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ACADEMY FOR STUDIES IN BUSINESS LAW JOURNAL

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LETTER FROM THE EDITOR

Welcome to the third edition of the *Academy for Studies in Business Law Journal*. The Academy for Studies in Business Law is an affiliate of the Allied Academies, Inc., a non profit association of scholars whose purpose is to encourage and support the advancement and exchange of knowledge, understanding and teaching throughout the world. The *ASBLJ* is a principal vehicle for achieving the objectives of the organization. The editorial mission of this journal is to publish legal, empirical and theoretical manuscripts which advance the discipline.

The articles contained in this volume have been double blind refereed. The articles in this issue of the journal represent both submissions to conferences and direct submissions from authors and they conform to our editorial policies.

We are introducing a new Editor for this Edition as well. We wish her well in her endeavors and look forward to a good working relationship.

JoAnn and Jim Carland
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Articles

FROM *POSADAS* TO *GREATER NEW ORLEANS*: EXPANDING COMMERCIAL SPEECH PROTECTION FOR THE GAMING AND ALCOHOL INDUSTRIES

Edward J. Schoen, Rowan University

ABSTRACT

In the past thirteen years, the United States Supreme Court has ventured at least five times into the constitutionality of advertising restrictions for two so called vice industries: gambling and alcoholic beverages. On June 14, 1999, the United States Supreme Court, in its most recent foray into the area, ruled in Greater New Orleans Broadcasting Association, Inc. v. United States ("Greater New Orleans"), 527 U.S. 173, 119 S.Ct. 1923, 144 L.Ed.2d 161 (1999), that a federal statute and related Federal Communications Commission regulations prohibiting radio and television broadcasters from carrying advertisements about privately operated commercial casino gambling, regardless of the casino's location, violate the First Amendment.

A close examination of New Orleans and its four compatriot decisions provides an interesting framework within which to view and analyze the shifting tides of First Amendment protection of commercial speech in the vice industries.

That analysis demonstrates that Greater New Orleans arguably provides the most extensive First Amendment protection for such advertisements, and that the United States Supreme Court (1) may now be willing to examine the advertising

restrictions more scrupulously when the restriction seeks to achieve an end not directly related to the inherent fairness of the bargain, (2) appears to be more willing to require the government to provide evidence that the stated policy end is substantial and that the restriction being evaluated materially and directly advances the stated policy end, (3) appears to be more willing examine the regulatory landscape in which the restriction operates to make sure the restriction will not be undermined by contradictory or inconsistent policies, (4) appears to be more attentive to the existence and operations of alternative means to achieve the stated policy end to make sure the restriction being examined is sufficiently tailored to its goal, and (5) has retreated on the "greater included the lesser" reasoning. In short, it appears that United States Supreme Court has given greater First Amendment protection to commercial speech promoting gambling and alcoholic beverages.

The purposes of this paper are to provide detailed analysis of the United States Supreme Court's decisions in the five key decisions, to examine how the court's application of the Central Hudson test, the traditional framework for resolving commercial speech decisions, has evolved in favor of vice industry advertisements, and to argue that the United States Supreme Court's most recent foray into the constitutionality of restrictions on advertisements for gambling and alcoholic beverages bodes well for protection of commercial speech.

INTRODUCTION

In *Greater New Orleans Broadcasting Association, Inc. v. United States ("Greater New Orleans"),*[1] the United States Supreme court ruled that a federal statute and related Federal Communications Commission regulation[2] prohibiting radio and television broadcasters from carrying advertisements about privately operated commercial casino gambling, regardless of the casino's location, violated the First Amendment.[3] This decision constitutes the court's fifth foray over the past thirteen years into the constitutionality of advertising restrictions for two so called vice industries: gambling and alcoholic beverages.[4] An examination of those decisions provides an interesting framework within which to view and analyze the shifting tides of First Amendment protection of commercial speech.

As the ensuing discussion of those five decisions will demonstrate, several significant changes are detectable: the United States Supreme Court now appears to be less willing to accept the government proffered justification for advertising restrictions, to be more willing to demand evidence that the proposed advertising restriction is truly needed to achieve the purported purpose of the advertising restriction, to be more demanding of a coherent governmental policy supporting the advertising restriction, and to be more receptive to arguments that less restrictive measures are more efficacious in achieving the ends for which the advertising restrictions are aimed.

