brooks Faculty Development Research Award that helped support this article.

<sup>1</sup> Richard Baker et al., *An Institutional Perspective of the Sarbanes-Oxley Act*, 21 *Managerial Auditing J.* 23, 25-26 (2006).

involved in hiring and retaining the external auditor, the entity charged with reviewing the company's financial statements and providing an opinion on whether they were fairly stated, objective, and in compliance with appropriate accounting standards. The New York Stock Exchange recommendation offered a straightforward approach to eliminate this conflict of interest. If the external auditor only answered to a committee of external, non-employee directors, it would be more likely to perform its audit function in a robust and unbiased manner and less likely to capitulate to the demands of an overzealous management team.

This recommendation did not gain traction until the late 1960s when a series of business failures called into question the integrity of publicly released financial information. Key interest groups began to argue that such committees would improve financial reporting. Over the next forty years, this recommended committee, now labeled the "audit committee," slowly became common in many listed companies.<sup>2</sup> However, the audit committee underwent two fundamental changes. First, the role of the audit committee increased substantially. By the late 1980s, the committee was not only expected to promote the independence of the external audit, but also review and supervise the work of the company's internal auditing staff, oversee the financial reporting process in accordance with generally accepted accounting principles, negotiate the external auditor's fee, and review the company's process of assessing the risk of fraudulent financial reporting.<sup>3</sup>

---

<sup>2</sup> Paul Collier, *Factors Affecting the Formation of Audit Committees in Major UK listed companies* 23 ACCOUNTING & BUSINESS RESEARCH 421, 422-24 (1993); see also Karen Pincus et al., *Voluntary Formation of Corporate Audit Committees Among NASDAQ Firms* 8 JOURNAL OF ACCOUNTING & PUBLIC POL'Y 239, 240-45 (1989) (highlighting that, even into the late 1980s, a very large percentage of firms were not using audit committees).

<sup>3</sup> See generally The Treadway Commission, *Report of the National Commission on Fraudulent Financial Reporting*, 182, Oct. 1987, <http://www.coso.org/Publications/NCFFR.pdf> (last visited April 4, 2011); JOHN COLLEY ET AL., CORPORATE GOVERNANCE 45 (McGraw-Hill 2003); Public

Second, the initial recommendation that the committee be comprised entirely of external directors fell by the wayside. Several capital markets embraced the audit committee concept through formal recommendations, but left the door open so that the committee could be filled with executive directors or non-executive directors with significant ties to management.<sup>4</sup>

In recent years, the accounting profession and the financial reporting process have once again become targets of criticism as several high profile companies filed for bankruptcy soon after they had published financial statements showing a strong financial position. Not surprisingly, numerous commentators have once again pointed to the audit committee as the linchpin to improved financial reporting. This time, many countries and stock exchanges reacted by doing more than merely recommending the formation of an audit committee. Now, they mandated its use.

Fichtner's 2010 study of the growth of audit committee regulation since the passage of the Sarbanes-Oxley Act of 2002 reveals that thirty-one of the world's forty largest capital markets now have statutory regulations or stock exchange listing requirements mandating the use of audit committees in listed companies.<sup>5</sup> However, a cursory review of these rules reveals that the membership composition requirements for these committees are, for lack of a better term, all over the board. For example, in the United States, Sarbanes-Oxley mandates that every member of the audit committee be independent from management, while the European Union's Statutory Audit Directive only mandates that

---

Oversight Board, *A Special Report by the Public Oversight Board of the SEC Practice Section, AICPA, In the Public Interest*, 52-53, March 5, 1993.

<sup>4</sup> David Vicknair et al., *A Note on Audit Committee Independence: Evidence From the NYSE on "Grey" Area Directors*, 7 ACCOUNTING HORIZONS 53, 56-57 (1993).

<sup>5</sup> J. Royce Fichtner, *The Recent International Growth of Mandatory Audit Committee Requirements*, 7 INT'L J. DISCLOSURE & GOVERNANCE 227, 227 (2010).



one member of the committee be independent from management. Clearly, policymakers for the world's largest capital markets agree that audit committees are an essential component of good corporate governance. However, these same policymakers cannot agree as to what percentage of the members of this committee should be independent from firm management.

The purpose of this article is twofold. First, it summarizes the large body of research studying independent audit committee membership and its effect on the quality of publicly released financial information to determine whether there is empirical support for any of the various independence requirements. This analysis reveals an overwhelming number of studies suggesting that firms provide higher quality financial statements when all audit committee members are independent from firm management. Results from studies analyzing lesser independence configurations are mixed. This article then researches the current company laws and stock exchange listing requirements for the world's forty largest capital markets to determine whether the leading capital markets are putting this academic research to use. This study reveals that a vast majority of the world's largest capital markets do not mandate the use of fully independent audit committees. Instead, most major capital markets have implemented lesser independence requirements that are not supported by empirical research.

## II. EMPIRICAL STUDIES OF AUDIT COMMITTEE MEMBERSHIP

There are several academic debates discussing the appropriate composition of the audit committee. The major topics of debate concern (1) the appropriate number of independent members on the committee, (2) the minimum number of times an audit committee should meet during the fiscal year, (3) the optimal size of the committee, and (4) whether a certain percentage of members should have accounting or financial expertise. This article focuses on the first topic of debate because nearly every major capital

market that has mandated the use of audit committees has also taken the further step to mandate the minimum number (or percentage) of members who must be independent from management. The other topics have received much less attention from policymakers and academic researchers. For example, Sarbanes-Oxley, which is viewed by many as having the world's most stringent audit committee requirements, does not mandate the use of financial experts on the committee. Instead, section 407 of Sarbanes-Oxley only requires companies to report whether or not one of the members of the committee could be classified as a "financial expert."

Over the past twenty-two years, numerous commissions and professional bodies have made a strong push for fully independent audit committees. The Treadway Commission, the Macdonald Commission, the Cadbury Committee, the Public Oversight Board, and the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees all recommended that the audit committee be comprised solely of independent directors or at least outside, non-employee directors.<sup>6</sup> These composition recommendations were deemed essential because, as stated by the Blue Ribbon Commission, "common sense dictates that a director without any financial, family, or other material personal ties to management is more likely to be able to evaluate objectively the propriety of management's accounting, internal control and reporting practices."<sup>7</sup> These recommendations are also bolstered by research showing that independent directors are more likely to question management's actions and judgments and less likely to

---

<sup>6</sup> Treadway Commission, *supra* note 3, at 40; Public Oversight Board, *supra* note 3; Macdonald Commission, *The Report of the Commission to Study the Public's Expectations of Audits*, 1988; Cadbury Committee, *Report*, (Gee and Company Ltd.: 1992); New York Stock Exchange & National Association of Securities Dealers, *Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, Report and Recommendations*, 1999, <http://www.kpmg.com/aci/docs/blueribbon.pdf> (last viewed July 30, 2009).

<sup>7</sup> New York Stock Exchange & National Association of Securities Dealers, *supra* note 6, at 22.

endorse questionable or aggressive accounting practices because they fear potential legal liability and the reputational risk associated with fraudulent financial reporting.<sup>8</sup>

Some commentators question whether fully independent audit committees do more harm than good. They argue that fully independent audit committees are inefficient because independent directors lack information and/or knowledge about the inner-workings of the company and therefore must work harder to find false or manipulated financial information. Similarly, some commentators fear that independent directors simply do not have enough time to adequately perform their duties because most are employed elsewhere.<sup>9</sup> Others question whether independent directors have the same level of motivation or involvement as an executive or affiliated director.<sup>10</sup> Because independent directors are not fully vested in the outcomes of the corporation, some claim that they are more willing to make decisions that are not necessarily in the best interests of the firm.<sup>11</sup> As stated by one commentator, “The fact that independent directors have no reason to manipulate or distort financial results does not mean that they

---

<sup>8</sup> CurtisVerschoor, *Benchmarking the Audit Committee*, 176 J. ACCOUNTANCY 59, 62-63 (1993); Shaun F. O'Malley, *Improving Audit Committee Performance* 15 CORPORATE BOARD 9, 9-13 (May/June 1994) (detailing a major study of audit committees); Eugene Fama & Michael Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 315 (1983); Anil Shivdasani, *Board Composition, Ownership Structure, and Hostile Takeovers*, 16 J. ACCT. & ECON. 167, 167 (1993).

<sup>9</sup> A 1993 study of audit committees in large corporations reveals that 39.4% of the chairpersons of the audit committee also served as the chairman of the board or chief executive officer for another corporation. Verschoor, *supra* note, at 62-63.

<sup>10</sup> Peter J. Wallison, *All the Rage: Will Independent Directors Produce Good Corporate Governance?* 4 (2006) <http://www.aei.org/outlook/23648> (last visited April 4, 2011); see also Scott N. Bronson et al., *Are Fully Independent Audit Committees Really Necessary?* 28 J. ACCT. & PUB. POL. 265, 267 (2009) (explaining criticisms of Sarbanes Oxley's independence requirements).

<sup>11</sup> Simon M. Lorne, *Economics, Regulation and Governance*, 5 INT'L J. DISCLOSURE & GOVERNANCE 287, 292-93 (2008).

have an incentive to investigate whether this is happening.”<sup>12</sup> All of these arguments are bolstered by attention-grabbing headlines that cast doubt on the perceived benefits of a fully independent audit committee. For example, even though Enron’s audit committee was composed entirely of independent directors, it failed to recognize the complex web of accounting misinformation that ultimately destroyed the company.

In light of this debate, this article surveys the major academic studies researching independent audit committees to determine if there is empirical support for fully independent audit committee requirements or less than fully independent audit committee requirements. In doing so, it also attempts to find any empirical evidence to support the anecdotal criticisms of audit committee independence requirements.

This article identified twenty-nine academic studies, as identified in the Appendix, which directly analyze how independent audit committee membership affects the quality of financial reporting.<sup>13</sup> None of these studies produce any evidence to suggest that independent audit committee requirements negatively impact financial statement quality. At most, six of these studies suggest that audit committee independence requirements have no impact on financial statement quality.<sup>14</sup> The remaining twenty-three

---

<sup>12</sup> Wallison, *supra* note 10, at 4.

<sup>13</sup> This article is not an exhaustive review of the literature in this area. Citation to prior research is only meant to illustrate primary findings. This article also does not address studies researching other compositional requirements such as the size of the audit committee or the financial expertise of the committee.

<sup>14</sup> This article does not include studies that focus on the relationship between audit committee independence and firm performance. Regardless, none of these studies conclude that audit committee independence has a negative impact on firm performance or firm value. See Julie Cotter & Mark Silvester, *Board and Monitoring Committee Independence*, 39 ABACUS 211, 212 (2003); Nikos Vafeas & Elena Theodorou, *The Relationship Between Board Structure and Firm Performance in the UK* 30 BRITISH ACCT. REV. 383, 403-04 (1998); Charlie Weir et al., *Internal and External Governance Mechanisms: Their*

studies suggest that independent membership does have a positive impact on the integrity of publicly released financial information. Of these studies, the majority suggest that firms provide higher quality financial statements when all members of the audit committee are independent from management.

*A. Studies that Support Independent Membership Requirements*

Of the twenty-three studies that suggest independent membership has a positive impact on the integrity of publicly released financial information, sixteen find a correlation between fully independent audit committees and various indicators of earnings statement quality. These studies find that firms utilizing fully independent committees are less likely to restate their earnings,<sup>15</sup> less likely to have reporting problems,<sup>16</sup> less likely to be accused of fraud by the SEC,<sup>17</sup> less likely to exhibit internal control problems,<sup>18</sup> less likely

---

*Impact on the Performance of Large UK Public Companies*, 29 J. BUS. FIN. & ACCT. 579, 582 (2002). This corresponds with other studies that find no clear correlation between overall board independence and firm performance. See Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, J. CORP. L. 231, 235-37 (2002).

<sup>15</sup> Joseph V. Carcello et al., *CEO Involvement in Selecting Board Members and Audit Committee Effectiveness 2* (Working Paper 2006) (draft available on the Social Science Resource Network, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=927737](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=927737)) (last visited April 4, 2011) (finding that the relationship does not hold if the CEO is involved in the selection process); Lawrence J. Abbott et al., *Audit Committee Characteristics and Restatements*, 23 AUDITING: J. PRAC. & THEORY 69, 70 (2004) (finding significant negative association with fully independent audit committees that meet at least four times per year).

<sup>16</sup> Dorothy A. McMullen & K. Raghunandan, *Enhancing Audit Committee Effectiveness* J. ACCOUNTANCY 79, 80 (August 1996).

<sup>17</sup> Lawrence J. Abbott et al., *The Effects of Audit Committee Activity and Independence on Corporate Fraud*, 26 MANAGERIAL FIN. 55 (2000) (finding dependent on fully independent audit committee that meet at least twice a year); Mark S. Beasley et al., *Fraudulent Financial Reporting: Consideration of Industry Traits and Corporate Governance Mechanisms*, 14 ACCT. HORIZONS 441, 450 (2000) (analyzing three different categories of industry).

to engage in earnings mismanagement via discretionary accruals,<sup>19</sup> and more likely to have greater interaction with the internal auditing function.<sup>20</sup> Other studies find that completely independent audit committees have greater earnings transparency,<sup>21</sup> are negatively associated with auditor resignations and dismissals following the issuance of going concern opinions,<sup>22</sup> and are positively associated with audit fees.<sup>23</sup> Finally, one study found lower forecast dispersion and revision volatility when all members of the audit committee were independent.<sup>24</sup>

---

<sup>18</sup> Jayanthi Krishnan, *Audit Committee Quality and Internal Control: An Empirical Analysis*, 80 ACCT. REV. 649, 649 (2005).

<sup>19</sup> See Sonda Marrakchi Chtourou et al., *Corporate Governance and Earnings Management* (Working Paper 2001) 4 (draft available on the Social Research Network, <http://ssrn.com/abstract=275053>) (last visited April 4, 2011) (finding dependent on fully independent audit committees that meet more than twice a year); Jean Bedard et al., *The Effect of Audit Committee Expertise, Independence, and Activity on Aggressive Earnings Management*, 23 AUDITING: J. PRAC. & THEORY 13, 14 (2004).

<sup>20</sup> D. Paul Scarbrough et al., *Audit Committee Composition and Interaction with Internal Auditing: Canadian Evidence*, 12 ACCOUNTING HORIZONS 51, 61 (1998); K. Raghunandan et al., *Audit Committee Composition, "Grey Directors," and Interaction with Internal Auditing*, 15 ACCOUNTING HORIZONS 105, 116 (2001) (relates to audit committees comprised solely of independent directors with at least one member having financial or accounting expertise).

<sup>21</sup> Daniel Bryan et al., *The Influence of Independent and Effective Audit Committees on Earnings Quality* (Working Paper 2004) (draft available on the Social Science Research Network, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=488082&rec=1&srcabs=632041](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=488082&rec=1&srcabs=632041)) (last visited April 4, 2011).

<sup>22</sup> Ho Young Lee et al., *The Effect of Audit Committee and Board of Director Independence on Auditor Resignation*, 23 AUDITING: J. PRAC. & THEORY 131, 143 (2004); Bronson et al., *supra* note 10, at 277.

<sup>23</sup> Lawrence J. Abbott et al., *The Association Between Audit Committee Characteristics and Audit Fees*, 22 AUDITING: J. PRAC. & THEORY 1 (2003); Ho Young Lee & Vivek Mande, *The Relationship of Audit Committee Characteristics with Endogenously Determined Audit and Non-Audit Fees*, 44 QUARTERLY J. BUS. & ECON. 93, 110 (2005).

<sup>24</sup> M.H. Carol Liu, *The Association of Audit Committee Oversight with Financial Disclosure Quality* (Working Paper 2006)

Two studies find that audit committees comprised of a majority of independent directors have a positive effect on financial statement quality. Klein's 2002 study of discretionary accruals in large publicly-traded United States firms found that earnings management was more pronounced in firms that had audit committees comprised of less than a majority of independent directors.<sup>25</sup> Davidson's 2005 study of earnings management provides similar results.<sup>26</sup>

The last group of studies finding a positive relationship between independent audit committee membership and quality financial reporting consists of five studies that limited their analyses to proportional changes in audit committee membership. Each of these studies suggests that a proportional increase in the percentage of independent members on the committee results in higher quality financial statements.<sup>27</sup> Uzun found that as the number of independent outside directors on a firm's audit and compensation committees increased, the likelihood of corporate wrongdoing decreased.<sup>28</sup> Chen found that a higher proportion of non-executive directors on the audit committee is associated with use of a higher quality (industry specialist) audit firm.<sup>29</sup> Carcello and Neal's 2000

---

<http://centerforpbbeffr.rutgers.edu/2006/Paper%202006/02AS-041-PBFEAsubmission.pdf> (last visited April 4, 2011).

<sup>25</sup> April Klein, *Audit Committee, Board of Director Characteristics, and Earnings Management*, 33 J. ACCT. & ECON. 375, 376-80 (2002).

<sup>26</sup> Ryan Davidson et al., *Internal Governance Structures and Earnings Management*, 45 J. ACCT. & FIN. 241, 243 (2005).

<sup>27</sup> Krishnan's 2005 study also found a negative association between the proportion of independent members on the audit committee and the existence of control problems. As noted above, Krishnan found similar results if the audit committee consisted solely of independent directors. Krishnan, *supra* note 18, at 649.

<sup>28</sup> Hatice Uzun et al., *Board Composition and Corporate Fraud*, FINANCIAL ANALYSTS J. 33, 33 (May/June 2004).

<sup>29</sup> Yi Meng Chen et al., *Audit Committee Composition and the use of an Industry Specialist Audit firm*, 45 ACCT. & FIN. 217, 234 (2005).

and 2003 studies of the issuance of going concern reports reveal that the likelihood of auditor dismissals following a going concern report increases with the percentage of the audit committee composed of affiliated directors.<sup>30</sup> Similarly, Archambeault and Dezoort's study concludes that companies exhibiting suspicious auditor switchers have a smaller percentage of independent directors on the audit committee.<sup>31</sup>

While these twenty-three studies do provide general support for independent audit committee requirements, they also contain some conflicting results. Klein's 2002 study and Davidson's 2005 study both found that earnings management was more pronounced in firms that had audit committees comprised of less than a majority of independent directors.<sup>32</sup> However, when they compared firms utilizing fully independent audit committees with firms that did not utilize fully independent audit committees, they found no differences in earnings management. On the other hand, two studies directly refute these findings and cast doubt on the effectiveness of mere majority independence requirements. Bedard's study of United States firms exhibiting abnormal accruals found there was only a significant reduction in the likelihood of aggressive earnings management when all of the committee members were independent.<sup>33</sup> There was no significant effect if the committee was composed of only a majority of independent directors. Similarly, a 2009 study of auditor dismissals by Bronson suggests that the monitoring benefits of audit committee

---

<sup>30</sup> Joseph V. Carcello & Terry L. Neal, *Audit Committee Composition and Auditor Reporting*, 75 ACCT. REV. 453, 465 (2000) (suggesting that "auditors are less likely to modify the reports of distressed companies that have a greater percentage of affiliated directors on their audit committees"); Joseph V. Carcello & Terry L. Neal, *Audit Committee Characteristics and Auditor Dismissals Following "New" Going-Concern Reports*, 78 ACCT. REV. 95, 107 n.16 (2003).

<sup>31</sup> Deborah Archambeault & F. Todd Dezoort, *Auditor Opinion Shopping and the Audit Committee: An Analysis of Suspicious Auditor Switches*, 5 INT'L J. AUDITING 33, 46-47 (2001).

<sup>32</sup> Davidson et al., *supra* note 26, at 243; Klein, *supra* note 25, at 375-78.

<sup>33</sup> Bedard et al., *supra* note 19, at 14.



independence are not consistently realized unless the audit committee is fully independent.<sup>34</sup> In addition, Rainsbury's study, as discussed below, casts more doubt on the effectiveness of majority independence requirements.<sup>35</sup>

*B. Studies that Do Not Support Independent Membership Requirements*

Six studies find no association between audit committee independence and indicia of quality financial reporting. Five of these studies address proportional changes in audit committee independence, and one of the five also directly addresses fully independent audit committees. The final study only addresses whether audit committees comprised of a majority of independent members have an impact on financial statement quality. Agrawal and Chadha's study found no evidence to suggest that fully independent audit committees are less likely to restate their earnings and no evidence to suggest incremental changes in audit committee independence have any impact on the probability of restatements.<sup>36</sup> Felo found little support for the notion that independence of the audit committee is related to financial reporting quality, as reflected by financial analyst scores for quality from the AIMR database.<sup>37</sup> Similarly, Anderson found that audit committee independence incremental to the independence of

---

<sup>34</sup> Bronson et al., *supra* note 10, at 272, 275 (indicating that financially distressed firms with fully independent audit committees are more likely to receive a going concern opinion than similar firms with one or more affiliated members on the audit committee).

<sup>35</sup> Elizabeth A. Rainsbury et al., *The Impact of Audit Committee Quality on Financial Reporting Quality and Audit Fees*, 5 J. CONTEMP. ACCT. & ECON. 20, 20 (2009).

<sup>36</sup> Anup Agrawal & Sahiba Chadha, *Corporate Governance and Accounting Scandals*, 48 J.L. & ECON. 371, 372-73 (2005).

<sup>37</sup> Andrew J. Felo et al., *Audit Committee Characteristics and the Perceived Quality of Financial Reporting: An Empirical Analysis* 3 (Working Paper 2003) (draft available on the Social Science Research Network, <http://ssrn.com/abstract=401240>) (last visited April 4, 2011).

the full board was unrelated to the information content of earnings.<sup>38</sup> Studies by Xie as well as Yang and Krishnan found no significant association between audit committee independence and discretionary accruals.<sup>39</sup> Finally, Rainsbury's study of New Zealand companies found no association between audit fees and committees comprised of a majority of independent members.<sup>40</sup>

### C. Summary of Academic Studies

Three observations can be drawn from these twenty-nine studies. First, there is much debate as to whether independent audit committee membership has any impact on discretionary accruals. Six studies focus on this performance measure. Two conclude that fully independent audit committees reduce discretionary accruals.<sup>41</sup> One of these two studies goes on to find that this correlation evaporates if the committee contains even one non-independent member and the other finds that this correlation exists only if the audit committee meets more than twice a year.<sup>42</sup> On the other hand, two different studies find that committees comprised of a majority of independent members demonstrate less earnings management via discretionary accruals, although they find no such correlation if the entire committee is independent from management.<sup>43</sup> Finally, two studies find no support for either correlation as they determine that proportional increases in audit

---

<sup>38</sup> Kirsten Anderson et al., *Boards of Directors, Audit Committees, and the Information Content of Earnings* 24 (Working Paper 2003) (draft available on the Social Science Research Network, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=444241](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=444241)) (last visited April 4, 2011).

<sup>39</sup> See Biao Xie et al., *Earnings Management and Corporate Governance: The Roles of the Board and the Audit Committee*, 9 J. CORP. FIN. 295, 308-10 (June 2003); Joon S. Yang & Jagan Krishnan, *Audit Committees and Quarterly Earnings Management*, 9 INT'L J. AUDITING 201, 215 (2005).

<sup>40</sup> Rainsbury et al., *supra* note 35, at 20.

<sup>41</sup> See Bedard et al., *supra* note 19, at 14; Chtourou et al., *supra* note 19, at 4.

<sup>42</sup> See Bedard et al., *supra* note 19, at 14; Chtourou et al., *supra* note 19, at 4.

<sup>43</sup> See Davidson et al., *supra* note 26, at 243; Klein, *supra* note 25, at 375-78.

committee independence have no impact on discretionary accruals.<sup>44</sup> In light of the number of studies that squarely contradict each other in this area, it is difficult to draw any conclusions as to whether independent audit committee membership has any impact on discretionary accruals.<sup>45</sup>

The second observation is that only a handful of studies directly contradict the overwhelming number of studies which support full independence requirements. As noted above, sixteen studies provide evidence to support the numerous calls for fully independent audit committees. Seven studies contradict these results. However, four of these seven studies only conclude that proportional increases in audit committee independence do not result in higher reporting quality.<sup>46</sup> As pointed out by the Bedard and Bronson studies, the actual benefit of a fully independent audit committee may disappear if even one member of the committee is not independent from management. Because the authors of these four studies do not directly address correlations between fully independent audit committees and the various indicia of reporting quality, it is difficult to determine whether they contradict (or to what extent they contradict) the sixteen aforementioned studies.<sup>47</sup> Of the three remaining studies which directly conclude that fully independent audit committees have no impact on financial reporting, two derive their results from an analysis of discretionary accruals.<sup>48</sup> As discussed above, there is much debate as to whether independent membership has any impact on discretionary accruals. The one remaining study by Agrawal and Chada

---

<sup>44</sup> Xie et al., *supra* note 39, at 308-10; Yang & Krishnan, *supra* note 39, at 215.

<sup>45</sup> Anderson et al., *supra* note 38, at 7 (summarizing debate as to whether it is appropriate to use accruals to measure earnings quality).

<sup>46</sup> See Anderson et al., *supra* note 38, at 24; Felo et al., *supra* note 37, at 3; Xie et al., *supra* note 39, at 308-10; Yang & Krishnan, *supra* note 39, at 215.

<sup>47</sup> Arguably, Felo's study and Anderson's study likely suggest that no such correlation exists, but this topic was never directly addressed by the authors. Anderson et al., *supra* note 38, at 23-24; Felo et al., *supra* note 37, at 3.

<sup>48</sup> Davidson et al., *supra* note 26, at 243; Klein, *supra* note 25, at 375.

constitutes the strongest argument against full independence requirements as it finds no correlation between fully independent audit committees and earnings restatements.<sup>49</sup> While the results of this study cannot be ignored, it is important to note that three studies directly contradict its findings. These three studies find substantial evidence suggesting that companies with fully independent audit committees are less likely to restate their earnings.<sup>50</sup>

Finally, there is little empirical support for majority independence requirements or lesser independence requirements. Only two studies directly support majority independence requirements and both base their results on an analysis of discretionary accruals.<sup>51</sup> These two studies are also directly contradicted by three studies that find there is no correlation between audit committees comprised of only a majority of independent members and other indicia of reporting quality.<sup>52</sup> Similarly, those studies which suggest that mere proportional increases in audit committee independence have a positive impact on reporting quality are squarely contradicted by several studies finding no such correlation.

In summary, no academic research suggests that independent audit committee requirements have a negative impact on financial reporting. However, a significant number of studies suggest that full independence requirements could have a positive impact on financial reporting. Research into the benefits of majority independence requirements or lesser independence requirements is, at best, inconclusive. The remainder of this article will analyze audit committee composition requirements for the world's forty

---

<sup>49</sup> Agrawal & Chada, *supra* note 36, at 372-73.

<sup>50</sup> Abbott et al., *supra* note 15, at 70; Carcello et al., *supra* note 15, at 2; McMullen & Raghunandan, *supra* note 16, at 80.

<sup>51</sup> Davidson et al., *supra* note 26, at 243; Klein, *supra* note 25, at 375-78.

<sup>52</sup> Rainsbury et al., *supra* note 35, at 20; Bronson, *supra* note 10, at 272; Bedard et al., *supra* note 19, at 14.

largest capital markets to determine whether the capital markets are putting this research to use.

### III. RESEARCH METHODOLOGY

In order to determine whether the international markets have adopted the independent audit committee concept, either in whole or in part, this article researched the company laws and stock exchange listing requirements for each of the world's forty largest capital markets.<sup>53</sup> Independent director requirements were distinguished from mere non-executive director requirements because, while all independent directors are non-executive directors, all non-executive directors are not necessarily independent. Some non-executive directors have significant ties to management. For example, some non-executive directors have material business relationships with the listed company, some are former managers in the company, and some are spouses of current or former company executives. Therefore, if a regulation or listing requirement merely mandates that members of the audit committee be non-executive directors, this does not, for the purposes of this article, constitute an independent director requirement. A composition requirement is classified as an independence requirement only if it mandates something more than mere non-executive status. This distinction is common throughout many corporate governance codes. For example, in the United Arab Emirates, audit committees must have at least three non-executive directors, of whom at least two must be independent.<sup>54</sup>

### IV. INTERNATIONAL AUDIT COMMITTEE COMPOSITION REQUIREMENTS

---

<sup>53</sup> This ranking is based on 2009 gross domestic product as listed by the World Development Indicators database, September 27, 2010.

<sup>54</sup> See Hamish Walton & Chloe Lake, *Big Changes Required by the New UAE Corporate Governance Rules*, Feb. 10, 2010, <http://www.clydeco.com/knowledge/articles/big-changes-required-by-the-new-uae-corporate-governance-rules.cfm> (last visited April 4, 2011).

A review of the historical growth of audit committee requirements reveals that most capital markets have been very hesitant to mandate the use of audit committees in listed companies, much less mandate the composition of the committee. Even though the New York Stock Exchange Board of Governors first recommended the use of audit committees in 1940, audit committees did not become mandatory in any major capital market until 1975 when Canada amended its Business Corporations Act to require that all federally incorporated public companies establish an audit committee comprised of at least a majority of members who were not officers or employees of the corporation.<sup>55</sup> Two years later, the New York Stock Exchange changed its audit committee recommendation to a mandatory listing requirement, but efforts to pass similar legislation mandating this rule in all United States listed companies were unsuccessful.<sup>56</sup> In 1987, Israel passed legislation mandating that all public companies form an audit committee with at least two outside directors and Malaysia enacted legislation in 1994 making it mandatory for all public listed companies to form an audit committee.<sup>57</sup> Today, Bursa Listing Requirements mandate that a majority of these members be independent.<sup>58</sup>

---

<sup>55</sup> Gerald Vinten, *Corporate Governance: An International State of the Art*, 13 *MANAGERIAL AUDITING J.* 419, 424 (1998); R. G. Walker, *Gaps in Guidelines on Audit Committees*, 40 *ABACUS* 157, 160 (2004).

<sup>56</sup> Brenda Birkett, *The Recent History of Corporate Audit Committees*, 13 *ACCT. HISTORIANS J.* 109, 110-114 (1986).

<sup>57</sup> Yael Ben-Zion, *The Political Dynamics of Corporate Legislation: Lessons from Israel*, 11 *FORDHAM J. CORP. & FIN. L.* 185, 271-74 (2006); Zohar Goshen, *Controlling Corporate Agency Costs: A United States-Israeli Comparative View*, 6 *CARDOZO J. INT'L & COMP. L.* 99 (1998); Hasnah Haron et al., *Audit Committee Compliance with Kuala Lumpur Stock Exchange Listing Requirements*, 9 *INT'L J. AUDITING* 187, 188 (2005).

<sup>58</sup> *GETTING THE DEAL THROUGH: CORPORATE GOVERNANCE* 138 (Ira Millstein & Holly Gregory eds., 2010).

By 1998, numerous corporate scandals had begun to draw attention to shortcomings in the audit process.<sup>59</sup> In 1999, the New York Stock Exchange and the National Association of Securities Dealers reacted by sponsoring the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. The Blue Ribbon Committee ultimately developed a series of recommendations for the composition, operation, and empowerment of such committees. Foremost among these recommendations was the Blue Ribbon Committees' conclusion that the audit committee should be comprised of independent, rather than mere non-executive, directors.<sup>60</sup> In response to the Blue Ribbon report, the American Stock Exchange, the New York Stock Exchange, and the National Association of Securities Dealers changed their listing requirements so as to require that audit committees be comprised almost entirely of independent directors.<sup>61</sup> Stock exchanges in Hong Kong,<sup>62</sup> Thailand,<sup>63</sup> India,<sup>64</sup>

---

<sup>59</sup> Joann S. Lublin & Elizabeth MacDonald, *Management: Scandals Signal Laxity of Audit Panels*, WALL ST. J., July 17, 1998, at B1.

<sup>60</sup> New York Stock Exchange & National Association of Securities Dealers, *supra* note 6, at 22.

<sup>61</sup> Gregory S. Rowland, *Earnings Management, the SEC, and Corporate Governance: Director Liability Arising from the Audit Committee Report*, 102 COLUMBIA L. REV. 168, 173-74 (2002); U.S. Securities and Exchange Commission, *Audit Committee Disclosure*, Final Rule, SEC Release No. 34-42266 (2000) <http://www.sec.gov/rules/final/34-42266.htm>, (last visited April 4, 2011).

<sup>62</sup> See Deloitte, *Hong Kong SAR* (2010) <http://www.corpgov.deloitte.com/site/ChinaEng/hk-audit-remuneration-committees/> (last visited Nov. 15, 2010); Hong Kong Exchange, *Hong Kong Exchange Fact Book* (1999) [http://www.hkex.com.hk/data/factbook/1999/FB99\\_12.pdf](http://www.hkex.com.hk/data/factbook/1999/FB99_12.pdf) (last visited July 30, 2009).

<sup>63</sup> See S. Montreevat, *Corporate Governance in Thailand*, Singapore 94 (Institute of Southeast Asian Studies 2006); Stock Exchange of Thailand, *Listing Information* (2010) [http://www.set.or.th/en/products/listing/parties\\_p1.html](http://www.set.or.th/en/products/listing/parties_p1.html) (last visited April 4, 2011).

<sup>64</sup> Afra Afsharipour, *Corporate Governance Convergence: Lessons from the Indian Experience*, 29 NW. J. INT'L L. & BUS. 335, 383-385 (2009); Securities and Exchange Board of India, *Corporate Governance in Listed Companies* § 49,

and Indonesia quickly followed suit and began to impose varying audit committee rules through stock exchange listing requirements.<sup>65</sup> By the beginning of the new millennium, South Korea, Mexico, and Argentina enacted legislation mandating the use of audit committees in listed companies with varying compositional requirements.<sup>66</sup>

At about the same time, high profile accounting scandals at major companies such as Enron and WorldCom darkened the cloud hanging over the financial reporting process. The United States government responded by enacting the Sarbanes Oxley Act of 2002, definitively mandating that all companies listed on United States stock exchanges must form an audit committee comprised solely of independent members of the board of directors.

Prior to the passage of Sarbanes-Oxley, most major capital markets were hesitant to institute strong-handed corporate governance rules and regulations. Instead, most relied upon soft enforcement mechanisms that merely encouraged companies to comply with stated corporate governance principles. Numerous corporate governance principles and guidelines were established to provide best practices or benchmarks against which the public could assess

---

<http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf> (last visited November 15, 2010); Chairman of Capital Market Supervisory Agency, Rule Number IX.I.5 (2003) [http://www.bapepam.go.id/old/old/E\\_legal/rules/Issuer/Rule.IX.I.5..pdf](http://www.bapepam.go.id/old/old/E_legal/rules/Issuer/Rule.IX.I.5..pdf) (last visited April 4, 2011).

<sup>65</sup> Asian Corporate Governance Association, *Listing Mechanism on the Jakarta Stock Exchange (JSX)* (2000) [http://www.acga-asia.org/public/files/JSX\\_CGRules\\_2000.pdf](http://www.acga-asia.org/public/files/JSX_CGRules_2000.pdf) (last visited April 4, 2011).

<sup>66</sup> Kon Sik Kim, *Transplanting Audit Committees to Korean Soil: A Window into the Evolution of Korean Corporate Governance*, 9 ASIAN-PACIFIC L. & POL'Y J. 163, 170-172 (2007); Thomas Heather, *Current Issues in Corporate Governance for Mexican Companies, Including Effects of Sarbanes-Oxley*, 12 U.S.-MEX. L.J. 55, 57 (2004); Decree No. 677/01 Capital Markets Transparency and Best Practices (2001) <http://www.cnv.gov.ar/english/leyesyreg/Decretos/D677.html> (last visited April 4, 2011); GETTING THE DEAL THROUGH: CORPORATE GOVERNANCE (2010), *supra* note 58, at 11.



a firm's corporate governance system. For example, during the 1990s the London Stock Exchange utilized a "comply or explain" approach whereby firms could either follow the stock exchange's corporate governance recommendations or explain their reasons for not doing so.<sup>67</sup> This approach assumed that capital market forces would monitor and possibly punish those firms that chose not to follow such recommendations. Once Sarbanes-Oxley was signed into law, a large number of capital markets abandoned voluntary recommendations for the certainty of mandatory regulations.<sup>68</sup> Spain and Turkey quickly enacted legislation requiring audit committees comprised of a majority of non-executive directors.<sup>69</sup> In 2004 the Australian Stock Exchange amended its listing rules to require that all entities included in the S & P All Ordinaries Index establish an audit committee with a majority of independent members.<sup>70</sup> One year later, Colombia enacted rules requiring that listed companies form fully independent audit committees.<sup>71</sup>

---

<sup>67</sup> Alan Dignam, *Capturing Corporate Governance: The End of the UK Self-Regulating System*, 4 INT'L J. DISCLOSURE & GOVERNANCE 24, 26 (2007).

<sup>68</sup> Fichtner, *supra* note 5, at 283.

<sup>69</sup> See CHRISTINE MALLIN, INTERNATIONAL CORPORATE GOVERNANCE: A CASE STUDY APPROACH 85 (Edward Elgar 2006); Communiqué series X, No: 22 on Auditing Standards in Capital Markets (2002) <http://www.cmb.gov.tr/apps/teblig/displayteblig.aspx?id=235&ct=f&action=displayfile&ext=.pdf> (last visited April 4, 2011).

<sup>70</sup> See Australian Stock Exchange, *On-Going Requirements*, §12.7, 2004, <http://www.asx.com.au/ListingRules/chapters/Chapter12.pdf> (last visited July 29, 2009); Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, 2003, <http://www.shareholder.com/shared/dynamicdoc/ASX/364/ASXRecommendations.pdf> (last visited July 29, 2009).

<sup>71</sup> See Brigard and Urrutia Abogados S.A., *Guide to Doing Business in Colombia*, Sept. 2006, [http://www.lexmundi.com/images/lexmundi/PDF/guide\\_colombia.pdf](http://www.lexmundi.com/images/lexmundi/PDF/guide_colombia.pdf) (last visited April 4, 2011).

In 2004, Canada issued new regulations requiring that all audit committee members be independent.<sup>72</sup> Mexico enacted similar legislation in 2005.<sup>73</sup> Over the next two years, South Africa passed legislation mandating the use of fully independent audit committees and Austria passed legislation requiring that at least one independent director serve on the committee.<sup>74</sup>

In 2006, the European Council of Ministers adopted the Directive on Statutory Audits of Annual Accounts and Consolidated Accounts (hereinafter the Directive) to enhance financial statement confidence across the European Union. The Directive required listed companies to establish an audit committee; however the Directive only required that the committee have at least one independent member.<sup>75</sup> All European Union countries transposed

---

<sup>72</sup> See Canadian Securities Administrators, *CSA Staff Notice 52-312 Audit Committee Compliance Review*, 2006, [http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part5/csa\\_20060113\\_52-312\\_audit-comm-cp.pdf](http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part5/csa_20060113_52-312_audit-comm-cp.pdf) (last visited Aug. 12 2009).

<sup>73</sup> See J. Girolami, *Obligations of Publicly Held Companies under the New Mexican Securities Act*, 2008, [http://www.abanet.org/intlaw/sao\\_paulo/materials/Capital%20Markets%20-%20TEXT%20-%20Tony.doc](http://www.abanet.org/intlaw/sao_paulo/materials/Capital%20Markets%20-%20TEXT%20-%20Tony.doc) (last visited July 29, 2009).

<sup>74</sup> See Deloitte, *Audit Committee*, 2010, <http://www.corpgov.deloitte.com/site/AusEng/audit-committee/;jsessionid=MgfFMRTThQ6R90RBjNmMdkGSJMTTppfts8fLLGd192cqb9pdIshWT!-1280091366!NONE> (last visited April 4, 2011); Hellwig Torggler & Markus Schifferl, *New Companies Act Aims to Strengthen Economic Confidence*, Aug. 7, 2006, <http://www.internationallawoffice.com/newsletters/detail.aspx?g=e8244fae-4021-db11-8a10-00065bfd3168&redir=1> (last visited April 4, 2011); GETTING THE DEAL THROUGH: CORPORATE GOVERNANCE (2010), *supra* note 58, at 18; GETTING THE DEAL THROUGH: CORPORATE GOVERNANCE 235 (Ira Millstein & Holly Gregory eds., 2009); M.J. Hart, *Relevance of the Corporate Laws Amendment Act, 2006 to the Audit Committee*, 2007, [http://www.deneysreitz.co.za/images/news/CLAA\\_2006\\_hart.pdf](http://www.deneysreitz.co.za/images/news/CLAA_2006_hart.pdf) (last visited April 4, 2011).

<sup>75</sup> European Parliament and Council of the European Union, Directive 2006/43/EC, §§ 41.1, 41.5 May 17, 2006, <http://eur->

the Directive into their own systems of corporate governance.<sup>76</sup> Several went beyond the Directive and opted for more stringent composition requirements. For example, the Netherlands, Portugal, and Sweden all require that at least a majority of the members of the audit committee be independent while Finland requires that all members of the committee be independent.<sup>77</sup>

Several countries bordering the European Union have also recently instituted mandatory audit committee requirements. For example, Norway instituted composition requirements similar to the Directive, while the Russian Federation's Federal Financial Markets Service issued regulations mandating that certain types of listed companies establish audit committees with at least a majority of independent members.<sup>78</sup>

In the East, Chinese authorities promulgated new regulations in 2009 requiring that all listed companies establish an audit

---

[lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0107:EN:P](http://lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0107:EN:P) DF (last visited April 4, 2011).

<sup>76</sup> European Commission, *Scoreboard on the Transposition of the Statutory Audit Directive (2006/43/EC)*, Sept. 1, 2010, [http://ec.europa.eu/internal\\_market/auditing/docs/dir/01\\_09\\_10\\_scoreboard\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/dir/01_09_10_scoreboard_en.pdf) (last visited Nov. 16, 2010) (addressing Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Poland, and the United Kingdom).

<sup>77</sup> See GETTING THE DEAL THROUGH: CORPORATE GOVERNANCE 2010, *supra* note 58, at 154 (addressing Netherlands); Ari Kaarakainen & Juuli Kivelä, *M&A Activity in Finland 2008*, Jan. 7, 2009, <http://www.law.com/jsp/law/international/LawArticleIntl.jsp?id=1202427287560> (last visited April 4, 2011); Swedish Corporate Governance Board, *The Swedish Code of Corporate Governance*, 2008, [http://www.teliasonera.com/about\\_teliasonera/corporate\\_governance/swedish\\_code\\_of\\_corporate\\_governance.pdf](http://www.teliasonera.com/about_teliasonera/corporate_governance/swedish_code_of_corporate_governance.pdf) (last visited Nov. 16, 2009); GETTING THE DEAL THROUGH: CORPORATE GOVERNANCE (2010), *supra* note 58, at 185 (addressing Portugal).