CONSTITUTIONALITY OF REGULATIONS LIMITING GAMBLING AND ALCOHOLIC BEVERAGE PROMOTIONS

The following five United States Supreme Court opinions, which form the basis for this article, determined the constitutionality of federal and state restrictions on advertisements for casino and lottery gambling and on advertisements of prices and alcohol content of liquor and beer.

(1) *Posadas de P.R. Assoc. v. Tourism Co. of P.R.*

In *Posadas de Puerto Rico Associates v. Tourism Company of Puerto Rico (“Posadas”),*[5] the operator of a Puerto Rican gambling casino requested declaratory judgment determining that a Puerto Rico statute and regulations prohibiting the advertising of casino gambling to residents of Puerto Rico, who were not banned from using the casinos, violated its commercial free speech rights under the Constitution. The gambling casinos were permitted to advertise the casinos within Puerto Rico if the primary audience for the advertisement was tourists; they could not advertise the casinos if the primary audience was the local public. While the Superior Court of Puerto Rico acknowledged the advertising restrictions had been applied unconstitutionally to the casino's past conduct, it adopted a narrow construction of the statute and regulations and determined that the statute and the regulations were facially constitutional. The Supreme Court of Puerto Rico dismissed the casino's further appeal on the ground that it did not present a substantial constitutional question.

On appeal to the United States Supreme Court, Justice Rehnquist, writing for the majority and applying the four-prong *Central Hudson* test,[6] held that the statute and regulations, as construed by the Puerto Rico Superior Court, did not facially violate the First Amendment, and was not constitutionally vague in light of the narrowing construction of the statute and regulations provided by the Puerto Rico Superior Court.[7] With respect to the first *Central Hudson* prong, the Supreme Court determined that the advertisements concerned a lawful activity and were not misleading or fraudulent.[8] With respect to the second prong, the Supreme Court determined that reducing demand for casino gambling by the residents of Puerto Rico was a substantial governmental interest.[9] With respect to the third prong, the Supreme Court determined that the regulation directly advanced the government's asserted interest in reducing gambling by residents of Puerto Rico.[10] In doing so, the court granted great deference to the Puerto Rico legislature, which, the Supreme Court of the United States felt, "obviously believed" that advertising would increase demand for casino gambling, even though the advertising restrictions were not applied to other more traditional forms of gambling in Puerto Rico, such as horse racing, cockfights and the lottery.[11] With respect to the fourth prong, the Supreme Court determined that the restrictions on advertising were no more extensive than necessary to serve the government's interest.[12] In doing so, the court again granted great deference to the Puerto Rico legislature, by noting that the legislature could, and apparently did, determine that less restrictive approaches were not as effective in reducing the demand for casino gambling. Concluding that the *Central Hudson* test had been met, the Supreme Court upheld the lower courts' decisions.

Finally, addressing the casino's argument that because casino gambling was legal, advertising for casino gambling could not be restricted under the First Amendment, the Supreme Court noted:

> In our view, [the casino] has the argument backwards. . . . [I]t is precisely *because* the government could have enacted a wholesale prohibition of the underlying conduct that it is permissible for the government to take the less intrusive step of allowing the conduct, but reducing the demand through restrictions on advertising. It would surely be a Pyrrhic victory for casino owners . . . to gain recognition of a First Amendment right . . . only to thereby force the legislature into banning casino gambling by residents altogether. It would just as surely be a strange constitutional doctrine which would concede to the legislature the authority to totally ban a product or activity, but deny to the legislature the authority to forbid the stimulation of demand for the product or activity through advertising.[13]

The obvious implication of the above quoted language is that, as long as a governmental unit has authority to ban an activity, it may have authority to ban advertisement for that activity. Notably, however, the Supreme Court did not resort to the “power to ban activity” is equal to the “power to ban advertisement for activity” until after it had applied *Central Hudson* test, an indication that the advertising ban must be scrutinized under First Amendment principles regardless of the power to ban the activity advertised.[14]

Clearly *Posadas* provides little, if any, protection to commercial speech. The court is extremely deferential to stated governmental policy in applying the third and fourth prong of the *Central Hudson* test, taking at face value the legislature's belief that advertising would increase demand for casino gambling and that less restrictive measures would not be effective in reducing demand for casino gambling. The court also overlooks inconsistent government policies on other forms of gambling, and fails to demand even minimal evidence that the government policy under review will achieve its desired end or that less restrictive alternatives may be effective in achieving that end. Under *Posadas*, then, infringements on commercial speech can pass constitutional muster as long as they are camouflaged with express statements of government policy.