<sup>78</sup> Norwegian Public Limited Liability Companies Act, § 6-42, 2009; KPMG, *The Role of the Audit Committee*, 2009, [http://www.kpmg.ru/russian/aci/\\_docs/toolkit/1\\_The%20role%20of%20the%20audit%20committee\\_eng.pdf](http://www.kpmg.ru/russian/aci/_docs/toolkit/1_The%20role%20of%20the%20audit%20committee_eng.pdf) (last visited Nov. 11, 2010); GETTING THE DEAL THROUGH: CORPORATE GOVERNANCE (2010), *supra* note 58, at 198.

committee with no specific independence requirements.<sup>79</sup> In the Middle East, Saudi Arabia's Board of Capital Market Authority recently issued listing requirements mandating the use of audit committees. These regulations do not specifically address independence, but they do stipulate that executive board members are not eligible to be members of the audit committee.<sup>80</sup> As of April 2010, companies listed on the ADX and the DFM in the United Arab Emirates must have an audit committee with a majority of independent members.<sup>81</sup>

Only five of the world's forty largest capital markets have no mandatory audit committee requirements. Switzerland and Venezuela merely recommend that public companies establish an audit committee.<sup>82</sup> In Japan, only those firms adopting the United States style committee system are required to have an audit committee with a majority of "outside" directors.<sup>83</sup> Brazil's audit committee equivalent does not even allow directors, let alone

---

<sup>79</sup> See PriceWaterhouseCoopers, *China Internal Control Regulation Update Newswire*, Oct. 2008,

[http://www.pwchk.com/webmedia/doc/633608096850982608\\_cn\\_internalcontrol\\_news\\_oct2008\\_1.pdf](http://www.pwchk.com/webmedia/doc/633608096850982608_cn_internalcontrol_news_oct2008_1.pdf) (last visited April 4, 2011); KPMG, *China Boardroom Update: Internal Control Regulatory Developments*, Feb. 2009, [http://www.kpmg.com/hk/en/virtual\\_library/Risk\\_advisory\\_services/China\\_Boardroom/CBU0904.pdf](http://www.kpmg.com/hk/en/virtual_library/Risk_advisory_services/China_Boardroom/CBU0904.pdf) (last visited Mar. 10, 2011).

<sup>80</sup> Board of Capital Market Authority, *Corporate Governance Regulations in the Kingdom of Saudi Arabia*, § 14(a), May 1, 2009, [http://www.ecgi.org/codes/documents/cg\\_regulations\\_saudi\\_arabia\\_nov2006\\_en.pdf](http://www.ecgi.org/codes/documents/cg_regulations_saudi_arabia_nov2006_en.pdf) (last visited Mar. 10, 2011).

<sup>81</sup> Walton & Lake, *supra* note 54.

<sup>82</sup> Economiesuisse Board of Directors, *Swiss Code of Best Practice for Corporate Governance*, § 2.2, Sep. 6, 2007, [http://www.ecgi.org/codes/documents/swiss\\_code\\_feb2008\\_en.pdf](http://www.ecgi.org/codes/documents/swiss_code_feb2008_en.pdf) (last visited April 4, 2011); GETTING THE DEAL THROUGH: CORPORATE GOVERNANCE (2009), *supra* note 74, at 288 (Venezuela).

<sup>83</sup> Ronald Gilson & Curtis Milhaupt, *Choice as Regulatory Reform: The Case of Japanese Corporate Governance*, 53 AM. J. COMPARATIVE L. 343, 353 (2005).

independent directors, to be members of the committee.<sup>84</sup> Iran simply has no audit committee requirements.<sup>85</sup>

At the close of 2010, thirty-five of the world's largest forty largest capital markets now mandate the use of audit committees. Table 1 illustrates that only eight follow Sarbanes-Oxley's stringent requirements and mandate that each member of the audit committee be independent. Eleven capital markets mandate that at least a majority of the members be independent, while fifteen require something less than a majority of independent directors on the audit committee. The remaining six countries either have no audit committee independence requirements or, as in the case of China, mandate the use of audit committees without any corresponding independence requirements.

---

<sup>84</sup> See CFA Institute, *Shareowner Rights across the Markets: A Manual for Investors*, 2009, [http://www.cfainstitute.org/centre/topics/pdf/brazil\\_sor.pdf](http://www.cfainstitute.org/centre/topics/pdf/brazil_sor.pdf) (last visited Aug. 11, 2009).

<sup>85</sup> Mahdi Salehi et al., *Audit Committee: Iranian Imperative*, SCMS J. INDIAN MANAGEMENT 70, 70 (April-June 2009).

TABLE 1  
AUDIT COMMITTEE INDEPENDENCE REQUIREMENTS FOR THE  
FORTY LARGEST CAPITAL MARKETS

<i>Fully Independent</i>	<i>At Least A Majority Independent</i>	<i>Less Than Majority</i>	<i>None</i>
Canada	Argentina	Austria	Brazil
Colombia	Australia	Belgium	China
Finland	Hong Kong	Denmark	Iran
Indonesia	India	France	Japan
Mexico	Korea	Germany	Switzerland
South Africa	Malaysia	Greece	Venezuela
Thailand	Netherlands	Ireland	
United States	Portugal	Israel	
	Russia	Italy	
	Sweden	Norway	
	United Arab Emirates	Poland	
		Saudi Arabia	
		Spain	
		Turkey	
		United Kingdom	

V. CONCLUSION

When the audit committee concept was first introduced in 1940, its primary function was to safeguard the independence of the external auditor. It did so by ensuring that the external auditor would not answer to management, but to a committee of external, non-executive directors. Over the years, the role of the audit committee increased while the committee's independence from management decreased. However, the committee's primary function remained the same, to ensure the objectivity of the audit by allowing the

external auditors to remain free from undue influence and interference by corporate management.

In recent years, high-profile failures in the audit function have led policymakers in thirty-five of the world's forty largest capital markets to require the use of audit committees in listed companies. Despite strong empirical evidence suggesting that all members of the audit committee should be independent, only eight major capital markets mandate such stringent requirements. The remaining twenty-seven capital markets implement lesser standards ranging from no independence requirements to majority independence requirements. A review of the key studies researching the impact of independent audit committee membership on the quality of financial reporting suggests that there is little reason to believe that these lesser independence requirements will have any impact on the quality of financial reporting.

APPENDIX

MAJOR STUDIES RESEARCHING THE IMPACT OF INDEPENDENT  
AUDIT COMMITTEE MEMBERSHIP ON THE QUALITY OF FINANCIAL  
REPORTING

<i>Study</i>	<i>Performance Measure</i>	<i>Results provide:</i>
Abbott et al., 2000	Accounting and auditing enforcement releases	Evidence in support of full independence requirements
Abbott et al., 2003	Audit fees	Evidence in support of full independence requirements
Abbott et al., 2004	Earnings restatement	Evidence in support of full independence requirements
Beasley et al., 2000	SEC enforcement actions	Evidence in support of full independence requirements
Bryan et al., 2004	Earnings response coefficient and degree of overpricing with accruals	Evidence in support of full independence requirements
Carcello et al., 2006	Earnings restatement	Evidence in support of full independence requirements

*INTERNATIONAL AUDIT COMMITTEE INDEPENDENCE REQUIREMENTS*

Chtourou et al., 2001	Discretionary accruals	Evidence in support of full independence requirements
Lee et al., 2004	Auditor resignations	Evidence in support of full independence requirements
Lee and Mande, 2005	Audit fees	Evidence in support of full independence requirements
Liu, 2006	Forecast dispersion and revision volatility	Evidence in support of full independence requirements
McMullen and Raghunandan, 1996	SEC enforcement actions and earnings restatements	Evidence in support of full independence requirements
Raghunandan et al., 2001	Interaction with internal auditor	Evidence in support of full independence requirements
Scarborough et al., 1998	Interaction with internal auditor	Evidence in support of full independence requirements
Krishnan, 2005	Disclosure of internal control problems	Evidence in support of both full independence and proportional increase in independence
Bedard et al., 2004	Discretionary accruals	Evidence in support of full independence requirements, no support for any lesser independence
Bronson et al., 2009	Auditor dismissals	Evidence in support of full independence requirements, no support for any lesser independence
Davidson et al., 2005	Discretionary accruals	Evidence in support of majority independence, no support for full independence
Klein, 2002	Discretionary accruals	Evidence in support of majority independence, no support for full independence requirements
Archambeault and Dezoort, 2001	Auditor switches	Support for proportional increases in independence requirements
Carcello and Neal, 2000	Going concern reports	Support for proportional increases in independence requirements
Carcello and Neal, 2003	Auditor dismissals following new going concern reports	Support for proportional increases in independence requirements



Chen et al., 2005	Industry specialist audit firm	Support for proportional increases in independence requirements
Uzun, 2004	Fraud accusations	Support for proportional increases in independence requirements
Agrawal and Chadha, 2005	Earnings restatement	No support for full independence or proportional increase in independence requirements
Anderson et al., 2003	Stock market response to unexpected earnings	No support for proportional increase in independence requirements
Felo et al., 2003	Financial analysts score for quality from the AIMR database	No support for proportional increase in independence requirements
Xie et al., 2003	Discretionary accruals	No support for proportional increase in independence requirements
Yang and Krishnan, 2005	Discretionary accruals	No support for proportional increase in independence requirements
Rainsbury et al., 2009	Five accounting choices	No support for majority requirements



THE SERVICEMEMBERS CIVIL RELIEF ACT:  
CONTEMPORARY REVISIONS TO THE SOLDIERS' AND  
SAILORS' CIVIL RELIEF ACT OF 1940 REGARDING  
RIGHTS AND RESPONSIBILITIES OF THE MILITARY,  
THEIR DEPENDENTS  
AND THOSE WHO DO BUSINESS WITH THEM<sup>^</sup>

by

*Michael A. Katz*<sup>\*</sup>

I. INTRODUCTION AND PURPOSE

Although the United States terminated the draft in 1973, the Department of Defense instituted the Total Force Policy which involved an integration of reserve and active duty combat forces.<sup>1</sup> As a result, reserves are subject to active duty assignment

---

<sup>^</sup>A version of this article was originally accepted for publication in Volume 8 of the *Atlantic Law Journal*.

<sup>\*</sup>Professor, Delaware State University.

<sup>1</sup> Amy J McDonough, Gregory M. Huckabee and Christopher C. Gentile, *Crisis of the Soldiers' and Sailors' Civil Relief Act: A Call For the Ghost of Major (Professor) John Wigmore*, 43 MERCER LAW REVIEW 667 (1992). See also: Eric Schmitt, *Pentagon Will Call Up Combat Reserve Units*, N.Y. TIMES, Nov. 5, 1990 and Patrick E. Tyler and Dan Balz, *Bush Decides to Call Up Military Reserves; Iraq to Hold Foreigners at Army, Civil Sites; Cheney Sees Multi-Year Commitment*, WASH. POST, Aug. 18, 1990.

## *THE SERVICEMEMBERS CIVIL RELIEF ACT*

designation with minimal notice. Much like when the draft was in effect, a civilian could have a good job and substantial personal obligations that become totally disrupted upon activation.

The Soldiers' and Sailors' Civil Relief Act of 1940<sup>2</sup> (the SSCRA) and its subsequent amendments<sup>3</sup>, provided a number of necessary avenues of civil relief for members of the military, and their immediate families, while they are actively serving their country.

The purpose of the SSCRA is to relieve those in military service from the strain of litigation where their service would adversely affect their prosecution or defense of a particular case.<sup>4</sup>

The purpose of the Act is to postpone or suspend some of the civil obligations of military personnel to allow them to give full attention to their military duties. The Act should be read with an eye friendly to those who dropped their affairs to answer their country's call.<sup>5</sup>

In 2003, the SSCRA was rewritten and renamed the Servicemembers Civil Relief Act (SCRA).<sup>6</sup> The Congressional intent behind the amendment was to comprehensively restate the SSCRA and clarify and strengthen many of its protections.<sup>7</sup> It was

---

<sup>2</sup> 50 U.S.C. App. §§ 501-591.

<sup>3</sup> Lt. Colonel Gregory M. Huckabee, *Operation Desert Shield and Desert Storm: Resurrection of the Soldiers' and Sailors' Civil Relief Act*, 132 MIL. L. REV 141 (1991) provides a discussion of the amendments.

<sup>4</sup> Christine M. v. Superior Court, 69 Cal App. 4<sup>th</sup> 1233, 82 Cal. Rptr. 2d 220 (2<sup>nd</sup> Dist. 1999). See also: Driver v. Driver, 36 Conn. Supp. 229, 416 A. 2d 705 (reversed on other grounds [desertion]) and In Re Paternity of T.M.Y., 725 N.E.2d 997 (Ind. Ct. App. 2000).

<sup>5</sup> Hellberg v. Warner, 319 Ill. App. 1117, 48 N.E.2d 972 (1<sup>st</sup> Dist. 1943); LeMaistre v. Leffers, 333 U.S. 1, 68 S.Ct. 371, 92 L.Ed. 429 (1948).

<sup>6</sup> 50 U.S.C. App §§ 501-596.

<sup>7</sup> H.R. Rep. No. 108-81 at 32-34 (2003). See also Grantham v. Grantham 2004 WL 2579567 (Iowa App.) 2004.

signed into law by President George W. Bush on December 19, 2003 and applies to any case that is not final before that date<sup>8</sup>. Courts continue to cite general case law found in pre-December 19, 2003 cases as precedent, applying any SCRA modifications where appropriate.

In short, the SSCRA<sup>9</sup> and the more modern SCRA<sup>10</sup> allows the service man or woman to, “devote their entire energy to the military needs of the nation.”

## II. HISTORICAL BACKGROUND

The right of Congress to enact protective legislation was established soon after the Civil War<sup>11</sup> and was reestablished in 1919 in the case of *Dameron v. Broadhead*<sup>12</sup> when the Supreme Court equated the powers of Congress to establish such legislation as a natural extension of the Congress’s power to declare war<sup>13</sup> and raise and support armies.<sup>14</sup> The SSCRA, a modernization of a Civil War relief statute<sup>15</sup>, then followed by a World War I era statute<sup>16</sup>, greatly expanded the protections originally provided. The 2003 SCRA has further expanded and refined the SSCRA rights.<sup>17</sup> Today, protections are extended to regular members of the Army, Navy, Air Force, Marines and Coast Guard.<sup>18</sup> Reserve and

---

<sup>8</sup> 50 U.S.C. App § 501. See also: In Re: Gaddy, 2004 WL 2044107 (Bankr.D. Kan. 2004), *Grantham v. Grantham*, 2004 WL 2579567 (Iowa App.2004).

<sup>9</sup> *Clark v. Mechanics’ Am. Nat’l Bank*, 282 F. 589 (8<sup>th</sup> Cir. 1922).

<sup>10</sup> *Perkins v. Global Forest Productions Company*, 122 Wash.App. 1053, 2004 WL 1732480 (Wash...App. Div 2, 2004) (unpublished).

<sup>11</sup> *Stewart v. Kahn*, 78 U.S.493 (1870).

<sup>12</sup> 345 U.S. 322 (1953).

<sup>13</sup> U.S. Const., Art. 1, § 8, cl. 11.

<sup>14</sup> U.S. Const., Art. 1, § 8, cl. 12.

<sup>15</sup> Act of June 11, 1984, ch. 118, 13 Stat.123, provided immunity from the service of process and arrest.

<sup>16</sup> Act of Mar. 8, 1918, ch. 20, 40 Stat. 440.

<sup>17</sup> See note 7.

<sup>18</sup> 50 U.S.C. App. § 511.

## THE SERVICEMEMBERS CIVIL RELIEF ACT

National Guard members who have been activated, whether voluntarily or involuntarily, Public Health Service Officers assigned to the armed services<sup>19</sup> and those in training, preliminary to induction are also covered.<sup>20</sup> Certain benefits are extended to dependents of military personnel<sup>21</sup>, certain persons who have guaranteed obligations with active duty military personnel<sup>22</sup> and U.S. citizens serving with the armed forces of U.S. allies during war time periods.<sup>23</sup>

The SCRA only applies to military personnel on active duty and under certain circumstances, their dependents.<sup>24</sup> The acts applicability to dependents is limited to the dependent's ability to comply with a lease, contract, bailment or other obligation and is materially affected by reason of the servicemember's military service.<sup>25</sup> Dependents were not specifically defined in the SSCRA.<sup>26</sup> The SCRA does define dependents, as being (a) the servicemember's spouse, (b) the servicemember's child and, or (c) an individual for whom the servicemember provided more than one-half of the individual's support for 180 days immediately preceding an application for relief under the act.<sup>27</sup> Since the rights extend only to those in active military service, military personnel therefore lose their SCRA rights, just as with the SSCRA, upon retirement<sup>28</sup> and Reserve and National Guard members only fall

---

<sup>19</sup>*Omega Industries, Inc. v. Raffaele*, 894 F. Supp. 1425 (D Nev. 1995).

<sup>20</sup>50 U.S.C. App. § 511.

<sup>21</sup>*Id.* § 536.

<sup>22</sup>*Id.* § 513.

<sup>23</sup>*Id.* § 514.

<sup>24</sup>*Id.* § 511.

<sup>25</sup>*Perkins v. Global Forest Productions Company*, 122 Wash.App. 1053, 2004 WL 1732480 (Wash. App. Div 2, 2004) (unpublished).

<sup>26</sup>Courts have interpreted dependents to include those who rely on the military person for maintenance or support. This included mothers of deceased military personnel, see: *Great Barrington Sav. Bk. v. Brown*, 239 Mass. 546, 132 N.E. 398 (1921) and ex-wives caring for the military persons children, see: *Balconi v. Drascus*, 133 Misc.2d 685, 507 N.Y.S. 2d 788 (1986).

<sup>27</sup>50 U.S.C. App. § 511.

<sup>28</sup>*Lang v. Lang*, 25 N.Y.S.2d 775 (NY Sup. 1941).

under the statutory protections when activated.<sup>29</sup> Under the SSCRA, there was no coverage intended for National Guard personnel called to duty under state orders, however, the SCRA expanded coverage to National Guard members serving more than 30 consecutive days for purposes of responding to a national emergency declared by the President and supported by federal funds.<sup>30</sup>

### III. SCOPE OF THE ACT

The protections provided military personnel generally provide shelter regarding financial obligations, forfeiture of property and guarantees of fair judicial processes. Specific protections include relief regarding non-payment of rent<sup>31</sup>, installment sales contracts<sup>32</sup>, mortgages and trust deeds<sup>33</sup>, leases<sup>34</sup> protection of assignor's of life insurance policies<sup>35</sup> and enforcement of storage liens.<sup>36</sup> Other relief extends to protection from the sale of personal or real property in order to satisfy tax liens and deficiencies<sup>37</sup>. Important further relief under the SSCRA and continued in the SCRA exists regarding stays of enforcement regarding obligations and liabilities affecting the service man or woman by providing extensions and suspending the tolling of statutes of limitations during the period of active military service.<sup>38</sup> Under the SSCRA, doctors, and other professionals as the Secretary of Defense may designate, were given the opportunity to suspend professional liability protection with reinstatement and

---

<sup>29</sup>*Bowen v. United States*, 292 F.3d 1383 (C.A. Fed. 2002).

<sup>30</sup> 50 U.S.C. App. § 511.

<sup>31</sup> 50 U.S.C. App. § 531. (Formerly § 530 under the SSCRA).

<sup>32</sup> *Id.* § 532. (Formerly § 531 under the SSCRA).

<sup>33</sup> *Id.* § 533. (Formerly § 532 under the SSCRA).

<sup>34</sup> *Id.* § 535. (Formerly § 534 under the SSCRA).

<sup>35</sup> *Id.* § 536. (No change).

<sup>36</sup> *Id.* § 537. (Formerly § 536 under the SSCRA).

<sup>37</sup> *Id.* § 561. (Formerly § 560 under the SSCRA).

<sup>38</sup> *Id.* § 591. (Formerly § 590 under the SSCRA).

## THE SERVICEMEMBERS CIVIL RELIEF ACT

premium increase protection provided.<sup>39</sup> The SCRA has expressly added servicemembers serving the legal profession to this protection.<sup>40</sup>

### IV. APPLICATION

The rights afforded under the SSCRA and now the SCRA are not all automatic and don't all necessarily apply to everyone. In most instances, the service member must be able to prove<sup>41</sup> that they are "materially effected" by their active service such that they cannot meet their previous obligations and/or cannot adequately defend themselves in a judicial situation due to their service.<sup>42</sup> Originally, under the SSCRA, the court had discretion as to whom the court may ask to provide evidence of the material effect of military service.<sup>43</sup> Expressly under the SCRA, the burden of proving the material effect military service is now on the servicemember.<sup>44</sup>

Merely meeting the definitional requirements and following the correct procedures is not sufficient to invoke the Act's protection. Defendant servicemembers must show that the military service has had a "material effect" on their ability to prosecute or defend their rights in the case.<sup>45</sup>

---

<sup>39</sup> 50 U.S.C. App. § 592 (SSCRA).

<sup>40</sup> 50 U.S.C. App. § 593.

<sup>41</sup> During Desert Storm, Congress created a temporary exception and mandated an automatic stay of civil proceedings, upon request and without the necessity of showing material effect, until a date after June 30, 1991. This exception expired on July 1, 1991. See: Pub. L. No. 102-12, § 6, 105 Stat. 34, 37-38 (1991).

<sup>42</sup> *Henneke v. Young*, 761 N.E.2d 1140 (2001); *Grantham v. Grantham*, 2004 WL 2579567 (Iowa App.) 2004.

<sup>43</sup> *Boone v. Lightner*, 319 US 561 (1943).

<sup>44</sup> 50 U.S.C. App. § 522. See also *Grantham v. Grantham*, 2004 WL 2579567 (Iowa App.) 2004.

<sup>45</sup> Mary Kathleen Day, *Material Effect: Shifting the Burden of Proof for Greater Procedural Relief Under the Soldiers' and Sailors' Civil Relief Act*, 27 TULSA LAW JOURNAL 45, Fall, 1991.



There is no specific benchmark established for the courts to follow. The Act was intentionally written to specify particular rights and the situations in which they apply while leaving the courts reasonable latitude to interpret the SSCRA provisions to best achieve justice.<sup>46</sup>

The Act makes no express provisions as to who must carry the burden of showing that a party will or will not be prejudiced, in pursuance no doubt of its policy of making the law flexible to meet the great variety of situations no legislator or court is wise enough to foresee.<sup>47</sup>

To this end, the SCRA is similarly interpreted as being intended to be given a broad and liberal construction in favor of soldiers and sailors to provide them just protections.<sup>48</sup>

Generally, the courts look at two criteria to determine whether the military personnel is materially effected by active service.

When dealing with monetary based issues, the court will analyze the pre-service and in-service incomes of the party. If the monetary difference is such that a burden is created, the military personnel and any dependants are protected.<sup>49</sup> Where the salaries do not significantly differ, the courts will uphold prior obligations.<sup>50</sup>

---

<sup>46</sup> *Coburn v. Coburn*, 412 SO 2d 947 (Fla. App. 1982); *Cox v. Yates*, 100 S.E.2d 649 (Ga. App. 1957); *Le Maistre v. Leffers*, 333 US 1, 68 S.Ct. 371, 92 L.Ed. 429 (1948); *Hellberg v. Warner*, 48 NE.2d 972 (Ill. App. 1943).

<sup>47</sup> *Boone v. Lightner*, 319 US 561 (1943).

<sup>48</sup> *Grantham v. Grantham*, 2004 WL 2579567 (Iowa App. 2004).

<sup>49</sup> *Federal Nat'l Mortgage Ass'n v. Denzel*, 136 F. Supp. 859 (E.D. Mich. 1956).

<sup>50</sup> In *Holtzman Furniture Store v. Schapf*, 39 So.2d 450 (La. App. 1949), the defendant earned \$37.00 per week before induction and \$148.00 per month after induction. The court determined that a \$148.00 yearly reduction of income was not so substantial as to create a material effect on the defendant's ability to pay on the installment contract previously entered into.

## *THE SERVICEMEMBERS CIVIL RELIEF ACT*

In controversies regarding civil and other rights not directly considered monetary issues, the courts will look to the ability and opportunity of the military personnel to properly appear and defend themselves taking into account geographic locations and opportunity to appear.

This paper will concentrate on the property and monetary related provisions of 50 U.S.C. App. Title III, looking at rights and relief regarding foreclosures (§ 533), installment contracts (§ 532), leases and rents (§ 535) as well as interest rate matters from Title II, (§ 527).

SCRA matters relating to stays, statutes of limitations, taxes and default judgments will be the subject of a future paper.

### *A. Foreclosures*<sup>51</sup>

When the military personnel is on active duty<sup>52</sup>, lenders may not foreclose on mortgages entered into prior to the commencement of active duty unless it can be shown that the military service did not materially affect the ability of the military personnel to meet the terms of their obligation.<sup>53</sup> If the court cannot be satisfied that the military personnel is not materially effected by their service, no foreclosure or seizure of property may occur during the military service and for a three month period following the termination of active duty.<sup>54</sup>

If the court finds grounds for material effect, three possible forms of relief may be granted. The court may stay the proceedings and

---

<sup>51</sup> 50 U.S.C. App. § 533. (Formerly § 532 under the SSCRA).

<sup>52</sup> 50 U.S.C. App. § 511 specifies that military service includes “any period during which a servicemember is absent from duty on account of sickness, wounds, leave or other lawful cause”. See; *Secretary of Housing and Urban Development v. McClenan*, 4 Misc.3d 1027(A), 2004 WL 2187568 (N.Y. City Civ.Ct. 2004). (Unpublished opinion).

<sup>53</sup> 50 U.S.C. App. § 521. (Formerly § 520 under the SSCRA).

<sup>54</sup> *Secretary of Housing and Urban Development v. McClenan*, 4 Misc.3d 1027(A), 2004 WL 2187568 (N.Y. City Civ.Ct. 2004) (unpublished opinion).

extend the maturity dates; they may reopen an ordered foreclosure and set aside a previous judgement for review, or; they may enforce a period of redemption equal to the period of military service and three months beyond.<sup>55</sup>

Frequently, in foreclosure actions, the court, while granting a stay of the actual proceedings, will order a partial payment during the period of service. In *Brown Service Ins. Co. v. King*,<sup>56</sup> the defendant's income went from \$400 per month to \$134.80 per month after induction. The court ordered a payment of \$4.74 per month representing the taxes and insurance but nothing to principal, interest or FHA mortgage insurance. In *Cortland Sav. Bank v. Ivory*,<sup>57</sup> the defendant was ordered to pay \$26.95 towards taxes and insurance, but nothing towards P & I when his income went from \$203.80 to \$154.00 per month after induction. Similarly, in New York *Life Ins. Co. v. Litke*,<sup>58</sup> a \$5.00 payment was mandated when the defendant's income dropped from \$260.00 to \$50.00 per month following induction.

Any time that a foreclosure proceeding is commenced; an affidavit of non-military service is required to be filed with the court.<sup>59</sup> Failure to do so was grounds for dismissal of a default judgment or warrant of eviction under the SSCRA and continues under the SCRA.<sup>60</sup> Where a false affidavit is filed due to erroneous

---

<sup>55</sup> Bruce H. White and William L. Medford, *The Soldiers' and Sailors' Civil Relief Act - Are You Stayed From Obtaining Relief From Automatic Stays?*, 18 AM. BANKR. INST. J. 23, March, 1999.

<sup>56</sup> 247 Ala 311, 24 So. 2d 219 (1945).

<sup>57</sup> 27 N.Y.S.2d 313 (1941).

<sup>58</sup> 180 Misc. 297, 41 N.Y.S.2d 526 (1943).

<sup>59</sup> 50 U.S.C. App. § 521. (Formerly § 520 under the SSCRA). See also; *Department of Housing Preservation and Development of the City of New York v. West 129 Street Realty Corp.*, 3 Misc3d 1102(A), 2004 WL 1094926 (N.Y. Civ. Ct., Slip Op. 50340(U) 2004) (unpublished opinion).

<sup>60</sup> *Heritage East-West, LLC v. Chung & Choi et al.*, 785 N.Y.S.2d 317 (2004); *363 Associates, LLC v. Sharhan*, 2 Misc.3d 928, 2 Misc.3d 928,774 N.Y.S.2d 907 (N.Y. Slip Op. 23929, 2003).

## THE SERVICEMEMBERS CIVIL RELIEF ACT

information provided by an official source such as the Department of Defense Manpower Data Center (sscra.helpdesk@osd.pentagon.mil)<sup>61</sup>, a default judgment will be deemed voidable rather than void ab initio as a matter of law.<sup>62</sup>

### B. Interest Rate Caps<sup>63</sup>

Another monetary related right, which is provided to active military personnel, is an interest rate cap of 6%<sup>64</sup>, applied upon request, regarding any<sup>65</sup> interest bearing obligation<sup>66</sup> with the exception of federally guaranteed student loans.<sup>67</sup> In the case of federally guaranteed student loans, the Secretary of Education has encouraged lenders to grant extensions and forbearance to prevent deficiencies.<sup>68</sup> If the military member requests a rate reduction, the lender must comply or seek relief from the court.<sup>69</sup> Relief from the court will only be denied upon showing either, that the service member has not been materially affected by induction as previously discussed, or, upon proof that the obligation was entered into subsequent to the commencement of active service.<sup>70</sup> The 6% rate cap is available to cosigners and guarantors that are

---

<sup>61</sup> *363 Associates, LLC v. Sharan*, 2 Misc.3d 928, 2 Misc.3d 928,774 N.Y.S.2d 907 (N.Y. Slip Op. 23929, 2003).

<sup>62</sup> *Citibank, N.A. v. McGarvey*, 196 Misc.2d 292, 765 N.Y.S.2d 163 (Civ Ct Richmond Co 2003).

<sup>63</sup> 50 U.S.C. App. § 527. (Formerly § 526 under the SSCRA).

<sup>64</sup> This maximum rate of 6% per annum includes service charges, renewal charges and all other loan related fees other than loan related insurance.

<sup>65</sup> *Holmes v. California National Guard*, 90 Cal. App.4<sup>th</sup> 297, 109 Cal. Rptr.2d 154 (Cal. App. 1 Dist. 2001).

<sup>66</sup> 50 U.S.C. App. § 526. (Formerly § 526 under the SSCRA).

<sup>67</sup> Title 20, U.S.C. §1078(d) specifies that federally guaranteed student loans are not subject to interest rate limits.

<sup>68</sup> see: 34 C.F.R. § 682.211 (1997).

<sup>69</sup> *Holmes v. California National Guard*, 90 Cal. App.4<sup>th</sup> 297, 109 Cal. Rptr.2d 154 (Cal. App. 1 Dist. 2001).

<sup>70</sup> see: *Charles H. Jenkins & Company, Inc. v. Thomas H. Lewis*, 137 S.E.2d 49 (Super. Ct. NC 1963); *Commercial Credit Corp. v. Brown*, 166 S.W.2d 153 (Tex. Civ. App. 1942); *Shield v. Hall*, 207 S.W.2d 997 (1948).

materially effected by the induction to active service of their fellow signer. The cap also applies to debts related to bankruptcy proceedings.<sup>71</sup> It is not automatically available to dependents who have loans or obligations solely in their own names. Merely being a spouse or business partner of the activated military person does not, in and of itself, qualify for the 6% cap relief.<sup>72</sup>

Banks, interpreting the SSCRA, have applied the 6% cap in a number of ways, accruing interest, rewriting the loan and other ways in which the banks could minimize loss. Congress, by amendment in 1942<sup>73</sup>, specified, per statements of intent made by Congressman Kildary that the maximum rate that could be charged during active service is 6% and no accrual was permitted.<sup>74</sup> Nevertheless, the exact application of the reduction has remained in question.<sup>75</sup> In the SCRA, Congress specifically addressed the issue, not only limiting the rate of interest to 6%, but expressly forgiving interest in excess of 6%.<sup>76</sup>

### C. *Installment Contracts*<sup>77</sup>

Activated service personnel may obtain relief regarding installment contracts entered into prior to induction. Consistent with other parts of the SSCRA, this section did not apply to installment contracts entered into after beginning active duty.<sup>78</sup> This timing limitation has continued under the SCRA<sup>79</sup> and requires that a

---

<sup>71</sup> *In Re Watson*, 292 B.R. 441, (Bkrcty. S.D. Ga. 2003). Here a 6% interest rate cap was applied to a secured claim that was included in an approved and ongoing Chapter 13 plan.

<sup>72</sup> *Patrikes v. JCH Serv. Stations*, 46 N.Y.S.2d 233 (1943).

<sup>73</sup> Act Oct. 6, 1942, ch. 581, § 1, 56 Stat. 769.

<sup>74</sup> 88 Cong. Rec. 5366 (1942).

<sup>75</sup> *Greene v. Chase Manhattan Automotive Finance Corporation*, 2003 WL 22872102 (E.D.La. 2003).

<sup>76</sup> 50 U.S.C. App. § 527.

<sup>77</sup> *Id.* § 532. (Formerly § 531 under the SSCRA).

<sup>78</sup> *Jenkins v. Lewis*, 259 N.C. 86, 130 S.E.2d 49 (1963).

<sup>79</sup> <http://www.military.com/benefits/legal-matters/scra/installment-contracts> (last

## *THE SERVICEMEMBERS CIVIL RELIEF ACT*

deposit have been made or at least one payment has been made.<sup>80</sup> This section applies to installment contracts regarding both real and personal property, bailments or leases<sup>81</sup> and directs that no one may exercise any rights regarding repossession or forfeiture, based on nonpayment, unless a court order is obtained.<sup>82</sup>

In *Tucson Telco Fed. Credit Union v. Bowser*<sup>83</sup> a civilian woman rented a car in her own name and made the payments herself. She married a civilian who was then drafted. The court determined that the car could not be repossessed without specific court authorization because her husband's induction had materially affected her ability to meet her financial burdens.

Naturally, if the service member suffers no material effect to their ability to meet their obligations, no relief is warranted. Where material effect is shown, the courts generally have three options. They may terminate the contract, ordering reimbursement of any deposits and payments made to the service member while returning the property to the seller; they may stay the proceedings for the term of the members service plus three months, or; they may order the property sold if the property would be destroyed or its value diminished or if gross unfairness would result.<sup>84</sup>

---

visited 5/10/11).

<sup>80</sup> Rod Powers, *Servicemembers Civil Relief Act, Simplified, Your Guide to U.S. Military* at <http://usmilitary.about.com/cs/sscra/a/scra2.htm> (last visited 5/10/11).

<sup>81</sup> 50 U.S.C. App. § 532. (Formerly § 531 under the SSCRA).

<sup>82</sup> *Luke v. Mercantile Accept. Corp. of Cal.*, 111 Cal. App.2d 431, 244 P.2d 764 (1952).

<sup>83</sup> 451 P. 2d 322 (1969).

<sup>84</sup> *Associates Discount Corp. v. Armstrong*, 33 N.Y.S.2d 36 (1942); *Holtzman Furniture Store v. Schapf*, 39 So.2d 450 (La. App. 1949).

D. Termination of Leases<sup>85</sup>

If a person occupies a premises as a dwelling or for professional, agricultural or other business purposes,<sup>86</sup> when called to active duty, they may have the lease terminated upon written notice<sup>87</sup> to the landlord when such notice is made prior to commencement of duties.

This right to terminate the lease extends to nonmilitary spouses and dependents.<sup>88</sup> To this end, the courts have wide powers of interpretation.

If the service personnel or their dependent exercises their right to terminate a lease, rent or payments must be made until active duty commences.<sup>89</sup>

The SCRA adds a new provision, not included in the SSCRA, which permits a servicemember to terminate an automobile lease entered into either prior to the start of active military service or entered into after the start of active duty should the servicemember receive orders for a permanent change of duty station outside of the continental United States.<sup>90</sup> The lessor is prohibited from charging early termination fees although taxes, registration fees, charges for excess wear and excess mileage, unpaid at the time of termination may be collected.<sup>91</sup>

---

<sup>85</sup> 50 U.S.C. App. § 535. (Formerly § 534 under the SSCRA).

<sup>86</sup> In *Omega Industries, Inc. v. Raffaele*, 894 F. Supp. 1425 (D Nev. 1995), an optometrist leased an office that he conducted his professional business in. He was granted relief from the lease upon his entry into the Public Health Service.

<sup>87</sup> *Ostrowski v. Barzynski*, 24 Erie County L. J. 221, 45 Pa. D. & C. 452 (1942).

<sup>88</sup> 50 U.S.C. App. § 535. (Formerly § 534 under the SSCRA).

<sup>89</sup> *Patrikes v. JCH Serv. Stations*, 46 N.Y.S.2d 233 (1943).

<sup>90</sup> 50 U.S.C. App. § 535.

<sup>91</sup> [http://usmilitary.about.com/cs/sscra/a/scra2\\_2.htm](http://usmilitary.about.com/cs/sscra/a/scra2_2.htm) (Last visited 5/10/11).

## *THE SERVICEMEMBERS CIVIL RELIEF ACT*

### *E. Protection from Eviction*<sup>92</sup>

This section prevents the eviction or distress of active duty personnel or their dependents<sup>93</sup> without a court order<sup>94</sup> while the service member serving. If an active service member can evidence material effect, the court is required to provide a three month stay regarding any eviction proceedings for non-payment of rent or, may institute any order it deems just under the circumstance.<sup>95</sup> Pursuant to the 1991 amendments of the SSCRA<sup>96</sup>, the rental amount for which relief may be requested was adjusted to rental agreements of \$1,200.00 per month or less<sup>97</sup> The SCRA increased the monthly rent ceiling to \$2,400.00 per month for years after 2003 with interest rate adjustments thereafter.<sup>98</sup>

This is a very straightforward form of relief provided to protect service personnel and their dependents who serve their country and it is immaterial whether the rental obligation was entered into prior to or after induction into active service.<sup>99</sup>

### *F. Nondiscrimination Clause*<sup>100</sup>

The SCRA has added, what essentially is best described as a non-discrimination clause. Anyone who avails them self of a right

---

<sup>92</sup> 50 U.S.C. App. § 531. (Formerly § 530 under the SSCRA).

<sup>93</sup> *Prather v. Clover Spinning Mills*, 54 S.E.2d 529 (1949).

<sup>94</sup> *21948, LLC v. Riaz*, 745 N.Y.S.2d 389 (2000).

<sup>95</sup> *Academy St. Corp. v. Calderson*, 38 Misc. 393, 34 N.Y.S.2d 853 (1963).

<sup>96</sup> Pub. L. No. 120-12, § 2, 105 Stat. 34 (1991).

<sup>97</sup> The 1991 amendment raised the SSCRA ceiling for relief amount from \$150.00 per month to \$1,200.00 per month.

<sup>98</sup> 50 U.S.C. App. §531. This section allows for a floating rent ceiling based on housing price inflation adjustments added to the base amount of \$2,400.00. The housing price inflation adjustment is the percentage in which the Consumer Price Index (CPI), published by the Bureau of Labor Statistics of the Department of Labor published in November of the previous year exceeds the CPI component for November, 1984.

<sup>99</sup> , 164 F. 2d 173 (4th Cir. 1947).

<sup>100</sup> 50 U.S.C. App. 518.



contained in the SCRA may not be subjected to consequences for exercising their rights. Specifically, credit cannot be denied or revoked, existing agreements cannot be altered, insurance may not be refused and an adverse credit report may not be reported by or to person assembling a credit report.<sup>101</sup>

## V. ANALYSIS

Traditional analysis of this statute is generally inapplicable. The necessity for the SCRA and its previous iterations is obvious, not only from its long history<sup>102</sup>, but also from contemporary news reports highlighting abuses.<sup>103</sup> Traditional analysis is further hampered by the fact that statistics evidencing abuses are only available through the frequency of law suits and such a measure has no scientific validity and creates no measurable statistical confidence. In short, if an abuse occurs and the servicemember displays apathy and fails to come forward, or an affected dependent is unaware of their rights, the abuse falls through the cracks and goes unreported.

The SCRA has substantially increased monetary thresholds expanding rights and triggering liability. The result is that the statute, by increasing and making rent<sup>104</sup> and the application of interest rate numbers contemporary<sup>105</sup>, currently better meets its goal of protecting the servicemember and his or her dependents during the period of military service. It becomes incumbent on Congress and the President to monitor and adjust the threshold rights aforementioned as the economy changes in the future. Many

---

<sup>101</sup> *Id.* See also: Mary Beth Guard, *Soldiers' and Sailors' Civil Relief Act Q & A - Part 2*, at [www.bankersonline.com/lending/sscraquestionspt2.html](http://www.bankersonline.com/lending/sscraquestionspt2.html) (last visited 5/10/11).

<sup>102</sup> See notes 11-17.

<sup>103</sup> Sam Hananel, *Soldiers Facing Hurdles Back Home While Away at War*, Associated Press, March 27, 2005.

<sup>104</sup> See notes 93-99.

<sup>105</sup> See note 64-76.

## THE SERVICEMEMBERS CIVIL RELIEF ACT

other rights have been better defined and modernized to make the statute more effective and applicable to the servicemembers needs. In particular, the antidiscrimination clause designed to shield the servicemember and dependent from retaliation for enforcing their rights, protects them and should allow for better enforcement of applicable rights.<sup>106</sup> Finally, bringing the National Guard and Reservists under the umbrella of protection, the statute truly protects the gamut of those needing and deserving protection.<sup>107</sup>

## VI. CONCLUSION

It is imperative for businesses and their advisors to understand and apply the SCRA provisions whenever appropriate. Each of the aforementioned sections discussed above, features misdemeanor criminal penalties for violation, including sanctions in the form of fines and/or incarceration. The initial penalties general range up to a \$100,000.00 fine per violation and/or 1 year imprisonment.<sup>108</sup> Repeated or willful violations incur increasingly severe penalties.<sup>109</sup>

Courts have also permitted punitive actions to be brought by service personnel against those who have violated the SSCRA and caused the service personnel injury.<sup>110</sup> It is anticipated that the courts will afford the same remedies to SCRA violators.

The SCRA is an important piece of legislation that is not

---

<sup>106</sup> See note 101.

<sup>107</sup> See note 20.