(2) *United States v. Edge Broadcasting Co.*

In *United States v. Edge Broadcasting Co.("Edge Broadcasting"),*[15] the United States Supreme Court ruled that a federal statute prohibiting radio broadcast of lottery advertisements by licensees located in a state that does not allow the lottery[16] did not violate the First Amendment.[17]

Respondent, Edge Broadcasting ("Edge"), owned and operated a radio station which was licensed by the F.C.C. to serve a North Carolina community, and broadcast from near the Virginia-North Carolina border. North Carolina is a nonlottery state, and Virginia is a lottery state.[18] Over 90% of Respondent's listeners were in Virginia, but the remaining listeners lived in North Carolina.[19] Wishing to broadcast Virginia lottery advertisements, Edge filed a declaratory judgment action, alleging that, as applied to it, the lottery broadcast restriction violated the First Amendment and the Equal Protection Clause, and requesting declaratory judgment that §§1304 and 1307, together with corresponding FCC regulations, violated the First Amendment and the Equal Protection Clause of the Fourteenth, as well as injunctive protection against the enforcement of those statutes and regulations.[20]

The District Court assessed the restriction under the four-factor test for commercial speech set forth in *Central Hudson*, and concluded that the statutes, as applied to Edge, did not directly advance the asserted governmental interest.[21] The Court of Appeals affirmed in a per curium opinion,[22] and the United States Supreme Court, applying the *Central Hudson* test, reversed.[23]

With respect to the first prong, the United States Supreme Court assumed that Edge, if allowed to, would air nonmisleading advertisements about the Virginia lottery, a legal activity.[24] With respect to the second prong, the court, citing *Posadas,* indicated it was "quite sure" that the Government has a substantial interest in supporting the policy of nonlottery States, as well as not interfering with the policy of States that permit lotteries.[25] With respect to the third prong, the court stated it had "no doubt that the statutes directly advanced the governmental interest at stake in this case,"[26] because:

> Congress plainly made the commonsense judgment that each North Carolina station would have an audience in that State, even if its signal reached elsewhere and that enforcing the statutory restriction would insulate each station's listeners from lottery ads and hence advance the governmental purpose of supporting North Carolina's laws against gambling. This congressional policy of balancing the interests of lottery and nonlottery States is the substantial governmental interest that satisfies *Central Hudson*, the interest which the courts below did not fully appreciate. It is also the interest that is directly served by applying the statutory restriction to all stations in North Carolina; and this would plainly be the case even if, as applied to Edge, there were only marginal advancement of that interest.[27]

With respect to the fourth prong - whether the regulation is more extensive than is necessary to serve the governmental interest [28] - the court, noting that commercial speech cases require a fit between the restriction and the government interest that is not necessarily perfect, but reasonable [29], concluded:

> We have no doubt that the fit in this case was a reasonable one. Although Edge was licensed to serve the Elizabeth City area, it chose to broadcast from a more northerly position, which allowed its signal to reach into the Hampton Roads, Virginia, metropolitan area. Allowing it to carry lottery ads reaching over 90% of its listeners, all in Virginia, would surely enhance its revenues. But just as surely, because Edge's signals with lottery ads would be heard in the nine counties in North Carolina that its broadcasts reached, this would be in derogation of the substantial federal interest in supporting North Carolina's laws making lotteries illegal. In this posture, to prevent Virginia's lottery policy from dictating what stations in a neighboring State may air, it is reasonable to require Edge to comply with the restriction against carrying lottery advertising. In other words, applying the restriction to a broadcaster such as Edge directly advances the governmental interest in enforcing the restriction in nonlottery States, while not interfering with the policy of lottery States like Virginia. We think this would be the case even if it were true, which it is not, that applying the general statutory restriction to Edge, in isolation, would no more than marginally insulate the North Carolinians in the North Carolina counties served by Edge from hearing lottery ads.[30]

Finally, the court noted that §§1304 and 1307 were not "adopt[ed] ... to keep North Carolina residents ignorant of the Virginia Lottery for ignorance's sake," but to accommodate non-lottery States' interest in discouraging public participation in lotteries, even as they accommodate the countervailing interests of lottery States, that within the bounds of the general protection provided by the Constitution to commercial speech, the court must allow room for legislative judgments, and that the Government obviously legislated on the premise that the advertising of gambling serves to increase the demand for the advertised product.[31] Hence, the court concluded that, despite the fact North Carolina residents were legally subjected to lottery advertisements broadcast from Virginia, §§1304 and 1307 directly advance the governmental interest within the meaning of *Central Hudson*.[32] Accordingly, the court determined that, because the statutes challenged regulated commercial speech in a manner that does not violate the First Amendment, the judgment of the Court of Appeals was reversed.[33]

Edge Broadcasting, then, appears to replicate the worst features of *Posadas*. It accepts at face value a stated government interest that supporting antigambling policies in nonlottery states is substantial. It continues the court's very deferential attitude to legislative statements of policy. It ignores an inherently inconsistent if not contradictory regulatory approach to controlling broadcast advertisements for gambling enterprises. It fails to demand any evidence that the commercial speech restriction under review will directly achieve or advance the announced end and/or that less intrusive restrictions might be equally or better suited to achieve that end.