<sup>108</sup> See: *Marin v. Citibank, N.A.*, 208 F.3d (2<sup>nd</sup> Cir. 2000) regarding a wrongful repossession; *Bowling v. Stark*, 268 So.2d 201 (Fla. App. 1972) regarding a wrongful constructive repossession; *Engstrom v. First Nat'l Bank of Eagle Lake*, 47 F.3d 1459 (5<sup>th</sup> Cir. 1995) regarding a wrongful enforcement of loan; *Moll v. Ford Consumer Finance Co. Inc.*, (unpublished) 1998 WL 142411 (ND, Ill. 1988) regarding a violation of the 6% interest rate ceiling and *Hanson v. Crown Toyota Motors, Inc.*, 572 P.2d 380 (1977) regarding an automobile repossession.

<sup>109</sup> Id.

<sup>110</sup> Id.

universally known, understood and frequently not observed. Typically, in cities that have a substantial military presence, the act is more recognized and applied where appropriate. Conversely, when dealing in cities and towns that are not oriented to the military, the SCRA is frequently overlooked and frequently violated particularly, by small businesses or sole proprietorships that don't have legal or compliance departments. In particular, individuals that lend money or rent a second home frequently have no understanding of the SCRA unless they had themselves served in the military.<sup>111</sup>

---

<sup>111</sup> Based on informal conversations conducted by the author with bank and other business personnel in Dover, DE and Wilmington, DE. Note that Dover is the state capital of Delaware and home of the Dover Air Force base, which is Dover's and Kent County's second largest employer. Wilmington is approximately 50 miles from the Dover Air Force Base and approximately 45 miles from Philadelphia, the home of the recently closed Naval Yard.



THOMPSON v. WESTERN STATES MEDICAL CENTER: AN  
OPPORTUNITY LOST<sup>^</sup>

by

Joseph S. Falchek \* & Edward J. Schoen \*\*

I. INTRODUCTION

On May 24, 1976, in *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.* (hereinafter *Virginia Pharmacy*), the United States Supreme Court made its first clear statement that commercial speech was entitled to First Amendment protection.<sup>1</sup> In *Virginia Pharmacy*, consumers of prescription drugs brought suit against the Virginia State Board of Pharmacy, challenging the validity of a Virginia statute declaring it unprofessional for a licensed pharmacist to advertise the prices of prescription drugs. Recognizing that price information is important to consumers because it enables them to make intelligent decisions, the Court determined that the First Amendment protects the right to advertise any legal product or service, regardless of how tasteless and

---

<sup>^</sup>A version of this article was originally accepted for publication in Volume 8 of the *Atlantic Law Journal*.

\* Professor and Department Chairperson, King's College.

\*\* Professor and Dean, Rowan University.

<sup>1</sup> 425 U.S. 748 (1976).

excessive the advertisement might be.<sup>2</sup> While *Virginia Pharmacy* spoke glowingly of the importance and value of commercial speech and came close to extending full First Amendment protection to commercial speech,<sup>3</sup> it emphasized two characteristics of commercial speech - namely, it was more verifiable and durable than political speech - that ultimately led to what later would be described as “an intermediate level of protection for commercial speech.”<sup>4</sup>

Almost twenty-six years and scores of commercial speech decisions later, on April 29, 2002, the United States Supreme Court in *Thompson v. Western States Medical Center* (hereinafter *Western States*),<sup>5</sup> a case remarkably similar to *Virginia Pharmacy*, struck down § 503A of Food and Drug Administration Modernization Act of 1997 (FDAMA),<sup>6</sup> which restricted pharmacists from advertising and promoting the compounding of any particular drug, class of drug, or type of drug.<sup>7</sup> In reaching its decision, the Court applied the sometimes-maligned four-part *Central Hudson* test<sup>8</sup> in which it ascertains whether the advertising in question is truthful and nondeceptive, whether the government asserts a substantial interest in support of the advertising restriction

---

<sup>2</sup> *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 764, 772 (1976).

<sup>3</sup> Michael W. Field, *On Tap, 44 Liquormart, Inc. v. Rhode Island: Last Call for the Commercial Speech Doctrine*, 2 ROGER WILLIAMS U. L. REV. 57, 65 (1996).

<sup>4</sup> *Central Hudson Gas & Elec. Corp. v. Public Service Comm'n of N.Y.*, 447 U.S. 557, 563 (1980), and Arlen W. Langvardt, *The Incremental Strengthening of First Amendment Protection for Commercial Speech: Lessons from Greater New Orleans Broadcasting*, 37 AM. BUS. L.J. 587, 598 (2000).

<sup>5</sup> 122 S. Ct. 1497 (2002).

<sup>6</sup> 111 Stat. 2328, 21 U.S.C. § 353a.

<sup>7</sup> *Thompson v. Western States Medical Center*, 122 S. Ct. 497, 1509 (2002).

<sup>8</sup> See, e.g., *Greater New Orleans Broadcasting Assn., Inc. v. United States*, 527 U.S. 173, 197, (1999) (THOMAS, J., concurring in judgment); *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 501, 510-514 (1996) (opinion of STEVENS, J., joined by KENNEDY, and GINSBURG, JJ.); *id.*, at 517 (SCALIA, J., concurring in part and concurring in judgment); *id.*, at 518 (THOMAS, J., concurring in part and concurring in judgment).

in question, whether the restriction directly and materially advances the purported government interest, and whether there is a reasonable fit between the government restriction and the purported government interest to be achieved.<sup>9</sup>

While at least one commentator had expressed hope the United States Supreme Court would use *Western States* as an opportunity to accord commercial speech the full, First Amendment protection provided political speech,<sup>10</sup> the Court declined to do so. Instead, in an opinion authored by Justice O'Connor, joined by Justices Scalia, Kennedy, Souter and Thomas, the Court again applied the *Central Hudson* test in reaching its decision.<sup>11</sup> In doing so, however, the Court appears to have extended its recent practice of carefully analyzing the operation of the commercial speech restriction at hand, requiring the government to provide evidence that the restriction materially advanced the stated policy interest, carefully scrutinizing the purported efficacy of both the commercial speech restriction and the alternative means to achieve the stated policy

---

<sup>9</sup> *Central Hudson Gas & Elec. Corp. v. Public Service Comm'n of N.Y.*, 447 U.S. 557, 566 (1980). In order to ascertain whether the governmental restriction violates the First Amendment, the Court devised the following test:

[C]ommercial speech may be restricted, provided the state's restriction satisfies the following four prongs: At the outset, we must determine whether the expression is protected by the First Amendment. For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading. Next, we ask whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the governmental interest asserted, and whether it is not more extensive than is necessary to serve that interest. *Id.*

<sup>10</sup> See David L. Hudson, *Can Congress Stop Pharmacists from Advertising Compound Drugs*, 5 ABA PREVIEW 255, 256-57 (February 13, 2002); and David Hudson, *Compounding the Problem: Another Pharmacy Case May Test the Limits of Commercial Speech*, 7 ABA J. E-REPORT 5 (February 22, 2002). See also David Hudson, *Drugstore Ad Restrictions Violate First Amendment*, 17 ABA J. E-REPORT 7 (May 3, 2002).

<sup>11</sup> *Thompson*, 122 S. Ct. at 1500.

end, and making sure the restriction was sufficiently tailored to its goal.<sup>12</sup>

The purposes of this article are (1) to compare *Virginia Pharmacy* and *Western States* to ascertain whether *Western States* really provided an appropriate opportunity to equalize the protections given to political and commercial speech, (2) to examine the most recent commercial speech decisions of the United States Supreme Court to assess whether the Court is becoming more comfortable with the *Central Hudson* test, and (3) to determine whether *Western States* bodes well for the Court's heightened scrutiny of the *Central Hudson* test in reviewing commercial speech restrictions that seek to ban expression.

## II. VIRGINIA PHARMACY: INAUGURATOR OR PRECURSOR

In *Virginia Pharmacy*, consumers of prescription drugs pursued an action for declaratory judgment determining that a provision of the Virginia Code prohibiting licensed pharmacists from advertising the price of prescription drugs be declared unconstitutional under First Amendment.<sup>13</sup> Notably, because only

---

<sup>12</sup> See Edward J. Schoen et al., *United Foods and Wileman Bros.: Protection Against Compelled Commercial Speech - Now you See It, Now You Don't*, 39 AMER. BUS. L.J. 467, 480 (2002).

<sup>13</sup> *Virginia Citizens Consumer Council, Inc. v. State Board of Pharmacy*, 373 F.Supp. 683, 684 (1974), and *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748, 750 (1976). Under § 54-524.35 of Va. Code Ann. a pharmacist licensed in Virginia was guilty of unprofessional conduct if he advertised or promoted prescription drugs on the basis of price. *Va. State Bd. of Pharmacy*, 425 U.S. at 750. Section 54-524.35 provided:

Any pharmacist shall be considered guilty of unprofessional conduct who (1) is found guilty of any crime involving grave moral turpitude, or is guilty of fraud or deceit in obtaining a certificate of registration; or (2) issues, publishes, broadcasts by radio, or otherwise, or distributes or uses in any way whatsoever advertising matter in which statements are made about his professional service which have a tendency to deceive or defraud the public, contrary to the public health and welfare; or (3) publishes, advertises or promotes, directly or indirectly, in any manner whatsoever, any amount,



licensed pharmacists are permitted to dispense prescription drugs in Virginia, this prohibition effectively eliminated all advertisements of prescription drugs, both those filled with dosages prepared by the pharmaceutical manufacturer and those compounded by the druggist.<sup>14</sup> Moreover, prices of prescription drugs were deemed to be valuable information to consumers, because prescription prices "strikingly [varied] from outlet to outlet even within the same locality."<sup>15</sup> Noting that the First Amendment protects the rights of both the speaker and the listener,<sup>16</sup> and that the Court had abandoned the simplistic proposition that "commercial speech" is beyond the ambit of First Amendment protection,<sup>17</sup> the Court ruled for the first time that First Amendment protection applied to purely commercial speech.<sup>18</sup> Indeed, the purely economic interests of both the advertiser and the consumer compelled such a conclusion, because the operation of our market economy is entirely dependent on advertising:

Advertising, however tasteless and excessive it sometimes may seem, is nonetheless dissemination of

---

price, fee, premium, discount, rebate or credit terms for professional services or for drugs containing narcotics or for any drugs which may be dispensed only by prescription. *Id.*

<sup>14</sup> *Va. State Bd. of Pharmacy*, 425 U.S. at 752.

<sup>15</sup> *Id.* at 754.

<sup>16</sup> *Id.* at 757.

<sup>17</sup> *Id.* at 758-60, citing *New York Times Co. v. Sullivan*, 376 U.S. 254, 266 (1964) (applying First Amendment Protection to a political message in paid advertisement appearing in *The New York Times*); *Pittsburgh Press Co. v. Human Relations Comm'n*, 413 U.S. 376, 384, 385 (1973) (upholding an ordinance prohibiting newspapers from listing employment advertisements in columns according to whether male or female employees were sought to be hired, and noting that speech does not lose its protection because money is paid to project it); and *Bigelow v. Virginia*, 421 U.S. 809, 820 (1975) (reversing a conviction for violation of a Virginia statute that made the circulation of any publication to encourage or promote the processing of an abortion in Virginia a misdemeanor).

<sup>18</sup> *Va. State Bd. of Pharmacy*, 425 U.S. at 762.

information as to who is producing and selling what product, for what reason, and at what price. So long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure will be made through numerous private economic decisions. It is a matter of public interest that those decisions, in the aggregate, be intelligent and well informed. To this end, the free flow of commercial information is indispensable. And if it is indispensable to the proper allocation of resources in a free enterprise system, it is also indispensable to the formation of intelligent opinions as to how that system ought to be regulated or altered. Therefore, even if the First Amendment were thought to be primarily an instrument to enlighten public decision making in a democracy, we could not say that the free flow of information does not serve that goal.<sup>19</sup>

Having concluded that commercial speech was entitled to First Amendment protection, however, the Court also determined that commercial speech could be differentiated from other types of protected speech,<sup>20</sup> and that "commonsense differences" suggested a "different degree of protection is necessary to insure that the flow of truthful and legitimate commercial information is unimpaired."<sup>21</sup> For example, because information in commercial

---

<sup>19</sup> *Id.* at 765 (citations omitted).

<sup>20</sup> *Id.* at 772.

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

speech was more objective and verifiable than political opinion, less tolerance for inaccurate statements was accorded the speaker in commercial speech than the speaker in political speech.<sup>22</sup> Likewise, because commercial speech was the "sine qua non of commercial profits," it was deemed more "durable" than political speech and less likely be "chilled" by regulation.<sup>23</sup> Thus, the government could require "that a commercial message appear in such a form, or include such additional information, warnings, and disclaimers, as are necessary to prevent its being deceptive,"<sup>24</sup> and the prohibition against prior restraints was inapplicable to commercial speech.<sup>25</sup> Nonetheless, the Court ruled, the government cannot completely suppress of the dissemination of concededly truthful information about entirely lawful activity.<sup>26</sup>

Four years later, in *Central Hudson Gas & Electric Corp. v. Public Service Commission of N.Y.*,<sup>27</sup> the Court devised a separate test to assess the constitutionality of government restrictions on commercial speech that is largely derived from the perceived differences between commercial and political speech.<sup>28</sup> More particularly, the commercial speech must concern lawful activity and not be misleading; the government interest justifying the restriction on commercial speech must be substantial; the government regulation must directly advance the governmental interest asserted, and the government regulation must be no more

---

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

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

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

<sup>26</sup> *Id.* at 773.

<sup>27</sup> 447 U.S. 557 (1980).

<sup>28</sup> *Central Hudson Gas & Elec. Corp. v. Public Service Comm'n of N.Y.*, 447 U.S. 557, 562-63 (1980) ("Our decisions have recognized the 'commonsense' distinction between speech proposing a commercial transaction, which occurs in an area traditionally subject to government regulation, and other varieties of speech. The Constitution therefore accords a lesser protection to commercial speech than to other constitutionally guaranteed expression." (citations omitted)).

extensive than is necessary to serve the pro-offered interest. If each of those inquiries can be answered in the affirmative, the regulation can be found constitutional.<sup>29</sup>

### III. WESTERN STATES INDORSES CENTRAL HUDSON ROLE IN RESOLVING COMMERCIAL SPEECH DISPUTES

Licensed pharmacists have traditionally engaged in the process of "compounding" in which they combine various ingredients to create a medication tailored to the needs of an individual patient, upon receipt of a valid prescription from a doctor or other medical practitioner licensed to prescribe medication and without applying to the FDA for approval of those drugs.<sup>30</sup> Becoming concerned that pharmacists were manufacturing and selling drugs under the guise of compounding and thereby avoiding the FDA approval processes for new drugs, the FDA in 1992 issued a Compliance Policy Guide in which it listed activities that could trigger an enforcement action, including advertising compounded drugs, compounding inordinate amounts of drug products, using commercial scale manufacturing processes to compound drugs, and distributing inordinate amounts of compounded products out of state.<sup>31</sup>

Congress enacted the FDA's restrictions on drug compounding in the Food and Drug Administration Modernization Act of 1997 (FDAMA).<sup>32</sup> The FDAMA exempts compounded drugs from the new drug requirements, provided a number of restrictions are satisfied.<sup>33</sup> The drugs must be compounded by a licensed pharmacist or physician in response to a valid prescription for an identified individual patient, or, if prepared before the receipt of

---

<sup>29</sup> *Id.* at 566. See *Thompson*, 122 S. Ct. at 1504.

<sup>30</sup> *Id.* at 1500-01.

<sup>31</sup> *Id.* at 1501-02.

<sup>32</sup> 111 Stat. 2328, 21 U.S.C. § 353a. See *Thompson v. Western States Medical Center*, 122 S. Ct. at 1502.

<sup>33</sup> *Thompson*, 122 S. Ct. at 1502.

such a prescription, made in "limited quantities" in response to an established history of valid prescription orders involving the pharmacist, the physician and the patient.<sup>34</sup> Further, the prescription must be "unsolicited," that is, the pharmacist compounding the drug cannot "advertise or promote the compounding of any particular drug, class of drug, or type of drug."<sup>35</sup> The pharmacist may, however, advertise and promote the compounding service.<sup>36</sup>

Eight licensed pharmacies, which were located in seven states, which specialized in drug compounding, which generated between sixty and ninety percent of their total drug revenues from compounding, and which distributed promotional materials by mail and at medical conferences informing patients and physicians of the use and effectiveness of specific compounded drugs, feared prosecution under the FDAMA if they continued to distribute those promotional materials.<sup>37</sup> The pharmacies filed a complaint in the United States District Court for the District of Nevada, challenging the FDAMA's restrictions on advertising the compounding of particular drugs on the grounds those restrictions violated their First Amendment rights.<sup>38</sup> Determining that the FDAMA's restrictions on advertising were unconstitutional under the *Central Hudson* test, the District Court granted the pharmacies' motion for summary judgment and enjoined the enforcement of those restrictions.<sup>39</sup> The District Court determined, however, that those provisions were severable from the rest of § 503A compounding restrictions, and left the other compounding requirements intact.<sup>40</sup>

---

<sup>34</sup> 21 U.S.C. § 353a(a). See *Thompson*, 122 S. Ct. at 1502.

<sup>35</sup> 21 U.S.C. § 353a(a) and (c). See *Thompson*, 122 S. Ct. at 1502.

<sup>36</sup> *Ibid.*

<sup>37</sup> *Western States Medical Center v. Shalala*, 69 F.Supp.2d 1288, 1291-92 (D.Nev.1999). See *Thompson*, 122 S. Ct. at 1503.

<sup>38</sup> *Id.* at 1291. See *Thompson*, 122 S. Ct. at 1503.

<sup>39</sup> *Id.* at 1310. See *Thompson*, 122 S. Ct. at 1503.

<sup>40</sup> *Id.* At 1309-10, See *Thompson*, 122 S. Ct. at 1503.

On appeal, the Ninth Circuit Court of Appeals affirmed in part and reversed in part.<sup>41</sup> While the Court of Appeals agreed that the FDAMA's advertisement restrictions flunked the *Central Hudson* test - because the Government failed to demonstrate that the advertising restrictions would directly advance its interests and that less restrictive alternatives were unavailable<sup>42</sup> - the Court determined that the advertising restrictions were not severable from the rest of § 503A, and invalidated § 503A in its entirety.<sup>43</sup>

The United States Supreme Court granted certiorari to consider whether the FDAMA's prohibitions on soliciting prescriptions for, and advertising, compounded drugs violate the First Amendment.<sup>44</sup> Because neither party challenged the appropriateness of the *Central Hudson* test to the § 503A advertising restrictions,<sup>45</sup> and because *Central Hudson* "provides an adequate basis for decision,"<sup>46</sup> the Court determined initially that "there is no need in this case to break new ground," and proceeded to examine the § 503A advertising restrictions under the *Central Hudson* test.<sup>47</sup> Because the government conceded that the prohibited advertisements would not be about unlawful activity or would not be misleading,<sup>48</sup> the first prong of the *Central Hudson* test was

---

<sup>41</sup> *Western States Medical Center*, 238 F.3d at 1098). See *Thompson*, 122 S. Ct. at 1503.

<sup>42</sup> *Western States Medical Center*, 238 F.3d at 1094-96. See *Thompson*, 122 S. Ct. at 1503.

<sup>43</sup> *Western States Medical Center*, 238 F.3d at 1096-9. See *Thompson*, 122 S. Ct. at 1503.

<sup>44</sup> *Thompson*, 122 S. Ct. at 457. See *Thompson*, 122 S. Ct. at 1503. Because neither party petitioned for certiorari on the severability of the advertising restrictions from § 503A, the Court noted that it could not review that portion of the Court of Appeals decision and that the provisions of the FDAMA outside § 503A, unrelated to drug compounding, were not at issue and remained unaffected. *Id.*

<sup>45</sup> *Id.* at 1504.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

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

answered in the affirmative, and the Court focused on the remaining three prongs.<sup>49</sup>

With respect to the second prong - whether the government interest justifying the restriction on commercial speech was substantial - the court agreed with the government that the following interests were substantial: "[p]reserving the effectiveness and integrity of the [Food, Drug, and Cosmetic Act]'s new drug approval process,"<sup>50</sup> "permitting the practice of compounding drugs so that patients with particular needs may obtain medications suited to those needs,"<sup>51</sup> exempting "small scale drug compounding" from the new drug approval process so as "not to force pharmacists to stop providing compounded drugs" on economic grounds,<sup>52</sup> and achieving a balance between permitting the production of compounded drugs produced a small scale and prohibiting the production of compounding drugs on a large scale and thereby avoiding the necessity of new drug testing.<sup>53</sup>

With respect to the third prong - whether the government regulation must directly advance the governmental interest asserted - the Court both acknowledged and accepted as true the Government's argument that marketing drugs on a large scale requires extensive advertising, and therefore prohibiting advertising "is an ideal way to permit compounding and yet also guarantee that compounding is not conducted on such a scale as to undermine the FDA approval process."<sup>54</sup> Hence the Court conceded that FDAMA's prohibition on advertising compounded drugs "might indeed" advance the Government's asserted interests.<sup>55</sup>

---

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

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

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

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

<sup>53</sup> *Id.* at 1504-05.

<sup>54</sup> *Id.* at 1505.

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

With respect to the fourth prong - whether the government regulation must be no more extensive than is necessary to serve the pro-offered interest - the Court parted ways with the Government, and determined that the Government failed to meet its burden of proving that the speech restrictions are no more extensive than necessary to achieve its purported interests.<sup>56</sup> The court recognized several alternative approaches that might achieve the desired objective: banning commercial-scale drug compounding, prohibiting pharmacists from compounding drugs in advance of prescriptions; prohibiting pharmacists from compounding more drugs in advance of prescriptions than prescriptions already received; prohibiting pharmacists from compounding drugs at wholesale or for resale; or capping the amount of compounded drugs either by volume, number of prescriptions, or gross revenue or net profit in a given period of time.<sup>57</sup> Furthermore, the court noted:

The Government has not offered any reason why these possibilities, alone or in combination, would be insufficient to prevent compounding from occurring on such a scale as to undermine the new drug approval process. Indeed, there is no hint that the Government even considered these or any other alternatives. Nowhere in . . . petitioners' briefs is there any explanation of why the Government believed forbidding advertising was a necessary as opposed to merely convenient means of achieving its interests. Yet '[i]t is well established that the party

---

<sup>56</sup> *Id.* at 1505, 1507.

<sup>57</sup> *Id.* at 1506.



seeking to uphold a restriction on commercial speech carries the burden of justifying it.' The Government simply has not provided sufficient justification here. If the First Amendment means anything, it means that regulating speech must be a last - not first - resort. Yet here it seems to have been the first strategy the Government thought to try.<sup>58</sup>

Likewise, the Court highlighted its concern that the means selected by the Government to achieve its purported end was a complete prohibition on advertising, noting that "bans against truthful, nonmisleading commercial speech . . . usually rest solely on the offensive assumption that the public will respond 'irrationally' to the truth," and that the First Amendment "directs us to be especially skeptical of regulations that seek to keep people in the dark for what the government perceives to be their own good."<sup>59</sup> It was equally clear to the Court that the complete ban on advertising compounded drugs was a disproportionately large solution to a much narrower problem:

Forbidding the advertisement of compounded drugs would affect pharmacists other than those interested in producing drugs on a large scale. It would prevent pharmacists with no interest in mass-producing medications, but who serve clienteles with special medical needs, from telling the doctors treating those clients about the

---

<sup>58</sup> *Id.* at 1506-07 (citations omitted).

<sup>59</sup> *Id.* at 1508.

alternative drugs available through compounding. For example, a pharmacist serving a children's hospital where many patients are unable to swallow pills would be prevented from telling the children's doctors about a new development in compounding that allowed a drug that was previously available only in pill form to be administered another way. Forbidding advertising of particular compounded drugs would also prohibit a pharmacist from posting a notice informing customers that if their children refuse to take medications because of the taste, the pharmacist could change the flavor, and giving examples of medications where flavoring is possible. The fact that the FDAMA would prohibit such seemingly useful speech even though doing so does not appear to directly further any asserted governmental objective confirms our belief that the prohibition is unconstitutional.<sup>60</sup>

Accordingly, the Court affirmed the judgment the Ninth Circuit Court of Appeals that the speech-related provisions of FDAMA § 503A are unconstitutional. In doing so, the United States Supreme Court appears to have extended its recent practice of carefully analyzing the operation of the commercial speech restriction at hand, requiring the government to provide evidence that the restriction materially advances the stated policy interest, carefully

---

<sup>60</sup> *Id.* at 1508-09.

scrutinizing the purported efficacy of both the commercial speech restriction and the alternative means to achieve the stated policy end, and making sure the restriction was sufficiently tailored to its goal. While the Court did not seriously press the Government on the second prong (identifying a substantial government interest to be advanced by the restriction on commercial speech) and third prong (establishing that the restriction on commercial speech in fact advanced the identified interest), it emphatically enforced the required burden of proof imposed on the government, expressed its displeasure with the paucity of evidence demonstrating the efficacy of the restriction on commercial speech to achieve its purported end, and carefully examined whether less pervasive means were available to achieve the interest identified by the Government. Although the Court's ruling may stem from the nature of the solution selected by the Government - that is, a complete ban on advertising - the decision appears to extend a recent string of commercial speech decisions by the United States Supreme Court in which a heightened *Central Hudson* test is more stringently analyzed and applied.

#### IV. EXTENDING THE STRING: MORE HEIGHTENED *CENTRAL HUDSON* SCRUTINY<sup>61</sup>

In three of its most recent commercial speech decisions, the United States Supreme Court appears to have strengthened the application of the *Central Hudson* test.<sup>62</sup> While the Court appears to be

---

<sup>61</sup> Much of the analysis found in part (3) of this article is based upon research appearing in a prior publication of the authors. See Edward J. Schoen et al, *United Foods and Wileman Bros.: Protection Against Compelled Commercial Speech - Now you See It, Now You Don't*, 39 AM. BUS. L.J. 467, 480-487 (2002).

<sup>62</sup> *Central Hudson*, 447 U.S. at 566. In order to ascertain whether the governmental restriction violates the First Amendment, the Court devised the following test: commercial speech may be restricted, provided the state's restriction satisfies the following four prongs:

At the outset, we must determine whether the expression is protected by the First Amendment. For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading. Next, we ask

willing to concede that the stated "health, safety and welfare" interest served by the commercial speech restriction is substantial, the Court (a) has more carefully analyzed the operation of the restriction under question, (b) has required the government to provide evidence that the restriction materially advances the stated policy interest, (c) has examined more closely the regulatory landscape in which the restriction operated to satisfy itself that the restriction would in fact achieve its expressed end, and (d) has paid much closer attention to the existence and operations of alternative means to achieve the stated policy end to make sure the restriction was sufficiently tailored to its goal, particularly when the proposed restriction effectively banned advertisements.

In *Rubin v. Coors Brewing Co.* (hereinafter *Coors Brewing*),<sup>63</sup> the United States Supreme Court ruled that a Federal Alcohol Administration Act prohibition against displaying alcohol content on beer labels violates the First Amendment. In doing so, Court carefully delineated the proffered government interest supporting the regulation, namely protecting the health, safety, and welfare of citizens by preventing brewers from competing on the basis of alcohol strength.<sup>64</sup> It carefully scrutinized the likelihood the restriction could accomplish its announced objective.<sup>65</sup> It examined the broader regulatory landscape of the challenged restriction to make sure it rationally and consistently fit into that regulatory scheme and would not be undermined by inconsistent

---

whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the governmental interest asserted, and whether it is not more extensive than is necessary to serve that interest. *Id.*

<sup>63</sup> *Rubin v. Coors Brewing Co.*, 514 U.S. 476 (1995).

<sup>64</sup> *Id.* at 485, 488.

<sup>65</sup> *Id.* at 488. While the Court determined that the government's interest in protecting the health, safety, and welfare of its citizens by preventing brewers from competing on the basis of alcohol strength was a substantial interest, the Court concluded that beer labeling restriction "cannot directly and materially advance its asserted interest, because of the overall irrationality of the Government's regulatory scheme."

regulations.<sup>66</sup> It demanded evidence that the proposed restriction would in fact directly achieve or advance its proposed end, and that alternative measures could not advance the asserted government interest in a less intrusive manner.<sup>67</sup>

In *Greater New Orleans Broadcasting Association, Inc. v. United States* (hereinafter *Greater New Orleans*),<sup>68</sup> the United States Supreme Court was equally demanding in the application of the third and fourth prong of *Central Hudson*, and less deferential to the government's assertion that commercial speech restrictions are required to achieve a given policy interest. In *Greater New Orleans*, Louisiana broadcasters who operate FCC-licensed radio and television stations in the New Orleans metropolitan area were prohibited from running promotional advertisements for private commercial casinos that are lawful and regulated in Louisiana and

---

<sup>66</sup> *Id.* The challenged restriction prohibited the disclosure of alcohol content on labels, but left brewers free to disclose alcohol content in advertisements in much of the country, causing the Court to observe that the prohibition "makes no rational sense if the Government's true aim is to suppress strength wars. *Id.* Similarly, recognizing that the challenged restriction permitted the disclosure of alcohol content in the case of wine and spirits, 27 C.F.R. §5.37 (1994) and 27 C.F.R. §4.36 (1994), the Court stated: "If combating strength wars were the goal, we would assume that Congress would regulate disclosure of alcohol content for the strongest beverages as well as for the weakest ones." *Id.* The Court also noted that the government permits brewers to signal high alcohol content through use of the term "malt liquor," and "[o]ne would think that if the government sought to suppress strength wars by prohibiting numerical disclosures of alcohol content, it also would preclude brewers from indicating higher alcohol beverages by using descriptive terms." *Id.* at 488-89.

<sup>67</sup> *Id.* at 490. The Court determined that, even if the labeling restriction directly and materially advanced the government interest in protecting the health, safety, and welfare of its citizens, the restriction was not sufficiently tailored to its goal, and therefore could not survive First Amendment scrutiny. *Id.* at 490-91. More particularly, other alternatives, such as directly limiting the alcohol content of beers, prohibiting certain marketing efforts emphasizing high alcohol strength, or limiting the labeling ban only to malt liquors, could advance the government's asserted interest in a manner less intrusive to respondent's First Amendment. *Id.*

<sup>68</sup> *Greater New Orleans Broadcasting Ass'n, Inc. v. United States*, 527 U.S. 173 (1999).

Mississippi, because some broadcast signals could be heard in Texas and Arkansas, where private casino gambling is unlawful.<sup>69</sup> The Court ruled that the FCC regulations in question violate commercial speech protections under the First Amendment, and, in doing so, consolidated the gains made in *Coors Brewing*. The Court carefully delineated the governmental interest the advertising restriction was designed to support, namely reducing the social costs associated with gambling.<sup>70</sup> The Court did not defer to stated government policy, but rather required that the government interest be substantial and/or that the restriction be appropriately designed to achieve the government interest.<sup>71</sup> The Court sought coherence in the overall regulatory scheme in which the advertising restriction under scrutiny fit to make sure the challenged regulation would not be undermined by inconsistent government policy.<sup>72</sup> The Court looked for evidence demonstrating not only that the challenged regulation would directly advance the policy objective for which the regulation was created, but also that other less intrusive measures would not be

---

<sup>69</sup> *Id.* at 180-81.

<sup>70</sup> *Id.* at 184. These costs include the contributions of gambling to corruption and organized crime, its message of false but sometimes irresistible hope of financial advancement, and its role in expanding the incidence of compulsive gambling. *Id.* at 185.

<sup>71</sup> *Id.* at 187. The Court observed that, “[w]hatever its character in 1934 when the restriction was adopted, the federal policy of discouraging gambling in general, and casino gambling in particular, is now decidedly equivocal,” and that Congress appeared unwilling “to adopt a single national policy that consistently endorses either interest asserted by the Solicitor General.” *Id.*

<sup>72</sup> *Id.* at 188. The Court ruled that the Government cannot hope to achieve its interest in alleviating casino gambling’s social costs by limiting demand, because its regulations are pierced by multiple exemptions and exceptions. For example, federal law prohibits a broadcaster from carrying advertising about privately operated commercial casino gambling regardless of the station’s or casino’s location, but exempts advertising about state-run casinos, certain occasional commercial casino gambling, and tribal casino gambling even if the broadcaster is located in or broadcasts to a jurisdiction with the strictest of anti-gambling policies. *Id.*

able to achieve the policy objective.<sup>73</sup> Finally, *Greater New Orleans* seems to have restored consensus among the Justices for protecting commercial speech within a more tightly analyzed *Central Hudson* framework that previously existed in *Coors Brewing*.<sup>74</sup>

The United States Supreme Court repeated its heightened attention to commercial speech analysis in *Lorillard Tobacco Co. v. Reilly* (hereinafter *Lorillard*).<sup>75</sup> In *Lorillard*, the Court ruled: (1) the comprehensive, cigarette advertising regulations promulgated by the Attorney General of Massachusetts were pre-empted by the Federal Cigarette Labeling and Advertising Act (hereinafter FCLAA),<sup>76</sup> which prescribes mandatory health warnings for cigarette packaging and advertising,<sup>77</sup> and pre-empts similar state regulations,<sup>78</sup> (2) that the outdoor advertising restrictions prohibiting smokeless tobacco or cigar advertising within 1,000 feet of a school or playground violate the First Amendment on

---

<sup>73</sup> *Id.* at 191. The Court observed that, to the extent federal law distinguishes information about tribal, governmental, and private casinos based on the identity of their owners or operators, the Government presents no sound reason why such lines bear any meaningful relationship to the Government's asserted interest in reducing the social costs associated with gambling. *Id.*

<sup>74</sup> The consensus which appeared in *Coors Brewing* appeared to unravel in *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996). While all nine justices agreed to strike down the Rhode Island statutes prohibiting advertisement of liquor prices, they splintered over the reasoning for the conclusion, and only four justices agreed on the commercial speech analysis contained in parts III, IV, V, and VI of the opinion of Justice Stevens. Consensus was restored in *Greater New Orleans*.

<sup>75</sup> *Lorillard Tobacco Co. v. Reilly*, 121 S. Ct. 2404 (2001). The United States Supreme Court previously ruled that the FDA lacks statutory authority to regulate tobacco products in *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000).

<sup>76</sup> *Lorillard*, 121 S. Ct. at 2418. The Court's ruling on FCLAA preemption is found in Part IIA, IIB, IIC, and IID of the opinion.

<sup>77</sup> 15 U.S.C. §1333.

<sup>78</sup> 15 U.S.C. §1334(b).

tobacco products violated the First Amendment;<sup>79</sup> (3) that the indoor, point-of-sale advertising restrictions prohibiting advertising of smokeless tobacco and cigars lower than five feet from the floor of a retail establishment located within 1,000 feet of a school or playground violated the First Amendment;<sup>80</sup> and (4) that the

---

<sup>79</sup> *Lorillard Tobacco. Co. v. Reilly*, 121 S. Ct. at 2421-27. The Court's ruling on outdoor advertising restrictions is found in Part IIIB of the opinion. In examining the outdoor advertising restrictions, the Court closely examined the various studies and surveys (many of which were amassed by the Food and Drug Administration in its prior attempt to justify its regulation of tobacco products) on which the Massachusetts Attorney General relied to demonstrate that its interest in curtailing the use of tobacco products by minors was substantial. Based on that review the Court concluded the Attorney General's decision to regulate advertising of smokeless tobacco and cigars in an effort to combat the use of tobacco products by minors was not based on mere "speculation [and] conjecture," but in fact met the third Central Hudson prong. *Lorillard*, 121 S. Ct. at 2425. Similarly, the Court closely examined the vast reach of the outdoor advertising restrictions (particularly the 1000 foot restriction), the lack of tailoring of the restrictions to fit rural, suburban, and urban locales or to target communications that are aimed at and most appealing to youth, and the absence of any accommodations to the interest of tobacco retailers and manufacturers to convey truthful information about their products to adults and the interest of adults to receive truthful information about tobacco products. *Id.* at 2427. Based upon that review, the Court concluded the Attorney General "failed to show that the outdoor advertising regulations for smokeless tobacco and cigars are not more extensive than necessary to advance the State's substantial interest in preventing underage tobacco use." *Id.* See Edward J. Schoen and Joseph S. Falchek, *Joe Camel and 44 Liquormart: Has the FDA Gone Too Far?*, 27 ACAD. OF LEGAL STUD. IN BUS. NAT'L PROC. 191-201 (1998), and Edward J. Schoen and Bernard J. Healey, *Dear FDA: Here's More Ammunition for Your Restrictions on Tobacco Product Advertisements*, 1 ACAD. FOR STUD. IN BUS. LAW J. 1-13 (1998).

<sup>80</sup> *Id.* at 2427-28. The Court's ruling on the indoor, point-of-sale advertising restrictions is found in part IIIC of the opinion. The Court questioned whether the indoor advertising restriction could achieve the State's goal of preventing minors from using tobacco products by limiting youth exposure to tobacco product advertising. *Id.* at 2428. The Court noted that not all children are less than five feet tall and those who are certainly have the ability to look up and take in their surroundings. *Id.* at 2429. The Court concluded that, while "Massachusetts may wish to target tobacco advertisements and displays that entice children, much like floor-level candy displays in a convenience store . . .



regulations requiring retailers to place tobacco products behind counters and requiring customers to have contact with a salesperson before they are able to handle such a product did not violate the First Amendment.<sup>81</sup>

In all three opinions, then, the United States Supreme Court has more carefully analyzed the operation of the commercial speech restriction at hand, and required the government to provide evidence that the restriction materially advanced the stated policy interest. Likewise, the Court scrutinized more carefully the purported efficacy of both the commercial speech restriction and the alternative means to achieve the stated policy end to make sure the restriction was sufficiently tailored to its goal, especially when the proposed restriction effectively banned advertisements.

#### V. PROGNOSIS FOR BANNING COMMERCIAL SPEECH UNDER *CENTRAL HUDSON*.

While greater consistency in the application of the *Central Hudson* case appears to be emerging in *Coors Brewing*, *Greater New Orleans*, *Lorillard* and *Western States*, an analysis of the pattern of votes by members of the United States Supreme Court confronted with bans on commercial speech is instructive. More particularly, in *Coors Brewing*, *Greater New Orleans* and *Western States*, the

---

the blanket height restriction does not constitute a reasonable fit with that goal.”  
*Id.*

<sup>81</sup> *Id.* at 2428-30. The Court's ruling on the requirement retailers place tobacco products behind counters and require customer contact with a salesperson is found in Part IIID of the opinion. The Court noted: (1) that the restrictions regulating the placement of tobacco products did so for reasons unrelated to the communication of ideas; (2) that the restrictions prevent self-service which allows minors to purchase tobacco products without direct contact with a sales person; (3) that the restrictions insure the salesperson has an opportunity to verify the purchaser's age as required by law; and (4) that the State has demonstrated a substantial interest in preventing access to tobacco products by minor and has adopted an appropriately narrow means of advancing that interest. *Id.* at 2429-30.

Government unsuccessfully attempted to justify a ban on commercial speech to achieve its desired end: prohibiting the display of alcohol strength on beer labels, prohibiting promotional advertisements for private commercial casinos, and prohibiting advertisements for compounded drugs. In each of those decisions, at least a majority of the Justices voting to overturn the prohibition on advertising.<sup>82</sup> Because there appears to be some slippage in *Western States* in number of Justices voting against the Government's prohibition against advertising, it may be helpful to examine in greater detail the dissenting opinion of Breyer, J., in which Rehnquist, C.J., Stevens, J. and Ginsburg, J. joined.

In his dissenting opinion, Breyer, J. contends that Government provided a two-fold safety objective for the advertising ban: (1) preventing large-scale manufacturing and sale of untested drugs that escape the FDA's scrutiny for safety and efficacy,<sup>83</sup> and (2) preventing the sale of compounded drugs to patients who do not need them, including compounded drugs produced in small amounts.<sup>84</sup> While both of these objectives were advanced as supportive of FDAMA § 503A, Souter, J. notes, the majority

---

<sup>82</sup> See *Rubin v. Coors Brewing Co.*, 514 U.S. 476, 477 (1995); *Greater New Orleans Broadcasting Assoc., Inc. v. United States*, 527 U.S. 173, 175 (1999); and *Thompson*, 122 S. Ct. at 1509.. The Justices disapproving the proposed ban on commercial speech in each of those opinions are as follows:

JUSTICE	COORS BREWING	GREATER NEW ORLEANS	WESTERN STATES
BREYER	X	X	
GINSBURG	X	X	
KENNEDY	X	X	X
O'CONNOR	X	X	X *
REHNQUIST	X	X	
SCALIA	X	X	X
SOUTER	X	X	X
STEVENS		X *	
THOMAS	X *		X

\* The author of the opinion with which the other Justices concurred.

<sup>83</sup> *Thompson*, 122 S. Ct. at 1510.

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

opinion addresses only the former interest.<sup>85</sup> Because of the latter interest, Souter, J. states, the Government cannot achieve its objective merely by concentrating on large-scale production of compounded drugs, but necessarily must prohibit all advertisements for particular compounded drugs, while limiting pharmacists to advertise only the availability of the service of compounding drugs.<sup>86</sup>

Moreover, because (1) "compounded drugs carry with them special risks" to the patient by "combining different ingredients in new, untested ways" that "can for some patients, mean infection, serious side effects, or even death," (2) "there is considerable evidence that consumer oriented advertising will create strong consumer-driven demand for a particular drug,"<sup>87</sup> and (3) there is "strong evidence that doctors will often respond affirmatively to a patient's request for a specific drug that the patient has seen advertised . . . even if they would not normally prescribe it . . . and even in the absence of special need,"<sup>88</sup> there is strong justification for prohibiting advertisements of compounded drugs, even in small amounts, aimed at consumers, rather than at their physicians.<sup>89</sup> Hence, a ban on the advertisement of all specifically identified compounded drugs is necessary in order for the Government to achieve its objective of assuring "that demand for an untested compounded drug originates with the doctor, responding to an individual's special medical needs" and restricting the distribution of untested drugs to those most likely to need it, thereby advancing the safety goals of the statute.<sup>90</sup>

Furthermore, Souter, J. notes, while all of the alternative means suggested in the majority opinion are effective in attaining the first

---

<sup>85</sup> *Id.* at 1510-11.

<sup>86</sup> *Id.* at 1510-11.

<sup>87</sup> *Id.* at 1512.

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

<sup>89</sup> *Id.* at 1513.

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

Government-identified objective, i.e., preventing large-scale manufacturing and sale of untested drugs that escape the FDA's scrutiny for safety and efficacy, none of the suggested means are capable of achieving the second, overlooked objective, i.e., preventing the sale of compounded drugs to patients who do not need them.<sup>91</sup> In short, Souter, J., claims, the majority opinion "gives insufficient weight to the Government's regulatory rationale and too readily assumes the existence of practical alternatives," and "thereby applies the *Central Hudson* test too strictly."<sup>92</sup> Hence, Souter, J. suggests that:

[T]he Constitution demands a more lenient application, an application that reflects the need for distinctions among contexts, forms of regulation, and forms of speech, and which, in particular, clearly distinguishes between "commercial speech" and other forms of speech demanding stricter constitutional protection. Otherwise, an overly rigid "commercial speech" doctrine will transform what ought to be a legislative or regulatory decision about the best way to protect the health and safety of the American public into a constitutional decision prohibiting the legislature from enacting necessary protections.

While it is impossible to predict whether plea of Souter, J. for "a more lenient application" of the *Central Hudson* test will come to fruition in the future, it is safe to say that *Western States* presented

---

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

<sup>92</sup> *Id.* at 1515.

a much closer, commercial speech question, in which serious government-advanced interests were involved and reasonable individuals may differ with respect to whether there is a reasonable fit between the government restriction on commercial speech and the achievement of the purported government interest. Time and perhaps the next commercial speech case may tell.

## VI. SUMMARY

In *Virginia Pharmacy*, the United States Supreme Court made its first clear statement that commercial speech was entitled to First Amendment protection, and came close to extending full First Amendment protection to commercial speech. Two characteristics of commercial speech emphasized in the opinion - its verifiability and durability - soon led to the conferral of only "intermediate" protection for commercial speech in *Central Hudson*.

While *Western States*, a case remarkably similar to *Virginia Pharmacy*, raised some hopes that the United States Supreme Court would accord commercial speech the full, First Amendment protection provided political speech, the Court declined to do so. Rather, the Court again applied the *Central Hudson* test in reaching its decision striking down the Government's attempt to ban advertisements by pharmacists for compounded drugs.<sup>93</sup> While the Court appears to have extended its recent practice of carefully analyzing the operation of the commercial speech restriction at hand, requiring the government to provide evidence that the restriction materially advanced the stated policy interest, carefully scrutinizing the purported efficacy of both the commercial speech restriction and the alternative means to achieve the stated policy end, and making sure the restriction was sufficiently tailored to its goal, the surprisingly strong coalition of votes assembled in the Court's three most recent commercial speech decisions, may be splintering. Hence, while the Central

---

<sup>93</sup> *Id.* at 1500.

Hudson appears to be alive and well, the heightened scrutiny employed by the United States Supreme Court may be waning.



USING AN ARBITRATION SIMULATION TO TEACH  
CRITICAL SKILLS

by

*Harvey M. Shrage\**

I. INTRODUCTION

A course in labor-management relations covers the gamut of the labor relations process from union organizing to the administration of the collective bargaining agreement.<sup>1</sup> The final part of the process, contract administration, includes a section on the grievance/arbitration process. Teaching this section of the course offers an opportunity to provide an active learning experience for students and an opportunity to meet a number of critical pedagogical goals. As noted by Professor Lucille Ponte, “student-

---

\* Professor, Western New England University, Springfield, Massachusetts. The author would like to thank Lakota Denton, WNEU Law ‘11, Christopher J. Sugar, Esq., WNEU, Law ‘10 and Casey D. O’Connell, WNEU, ‘12 for their research assistance. Special thanks to my wife for her continued support for my work.

<sup>1</sup> The course is also likely to cover other areas such as labor history and public sector labor relations. *See, e.g.*, ARTHUR A. SLOAN & FRED WITNEY, LABOR RELATIONS (13th ed. 2009); MICHAEL R. CARRELL & CHRISTINA HEAVRIN, LABOR RELATIONS AND COLLECTIVE BARGAINING: CASES, PRACTICE, AND LAW (9th ed. 2009); WILLIAM H. HOLLEY, JR., KENNETH M. JENNINGS & ROGER S. WOLTERS, THE LABOR RELATIONS PROCESS, (9th ed. 2009).



centered or active learning is critical to student comprehension and retention of course concepts and skills. Unfortunately, the learning process has traditionally focused on a teacher-centered model in which instructors transmit information and students are largely passive recipients of information.”<sup>2</sup> The purpose of this article is to describe an arbitration exercise that provides students with an opportunity to learn about the arbitration process, reinforces arbitration principles, and improves a student’s critical thinking skills, writing skills, listening skills, teamwork, and note taking skills in an “active learning” environment.

## II. THE PEDAGOGICAL BASIS FOR THE EXERCISE

### A. Active Learning

Active learning simulations in higher education provide students with skills critical to their success.<sup>3</sup> As Professors Reid and Weber noted, “[t]o involve the student in active learning is to engage the student, to encourage fuller use of the student’s mind. The challenge becomes finding the tool and techniques that will

---

<sup>2</sup> Lucille M. Ponte, *The Case of the Unhappy Sports Fan: Embracing Student-Centered Learning and Promoting Upper-Level Cognitive Skills Through an Online Dispute Resolution Simulation*, 23 J. LEGAL STUD. EDUC. 169, 175-76 (2006).

<sup>3</sup> AACSB INTERNATIONAL — THE ASSOCIATION TO ADVANCE COLLEGIATE SCHOOLS OF BUSINESS, ELIGIBILITY PROCEDURES AND ACCREDITATION STANDARDS FOR BUSINESS ACCREDITATION (revised Jan. 31, 2011), available at <http://www.aacsb.edu/accreditation/standards-2011-revised-jan2011-final.pdf>. See particularly AACSB Standard 13 that states in pertinent part: “Actively involve students in the learning process. Encourage collaboration and cooperation among participants. Ensure frequent, prompt feedback on student performance. Basis for Judgment: The school has processes to encourage, support, and assess faculty members in their own knowledge development. The school’s programs actively involve students in the learning process. Peer review teams should consider the totality of the learning experience (in-class, extracurricular, technology-based, etc.). The following are examples of ways students may be involved in their education: --Student involvement in the formulation and solution of business or management problems.” *Id.* at 55-56.

encourage the student to move from passivity to active learning.”<sup>4</sup> By engaging and challenging the student, teachers are requiring more critical thinking, genre specific writing, teamwork, note-taking and listening skills that are crucial skills for student success in school and in the workplace. These skills are most effectively developed through active learning, and in situations where students make decisions about the direction of their work.<sup>5</sup> For example, in his article *Active Learning Through Appellate Simulation: A Simple Recipe for a Business Law Course*, McDevitt states that because of changes in the world of business due to globalization and technology the classical business school model has undergone a change.<sup>6</sup> According to McDevitt:

Today business schools and their faculty have altered their curricula and pedagogical practices. One change of note is the increased use of active learning in business school courses. Rather than strictly lecturing, business faculties have their students engage in a plethora of exercises and simulations that reflect the real world of business and help develop the skills that managers in this new world require.

...

Regardless of the type of activity

---

<sup>4</sup> Linda A. Reid & Curt M. Weber, *Using Technology-Enabled Active Learning Tools to Introduce Business Ethics Topics in Business Law Courses: A Few Practical Examples*, 25 J. LEGAL STUD. EDUC. 283, 288 (2008).

<sup>5</sup> Nancy Walker Perry et al., *An Active Approach to Teaching the Undergraduate Psychology and Law Course*, TEACHING OF PSYCHOL., April 1996, at 76, 77; see also Donna M. Steslow, *My Car Is a Lemon! Use of the Better Business Bureau's Auto Line® Program as a Pedagogical Model of ADR*, 27 J. LEGAL STUD. EDUC. 105, 106 (2010).

<sup>6</sup> William J. McDevitt, *Active Learning Through Appellate Simulation: A Simple Recipe for a Business Law Course*, 26 J. LEGAL STUD. EDUC. 245, 248 (2009).

professors use, active learning exercises tend to be an important supplement to a classroom education. Participating in such exercises makes students proactive in their own learning, and they can develop and hone skills such as the ability to work in teams, collaborating, and communicating effectively through writing or oral presentation, all of which are transferable to the business world.<sup>7</sup>

### B. *Critical Thinking*

Active learning simulations support critical thinking, which is an essential skill to success in school and the workplace. The ultimate goal of critical thinking in the school setting and in the business world is to be able to examine one's own thinking, and to evaluate it and assess its validity.<sup>8</sup> Critical thinking provides the tools with which to examine one's own thinking and the thinking of others.<sup>9</sup> More specifically, critical thinking is "a set of skills that enable students to think logically, to present well-reasoned arguments, and to examine logically the arguments of others."<sup>10</sup> It involves "researching and evaluating all sides of an argument, and debating different viewpoints."<sup>11</sup> When students are asked to critically analyze multiple correct solutions to a problem, they learn

---

<sup>7</sup> *Id.* at 249.

<sup>8</sup> De Vee E. Dykstra, *Integrating Critical Thinking and Memorandum Writing into Course Curriculum Using the Internet as a Research Tool*, 42 C. STUDENT J. 920 (2008).

<sup>9</sup> Perry et al., *supra* note 5, at 77.

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

<sup>11</sup> *Id.* See also McDevitt, *supra* note 6, at 250 ("[G]iving students the opportunity to grapple with both sides of an argument provides them with a valuable lesson that there is often more than one way to view a problem and that seemingly logical arguments can be advanced for opposing positions.").

adaptability and flexibility.<sup>12</sup> When asked to determine a course of action based on their own thinking, and multiple correct solutions, students learn valuable critical thinking skills.<sup>13</sup>

### C. *Writing Skills*

Active learning simulations involve students in genre specific writing catered to a specific context. Genre specific writing requires students to analyze the context, audience and purpose of their writing, making them more successful writers.<sup>14</sup> Alternatively, writing skills taught in isolation of context and audience do not last as long, and do not translate to other writing situations.<sup>15</sup> Many students report that writing contextualized business reports best prepared them for success in the workplace.<sup>16</sup> In-class simulation writing combines critical thinking skills with contextual problem solving. This combination translates into writing expertise.<sup>17</sup>

### D. *Teamwork*

In addition to enhancing critical thinking skills, active learning simulations encourage teamwork. Communication, leadership, and the ability to work with people different from oneself are important skills learned through teamwork.<sup>18</sup> Teamwork skills are acquired during these exercises because of cooperative learning that “is generally defined as an instructional method that requires students

---

<sup>12</sup> Dykstra, *supra* note 8.

<sup>13</sup> *Id.*

<sup>14</sup> James M. Stearns et al., *Contexts for Communication: Teaching Expertise through Case-Based In-Basket Exercises*, 78 J. EDUC. FOR BUS. 213 (2003).

<sup>15</sup> *Id.* at 214.

<sup>16</sup> Barbara Schneider & Jo-Anne Andre, *University Preparation for Workplace Writing: An Exploratory Study of the Preparation of Students in Three Disciplines*, 42 J. BUS. COMM. 195, 200 (2005).

<sup>17</sup> Stearns et al., *supra* note 14, at 215.

<sup>18</sup> S.E. Kruck & Faye P. Teer, *Interdisciplinary Student Teams Projects: Case Study*, 20 J. INFO. SYS. EDUC. 325 (2009).

to learn through interaction with the students' peers in group settings, rather than confining learning activities to the students' individual efforts."<sup>19</sup> One way to teach cooperative learning amongst students is through team learning; "a specific and systematic method of cooperative learning that was developed explicitly for higher education and has been implemented in university classrooms across the country, particularly in business courses."<sup>20</sup> As S.E. Kruck and Faye Teer noted "cooperative work among students can increase learning."<sup>21</sup> Because many workplaces use teams to accomplish goals, it is important to teach our students the skills of teamwork.<sup>22</sup>

### E. Listening Skills

Additionally, active learning enhances listening skills. Listening skills are critically important in both academic and organizational environments.<sup>23</sup> In the business setting, managers spend a large portion of their time listening.<sup>24</sup> In that business context, effective listeners can gain important and accurate information necessary to better perform their position.<sup>25</sup> However, most people are ineffective listeners; they forget, ignore, or fail to understand up to 75% of what they hear.<sup>26</sup> Given the importance of listening skills,

---

<sup>19</sup> Laurie A. Lucas, Diane F. Baker & Dave Roach, *Team Learning Versus Traditional Lecture: Measuring The Efficacy of Teaching Method in Legal Studies*, 19 J. LEGAL STUD. EDUC. 63 (2008).

<sup>20</sup> *Id.* at 64.

<sup>21</sup> Kruck & Teer, *supra* note 18, at 328.

<sup>22</sup> Judith A. Kolb & Louise E. Sandmeyer, *Supporting Project Teams: A Framework Used in a University-Community Collaborative Initiative*, 21 PERFORMANCE IMPROVEMENT Q. 61 (2008).

<sup>23</sup> Steven Golen, *A Factor Analysis of Barriers to Effective Listening*, 27 J. BUS. COMM. 25 (1990).

<sup>24</sup> C. Glenn Pearce, Iris W. Johnson & Randolph W. Barker, *Enhancing the Student Listening Skills and Environment*, 58 BUS. COMM. Q. 28 (1995).

<sup>25</sup> Patricia A. Lynott, *Teaching Business Communication in an Accelerated Program*, 61 BUS. COMM. Q. 20, 22 (1998).

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

it is paramount that university classrooms prepare students to be better listeners.<sup>27</sup>

One of the most effective listening skills is active listening.<sup>28</sup> Active listening is characterized by listening with full attention, and participation in the speaking-listening exchange.<sup>29</sup> Active listeners consciously monitor and evaluate their understanding of what they hear.<sup>30</sup> Conversely, passive listening, which is characterized by inattentiveness and a withdrawal from the speaker-listener exchange, is the least effective form of listening.<sup>31</sup> A recent study found that only 2% of managers are classified as active listeners.<sup>32</sup>

Active listening is not achieved in settings which appear contrived or unrealistic to students because there is less motivation to follow through with the listening skills, or pay close attention.<sup>33</sup> Active listening is best practiced in environments where students are exposed to realistic situations which force students to listen more carefully.<sup>34</sup> For example, where instructors regularly interact with students, active listening is enhanced.<sup>35</sup>

---

<sup>27</sup> Pearce, Johnson & Barker, *supra* note 24, at 28.

<sup>28</sup> *Id.* at 29.

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

<sup>30</sup> Hsueh-Jui, Liu, *A Study of the Interrelationship Between Listening Strategy Use, Listening Proficiency Levels, and Learning Style*, 5 ANN. REV. EDUC., COMM. & LANGUAGE SCI. 84, 86 (2008).

<sup>31</sup> Pearce, Johnson & Barker, *supra* note 24, at 29.

<sup>32</sup> *Id.* at 28.

<sup>33</sup> Anissa Rogers & Benjamin Welch, *Using Standardized Clients in the Classroom: An Evaluation of a Training Module to Teach Active Learning Skills to Social Work Students*, 29 J. TEACHING SOC. WORK 153, 154 (2009).

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

<sup>35</sup> Pearce, Johnson & Barker, *supra* note 24, at 32.

## F. Note Taking

Integral to active listening is the note-taking process; unless adequate listening is taking place, meaningful note taking is unlikely to follow.<sup>36</sup> One of the major benefits to a student improving his or her note taking skill is that it will improve the student's ability to use information to perform well on examinations.<sup>37</sup> Although it is generally agreed that note taking is integral to academic success, college students often fail to record important information in their class notes.<sup>38</sup> One problem with the traditional classroom lecture is that students' note taking practices are not designed to record a majority of the lecture's critical ideas, or to examine the relationships among those ideas.<sup>39</sup> Consequently, a typical college student will only record between 30% and 40% of critical lecture points.<sup>40</sup> Students increase their ability to comprehend material when they have an organizational framework within which to organize their notes.<sup>41</sup> Students also increase their ability to comprehend material when they summarize their notes, reorganize their notes,<sup>42</sup> or use their notes to write conceptually based essays.<sup>43</sup> One report noted, "75% of experimental studies under review indicated that note takers who review their notes perform better than note takers who do not."<sup>44</sup>

---

<sup>36</sup> Robert L. Williams & Alan C. Eggert, *Notetaking in College Classes: Student Patterns and Instructional Strategies*, 51 J. GEN. EDUC. 173, 174 (2002).

<sup>37</sup> *Id.* at 178.

<sup>38</sup> Jennifer L. Austin, Melissa Lee & Jeffrey P. Carr, *The Effects of Guided Notes on Undergraduate Students' Recording of Lecture Content*, 31 J. INSTRUCTIONAL PSYCHOL. 314 (2004).

<sup>39</sup> Michael P. Ryan, *Conceptual Models of Lecture Learning: Guiding Metaphors and Model-Appropriate Notetaking Practices*, 22 READING PSYCHOL. 289, 290 (2001).

<sup>40</sup> Williams & Eggert, *supra* note 36, at 176.

<sup>41</sup> Ryan, *supra* note 39, at 305.

<sup>42</sup> James W. Dyer, James Riley & Frank R. Yekovich, *An Analysis of Three Study Skills: Notetaking, Summarizing, and Rereading*, 73 J. EDUC. RES. 3 (1979).

<sup>43</sup> Williams & Eggert, *supra* note 36, at 182-83.

<sup>44</sup> *Id.* at 181.

Research strongly suggests that critical thinking, writing, note taking, listening, and teamwork skills are essential to the educational success of students. Active learning simulations promote engagement in class beyond rote memorization by forcing students to examine, analyze and evaluate information.<sup>45</sup> When students engage in active learning, they use information at higher cognitive levels.<sup>46</sup> Additionally, a simulation “allows a student to use all of his or her resources—subject knowledge, audience knowledge, context knowledge, rhetorical knowledge, and basic writing skill—to deal with complex managerial decision making situations.”<sup>47</sup> Active learning simulations also support students’ own choices about the direction of their learning experience. To learn most effectively, students must act on self-generated goals, actively interact with materials, and initiate action to solve problems.<sup>48</sup> Relying upon the education principles described, the author has created an arbitration exercise to enhance skills critical to student success both in school and in their careers.

### III. AN OVERVIEW OF THE GRIEVANCE/ARBITRATION PROCESS

Approximately 99% of collective bargaining agreements include a grievance/arbitration procedure.<sup>49</sup> The grievance-arbitration procedure is intended to create a process to resolve disputes that arise during the term of the collective bargaining agreement between labor and management. Issues that move through the grievance/arbitration generally fall into two categories—discipline cases (which involve an employee or employees being disciplined) and contract interpretation cases (which involve a dispute

---

<sup>45</sup> Perry et al., *supra* note 5, at 77.

<sup>46</sup> *Id.*

<sup>47</sup> Stearns et al., *supra* note 14, at 217.

<sup>48</sup> PAULA DENTON, *LEARNING THROUGH ACADEMIC CHOICE* (2005).

<sup>49</sup> Kenneth G. Dau-Schmidt & Timothy A. Haley, *Governance of the Workplace: The Contemporary Regime of Individual Contract*, 28 *COMP. LAB. L. & POL’Y J.* 313, 317 (2007).



regarding an interpretation of the collective bargaining agreement). For example, a discipline case might involve an employee terminated for insubordination.<sup>50</sup> An example of a contract interpretation case might involve an employee who claims that his employer violated the collective bargaining agreement when he was refused retiree health benefits.<sup>51</sup> A typical grievance/arbitration process includes four steps.<sup>52</sup> Often, step 1 of the process involves the employee's immediate supervisor meeting with the employee and his or her union steward.<sup>53</sup> Steps 2 and 3 involve union representatives with increasing rank meeting with management representatives of increasing rank.<sup>54</sup> In the event the union and management cannot resolve the grievance during the first three steps of the process, the grievance goes before a neutral third party arbitrator. In addition to including a grievance-arbitration procedure, 97% of collective bargaining agreements include a "just cause" provision.<sup>55</sup> The inclusion of a "just cause" standard significantly expands the rights of an "at-will" employee.<sup>56</sup> Over the years, the "just cause" standard has become relatively well defined. Arbitrator Dougherty, whose "seven questions" have become standard in defining just cause<sup>57</sup> posited

---

<sup>50</sup> Union Twp. Bd. of Trs., 125 Lab. Arb. Rep. (BNA) 1638 (2008) (Rosen, Arb.).

<sup>51</sup> City of Twinburg, 128 Lab. Arb. Rep. (BNA) 698 (2010) (Cohen, Arb.). See also Sw. Airlines, 128 Lab. Arb. Rep. (BNA) 534 (2010) (Jennings, Arb.) (failure to assign overtime to employee).

<sup>52</sup> Laura Cooper, *Discovery in Labor Arbitration*, 72 MINN. L. REV. 1281, 1284-85 (1988).

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

<sup>54</sup> See Collective Bargaining Agreement between American Postal Workers Union and U.S. Postal Service, 96-99 (Nov. 21, 2006), <http://www.apwu.org/dept/ind-rel/sc/APWU%20Contract%202006-2010.pdf>.

<sup>55</sup> Dau-Schmidt & Haley, *supra* note 49, at 317.

<sup>56</sup> Carlson v. Arnot-Ogden Mem'l Hosp., 918 F.2d 411, 414 (3d Cir. 1990) ("Under employment at-will, 'employees may be discharged at any time, for any reason, or for no reason at all.'").

<sup>57</sup> Sycamore Bd. of Educ., 123 Lab. Arb. Rep. (BNA) 1588, 1597 (2007) (Van Pelt, Arb.) (citing Enterprise Wire Co., 46 Lab. Arb. Rep. (BNA) 359 (1966) (Dougherty, Arb.)).

that in order for an employer to establish just cause for termination: 1) the employer must provide notice to the employee of possible discipline for the employee's conduct; 2) the rule must be reasonable and related to management's "orderly, efficient, and safe operation of the company's business;" 3) the employer must make reasonable efforts to determine if the employee did in fact violate the rule or policy; 4) the employer's investigation of the violation must be fair and objective<sup>58</sup>; 5) there must be "substantial evidence or proof that the employee was guilty as charged; 6) the employer must apply the punishment evenhandedly to all employees; and 7) the discipline must be reasonable given the offense and mitigated by the employees length of service and prior discipline with employer."<sup>59</sup>

Although arbitration is viewed as somewhat informal, the arbitration hearing has many of the trappings of a court trial.<sup>60</sup> The case is generally heard by a single arbitrator, akin to a judge hearing a case without a jury.<sup>61</sup> Management and the union are usually represented by an advocate who may be an attorney. However, unlike a formal judicial proceeding, the advocate is not required to be a lawyer and non-lawyers trained in the field of labor-management relations represent labor and/or management in a number of employment settings.<sup>62</sup> One other difference between an arbitration hearing and a judicial trial is that a stenographic

---

<sup>58</sup> See, e.g., *id.* at 1598 ("[I]f the investigation is less than full and fair, and if management has shown bias or been less than objective in its consideration of the facts, the validity of the employer's cause is called into question.")

<sup>59</sup> *Id.* at 1597 n.1.

<sup>60</sup> Judith A. McMorrow, *The Advocate As Witness: Understanding Context, Culture and Client*, 70 *FORDHAM L. REV.* 945, 975 (2001).

<sup>61</sup> LABOR AND EMPLOYMENT ARBITRATION, § 7.02[1] (Matthew Bender 2010).

<sup>62</sup> See *id.* § 3.02[1] ("[M]any arbitration advocates are lawyers . . . [b]ut legal training is not required to appear before an arbitrator."). During my twenty-three years as a labor arbitrator, non-lawyer advocates have appeared before me representing the United States Postal Service and the various Postal Service Unions, as well as in cases involving various municipal, state and federal employers, and the unions representing their respective employees.

record is not generally kept of an arbitration proceeding thus forcing the arbitrator to take detailed notes of the proceedings.<sup>63</sup> In order to ensure that the arbitrator leaves the hearing with a complete record of the testimony, an arbitrator must possess excellent listening skills and excellent note taking skills.

Generally, the case begins with the arbitrator working with both sides to frame the issue or issues to be considered at the hearing. A typical issue statement in a discipline case would be: “Was the discipline of Employee X for just cause? If not, what shall be the remedy?”<sup>64</sup> In a contract interpretation case, the issue agreed upon could read: “Did the Employer violate Section X of the Collective Bargaining Agreement by refusing to pay employee Y for working overtime? If so, what shall the remedy be?”<sup>65</sup> After the issue is framed, each side usually will make its opening statement. The opening statements are intended to provide the arbitrator with a “roadmap” of the arguments of each side.<sup>66</sup> However, the advocates’ opening statements are not evidence in the case, and are not relied upon by the arbitrator in making his or her decision.<sup>67</sup> Once the opening arguments are completed the side with the burden of proof calls its first witness. In a discipline case, the employer has the burden of proof while in a contract interpretation case the burden is on the union.<sup>68</sup> Each witness is “examined” and “cross-examined” by each advocate. The rules of evidence are not strictly adhered to in arbitration proceedings,<sup>69</sup> since “arbitration is

---

<sup>63</sup> *Id.* § 1.03 (2010).

<sup>64</sup> Stroehmann Bakeries, 98 Lab. Arb. Rep. (BNA) 873 (1990) (Sands, Arb.).

<sup>65</sup> Progress Energy Fla. Inc., 126 Lab. Arb. Rep. (BNA) 1121 (2009) (Baroni, Arb.).

<sup>66</sup> LABOR AND EMPLOYMENT ARBITRATION, *supra* note 61, § 1.03[5][a].

<sup>67</sup> Ariana R. Levinson, *Lawyering Skills, Principles and Methods Offer Insight as to Best Practices for Arbitration*, 60 BAYLOR L. REV. 1, 62-64 (2008).

<sup>68</sup> LABOR AND EMPLOYMENT ARBITRATION, *supra* note 61, § 5.06.

<sup>69</sup> LABOR AND EMPLOYMENT ARBITRATION, *supra* note 61, § 1.01[7][c]. In my years serving as an arbitrator, I have found that finding a balance between strict adherence to the rule of evidence and a “lax” view of the rules is critical to

widely recognized as a more informal and less highly structured forum for dispute resolution than civil litigation. It also operates with a contractual underpinning that is dissimilar in many respects to a commercial contract.”<sup>70</sup> Documents relevant to the case are introduced into evidence either through the agreement of the parties or through the testimony of a witness with first-hand knowledge of the origin of the document. After all the relevant evidence is introduced, each side either has an opportunity to orally argue its case to the arbitrator or the parties agree to submit written briefs to the arbitrator at some mutually agreeable time after the close of the hearing.

Either after hearing oral argument or after receiving the written briefs submitted by the parties, the case is “ripe” for the decision of the arbitrator.<sup>71</sup> Although the format for an arbitration decision varies somewhat according to the style of the arbitrator, decisions generally follow a format that includes: Issue or Issues Presented, Facts, Summary of Positions of the Union and Employer, Relevant Contract Provisions, Analysis and Decision. It has been my experience that the format for the arbitration decision provides students with a particularly “friendly” writing environment to help them organize their writing. In addition, the “just cause” standard used by an arbitrator to decide discipline cases provides a systematic approach that students can understand and use in their analysis.

---

running a hearing that allows both sides to fully present its case and promotes an efficient hearing.

<sup>70</sup> LABOR AND EMPLOYMENT ARBITRATION, *supra* note 61, § 5.01.

<sup>71</sup> Arbitrators appointed to arbitration cases under the auspices of the American Arbitration Association are expected to issue a decision within 30 days of receipt of briefs. *Labor Arbitration Rules*, AMERICAN ARBITRATION ASSOCIATION (July 1, 2005), <http://www.adr.org/sp.asp?id=25730#3>.

#### IV. THE EXERCISE

##### A. *The Arbitration Process – An Educational Platform for Learning*

In creating this exercise, some modification of the above described arbitration process was made to allow for an increased educational benefit to the students and to provide a more “user friendly” platform for both the students and instructor. For example, the exercise allows the students to use a modified version of “Dougherty’s” just cause standard that has been relied upon by labor arbitrators. This “modified” version consists of four factors: evidence that the employee is actually guilty of the offense, had notice that he or she was committing a disciplinary offense, was treated in a consistent manner with other employees, and was penalized in a just manner for the offense committed.<sup>72</sup> In addition, the exercise does not include either an “opening” or “closing” statement or written briefs. The exclusion of such “arguments” allows the instructor to require students to develop those arguments based upon their understanding of the facts, relevant contract/handbook provisions, and the just cause standard.

##### B. *Student Preparation Prior to the Start of Exercise*

The success of any classroom exercise or simulation is dependent upon students having a sufficient foundation prior to the start of the exercise. It is essential that students have a clear understanding of the arbitration process and the underlying principles relied upon by both advocates and arbitrators. Students need to understand how the collective bargaining agreement relates to the grievance-

---

<sup>72</sup> This includes consideration of whether the employer applied the principle of “progressive discipline”, and whether mitigating circumstances exist to justify reducing the penalty imposed by the employee. *See* 2008 AAA LEXIS 1432 (Shrage, Arb.); 2008 AAA LEXIS 1008 (Shrage, Arb.); 2008 AAA LEXIS 1143 (Shrage, Arb.).

arbitration process. Specifically, they should know that the “authority” of the arbitrator stems from the grievance-arbitration provision in the collective bargaining agreement. Moreover, students must have an understanding of the “just cause” standard. Furthermore, students must understand the basic rules of contract interpretation and how those rules interplay with the provisions of the collective bargaining agreement.

### *C. Teams*

The class is divided into teams of four students. Using a team approach provides students with an opportunity to work on their team building skills. It also provides students with a support group in applying newly learned concepts. Teams are not designated as “union” or “company” advocates. Although students learn that the arbitration process is adversarial, the teams are asked to evaluate the problem as if they were performing a neutral evaluation. The rationale for not designating the teams as union or company is to allow students to gather all the information that they think relevant to the case instead of only the information that would be helpful to the side they are representing.

### *D. Creating the Arbitration Problem*

Although the problem can be created to either reinforce principles of discipline or contract interpretation, for the purposes of this article, I will use a discipline case as the basis of the exercise. At the start of the exercise, each team is provided with a one-page fact narrative. It is critical that the narrative provides no more than the “skeleton” of the fact pattern and that certain key facts are left out of the problem (See Appendix A). In providing only a “skeleton” of the facts involving a discipline case, each team will have an opportunity to review the facts given to them, and consider what additional information they need to gather to fully analyze the case under the “just cause” standard. As described above, one element of the just cause principle is proof that the employee actually

committed the offense upon which the discipline was based. Thus, the facts included in the problem must be sufficiently vague to allow students to prepare a series of questions regarding the conduct or incident and to encourage the students to engage in a full analysis of the facts.

*E. Materials Provided to Each Team*

Each team is provided with a copy of the “facts” (Appendix A), excerpts from the collective bargaining agreement between the company and the union, and excerpts from the company employee handbook. Although excerpts are used to avoid students from becoming “overwhelmed” by too much information, the excerpts provided go beyond those sections of the collective bargaining agreement and employer handbook that are “relevant” to the problem. In providing more than the “relevant” sections of the two documents, teams are required to consider what sections are relevant in light of the facts gathered, and the “just cause” standard. In addition, students are provided with a “template” or outline of the headings for the arbitration decision.<sup>73</sup>

*F. Team Evaluation of “Skeletal Facts” – Preparing the Case for Arbitration*

Each team is given 45 minutes in class to: evaluate the problem; consider what additional information is necessary to fully analyze the problem; and determine what “witness” will likely have the information they are seeking; and develop a series of questions to ask each witness during the “hearing” to illicit the information.<sup>74</sup>

---

<sup>73</sup> In preparation for the exercise, the class has reviewed and discussed full text arbitration decisions to illustrate various arbitration principles and to familiarize students with the format for an arbitration decision.

<sup>74</sup> As previously noted, teams are instructed to develop questions from both the union and employer perspective. This allows a full evaluation of the case by the students, and allows the combining of the pre-arbitration

Determining what additional information is required and the appropriate witnesses required to establish the facts of a case is a process that is not only critical to the grievance-arbitration process, but is also critical in all situations in which an employer asks an employee to evaluate a problem. Requiring students to articulate the information needed in writing, coupled with requiring them to articulate a clear and concise question to elicit the information allows the instructor to determine whether they fully understand the application of the facts to the “just cause standard.”

### G. *The “Hearing”*

As in an actual arbitration hearing, the teams have prepared their “Q’s and A’s” for the witnesses. The instructor plays the role of each witness. In playing each witness the instructor is in the position to: frame his or her responses to help the students identify vague questions that will not illicit the information; and identify those questions that are not relevant to the case or would require a “hearsay” response.<sup>75</sup> Each team is given an opportunity to ask one question during each of three rounds of questioning. The team must identify the “witness” to whom the question is being directed. For example, if an employee was disciplined for sleeping on the job, Team 1 might call as a witness the supervisor that observed the employee sleeping. All students in the class are expected to take careful notes of the question and answer provided by each “witness.” This “note taking” process is intended to simulate the note taking process of a labor arbitrator. The process is also intended to sharpen student listening and note taking skills. After three rounds of questioning the “witnesses,” the teams caucus for

---

investigation/“information request” aspect of the grievance procedure with the hearing process.

<sup>75</sup> In teaching the labor-management course, I spend part of one class teaching the basics of the rules of evidence. In particular, the rules concerning relevancy and the rules of hearsay. My experience as a labor arbitrator has led me to the conclusion that they are the two most rules frequently used during arbitration hearings.



fifteen minutes to consider what follow up questions they would like to ask as a result of the responses given to their questions during “phase 1” of the hearing. After the caucus, each team is given an opportunity to ask one question during each of two rounds of “rebuttal.” After two rounds of “rebuttal” questioning, the arbitration hearing is closed.

#### H. *Decision Writing*

At the conclusion of the “arbitration hearing” the exercise moves from a team exercise to an individual student assignment. Each student is required to write his or her own arbitration decision. Students are instructed that they are prohibited from consulting with their “former” team members. As in the case of an actual arbitration, each student leaves with his or her notes from the hearing, contract language, and any documents that may have been provided to the students as “evidence” in the case.<sup>76</sup> In short, if they have taken careful notes, each student will have the questions and responses of each witness called during the case, the “skeletal facts,” contract provisions and company rules provided by the instructor, and any other documents “received into evidence” as a result of the questions asked by the students. Students are required to follow the format for an arbitration decision provided by the instructor. Students are also permitted to refer to the full-text arbitration decisions provided to them in class to assist them with regard to format and to use as “precedent” in writing the decision.<sup>77</sup>

---

<sup>76</sup> For example, if the Human Resource Manager is called as a witness and is asked for a copy of the letter of discipline, I will provide a copy of the letter to the students as a document “received into evidence.”

<sup>77</sup> I am careful in selecting “precedent” to provide students. Precedent plays a different role in arbitration than it does in the courts. See Timothy J. Heinsz, *Grieve it Again: Of Stare Decisis, Res Judicata and Collateral Estoppel in Labor Arbitration*, 38 B.C. L Rev. 275 (1997) (“[T]he decisions by other arbitrators may be persuasive but they are not binding on a subsequent arbitrator.”).

The various sections of an arbitration decision are well suited to have students consider all possible outcomes. At the outset, the student must identify the issue that has been presented by the union and company. In the second section of an arbitration decision, students are asked to fully describe in narrative format the facts of the case. In this section students must incorporate the facts that were provided in the “skeleton facts” with the facts gathered from “witnesses.” In the “position of parties” section, each student must articulate the arguments that would be presented by each side.<sup>78</sup> In the relevant contract/company rules section, each student must determine which, if any, of the contract provisions/rules provided by the instructor are relevant to the case. In the final section, the student is expected to provide a well reasoned decision by applying the facts of the case to the arbitration principles and contract language/company rules applicable to the issue.

## V. ASSESSMENT

As noted at the outset of this article, the purpose of the exercise is to enhance student learning about the arbitration process, and to improve several skill sets including critical thinking skills, teamwork, listening skills, note taking skills, and writing skills. By participating in the exercise, the students provide their instructor with a body of materials that allows for an individual assessment of each of these areas. Each student is expected to submit to the instructor a “portfolio” that includes the following: questions compiled by their team for witnesses; individual notes taken by the student during the witness examination phase of the exercise; the arbitration decision of the student. A review of the team

---

<sup>78</sup> In a typical arbitration decision, the “position of the parties” section would reflect the position articulated by each side during closing arguments or submitted to the arbitrator in closing briefs. The “arbitration exercise” requires students to develop on their own the arguments for each side. This provides the student writer with an opportunity to consider the case from the position of the advocate for the union and the company, as well as the arbitrator.

submissions allows some level of evaluation of the ability of the team to work together.<sup>79</sup> It also allows for an evaluation of the ability of the team to understand and apply the “legal/arbitration” principles to the skeletal facts provided by the instructor. A review of the individual student notes of the “hearing” will allow an assessment of the student’s listening skills as well as note taking skills. A review of the individual student arbitration “decision” allows for a critical assessment of the student’s understanding of the basic legal/arbitration principles as well as an appraisal of their writing skills and critical thinking skills. Although an overall review of the decision will allow an assessment of the student’s overall writing, the “background/fact” section will allow an assessment of the student’s ability to synthesize their “notes” into a coherent and organized description of the facts of the case.

## VI. CONCLUSION

One of the significant areas of study in a labor-management relations course is the section covering contract administration. This section includes the study of the grievance-arbitration process. The study of the grievance-arbitration process offers an opportunity to provide an active learning experience for students and an opportunity to meet a number of critical pedagogical goals. Active learning simulations in higher education provide students with skills critical to their success. As noted in one study, when students engage in active learning, they use information at higher cognitive levels.<sup>80</sup> Researchers studying active learning simulations found that students learned content equal to that of students in a passive learning lecture method, but learned thinking and writing skills more effectively.<sup>81</sup> The arbitration process requires an arbitrator to use many of the skills important to student success in the classroom and in their careers. The arbitration

---

<sup>79</sup> See Susan W. Dana, *Implementing Team-Based Learning in an Introduction to Law Course*, 24 J. LEGAL STUD. EDUC. 59, 78-80 (2007).

<sup>80</sup> Perry et al., *supra* note 5, at 77.

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

simulation described in this article helps students improve their critical thinking, writing, teamwork, listening, and note taking skills.

#### APPENDIX A

Sally was employed as a housekeeping employee at Eastern State, Inc. on June 25, 2007. Service Workers United Union represents Eastern State employees. Eastern State has an “Associate Handbook” (“Handbook”). Among the work rules and regulations addressed in the Handbook is the following:

No one is permitted to record another associate's time. An associate who fraudulently records his/her time or the time of another associate may be disciplined.

Eastern State uses a time clock to record the work hours of employees. Employees punch in and out for lunch between 12:00 p.m. and 1:00 p.m.

On December 1, Sally and employee George were returning to work at the expiration of their lunch break. Sally was on her cell phone talking to the nurse at her daughter’s elementary school. Sally asked George to punch her in so that she could finish her phone call. After spending two additional minutes on her cell phone speaking to the nurse, she went to her workstation.

Sally’s timecard records show that the timecards of both employees were punched at 12:59 p.m., one minute before the end of the lunch break.

Later that day Sally was terminated for having another employee punch her into work after lunch.

The Union filed a grievance challenging Sally's termination. The matter was not resolved through the first three steps of the grievance procedure and is ripe for arbitration.

**- END ARTICLES -**



## INFORMATION FOR CONTRIBUTORS

### I. MANUSCRIPT SUBMISSION PROCESS

All submissions to the *Journal* are double blind peer reviewed. The current acceptance rate for the *Journal* is less than 25%.

The *Journal* does not accept published manuscripts or those that will be published elsewhere. Manuscripts may be sent simultaneously to other journals on the condition that the *Journal* is advised, and that the author(s) undertake to inform the appropriate editor immediately if the work is accepted for publication elsewhere. All manuscripts should be sent to via email to:

Brian J. Halsey  
Editor-in-Chief, Atlantic Law Journal  
Email: bhalsey@wcupa.edu

### II. COPY

The author is primarily responsible for compliance with this system of citation and for the accuracy of the notes.

1. Papers should be no more than 20 single-spaced 8.5 x 11 sized pages, including footnotes. Use 12 point Times New Roman font. Skip lines between paragraphs and between section titles and paragraphs. Use full justification. Do not indent paragraphs.

2. Do not number pages. Page numbers will be inserted in the editing process.

3. Margins: 1/2 inch on all sides.

4. Upon acceptance, the first page must have the following format: the title should be centered in CAPITAL LETTERS, on



line 5. On line 7 center the word "by". On line 9 center the author's name followed by an asterisk (\*). Your first footnote shall be an asterisk footnote designating the author's position or title and affiliation. Begin text on line 15.

5. Headings:

I. FIRST LEVEL (caps, flush with left margin).

A. *Second Level* (center italics).

*Third Level:* (flush with left margin, italics, followed by a colon).

6. Charts: Any graphs, charts, table, or other illustrations must be finished and inserted into the proper location in the paper in camera-ready form suitable for reproduction. Do not use figures that will become illegible when reduced to journal page size. Any exhibits included must be numbered, have clear self-explanatory headings, and, if appropriate, the source at the bottom.

7. Footnotes should conform to the latest edition of *The Bluebook, A Uniform System of Citation*. Footnotes are to be placed at the bottom of each page in 10 point Times Roman typeface. Use full justification. Use Microsoft Word's function of embedding footnotes into the text. Do not attempt to manually create footnotes at the bottom of the text. Do not skip lines within the footnotes. Footnotes that do not reasonably conform to the Bluebook at submission constitute grounds for rejection of your manuscript.

III. ACTION

Consideration of manuscripts is normally completed by the annual meeting of the Mid-Atlantic Academy for Legal Studies in Business in late March or early April. Manuscripts are accepted for consideration on a continual basis throughout the year.

Accepted manuscripts normally are published electronically and in hard copy digest form in the summer of each year. Authors are expected to proofread edited clean hard copy, galley proofs, or page proofs. Authors are solely responsible for the content of their articles.

#### IV. COPYRIGHT NOTICE

The authors have granted to the *Journal* and its publisher a nonexclusive license throughout the world to publish, reproduce, distribute, and use their articles in all print or electronic formats and all languages, either separately or as part of a collective work, including but not limited to the nonexclusive right to publish the articles in an issue of the *Journal*, copy and distribute individual reprints of the articles, authorize reproduction of the articles in another publication by the Journal, and authorize the reproduction and distribution of the articles or an abstract thereof by means of computerized retrieval systems.

The authors retain ownership of the copyright in the articles, and all rights not expressly granted to the *Journal* in the *Atlantic Law Journal Publication and Copyright Agreement* authors must execute before publication.

#### V. GENERAL CORRESPONDENCE

All general correspondence should be addressed to:

Brian J. Halsey  
Editor-in-Chief, Atlantic Law Journal  
329 Anderson  
West Chester University of Pennsylvania  
West Chester, Pennsylvania 19383

Email: [bhalsey@wcupa.edu](mailto:bhalsey@wcupa.edu)





**- END -**