In short, like *Posadas*, *Edge Broadcasting* will tolerate restrictions on commercial speech as long as they are accompanied by express statements of government policy supporting those restrictions, even if the announced ends of those policies are undermined by inconsistent government policies or regulations.

(3) *Rubin v. Coors Brewing Co.*

In *Rubin v. Coors Brewing Co. ("Coors Brewing"),*[34] the United States Supreme Court ruled that a Federal Alcohol Administration Act prohibition against displaying alcohol content on beer labels violates the First Amendment.

Coors Brewing Co. ("Coors"), a brewer of beers, applied to the Bureau of Alcohol, Tobacco and Firearms (BATF) for approval of proposed beer labels and advertisements that disclosed the alcohol content of its beer. BATF rejected Coors' application, because §5(e)(2) of the Federal Alcohol Administration Act [35] ("the Act") prohibits beer labels and advertisements from displaying alcohol content.[36] Coors than filed an action in the District Court for the District of Colorado seeing declaratory judgment that the pertinent provisions of the Act violated the First Amendment. The Government took the position that the ban on displaying alcohol content was necessary in order to prevent "strength wars" among brewers as a means of competing in the marketplace by touting the potency of their beer products.[37]

The District Court granted the relief sought by Coors.[38] On appeal, a panel of the Tenth Circuit Court of Appeals, applying the *Central Hudson* framework, concluded that, although the government's interest in suppressing strength wars was substantial, there was insufficient evidence in the record demonstrating that the ban "directly advanced" that interest. The Tenth Circuit then reversed and remanded the matter to the District Court to determine whether there was a reasonable fit between the ban and the intended goal of preventing strength wars.[39]

After further fact finding, the District Court upheld the ban on the disclosure of alcohol content in advertising but invalidated the ban as it applied to labels. Although the Government asked the Tenth Circuit to review the invalidation of the labeling ban, Coors did not appeal the court's decision sustaining the advertising ban. On the case's second appeal, the Court of Appeals affirmed the District Court.[40] Upon reviewing the record, the Court of Appeals concluded that the Government had failed to demonstrate that the prohibition in any way prevented strength wars. The court found that there was no evidence of any relationship between the publication of factual information regarding alcohol content and competition on the basis of such content.[41]

The United States Supreme Court granted certiorari, [42] concluded that the ban infringed upon Coors' freedom of speech, and affirmed the Court of Appeals. Acknowledging (1) that the information on beer labels constitutes commercial speech, [43] and (2) that that respondent sought to disclose only truthful, verifiable, and nonmisleading factual information about alcohol content on its beer labels, [44] the court focused its analysis on the third and fourth prongs of the *Central Hudson* test: whether the interest purportedly advanced by §205(e)(2) was substantial, and whether the labeling ban bore an acceptable fit with the Government's goal.[45]

Concerning the former issue, 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:

> So too the Government here has a significant interest in protecting the health, safety, and welfare of its citizens by preventing brewers from competing on the basis of alcohol strength, which could lead to greater alcoholism and its attendant social costs. Both panels of the Court of Appeals that heard this case concluded that the goal of suppressing strength wars constituted a substantial interest, and we cannot say that their conclusion is erroneous. We have no reason to think that strength wars, if they were to

> occur, would not produce the type of social harm that the Government hopes to prevent.[46]

Concerning the latter issue, the court concluded that §205(e)(2) "cannot directly and materially advance its asserted interest because of the overall irrationality of the Government's regulatory scheme."[47] More particularly, while §205(e)(2) prohibits the disclosure of alcohol content unless required by state law, federal regulations [48] prohibit statements of alcohol content in advertising but only in States that affirmatively prohibit such advertisements. Because only 18 states prohibit disclosure of content in advertisements, brewers remained free to disclose alcohol content in advertisements, but not on labels, in much of the country. The failure to prohibit alcohol content in advertising, the court noted, " makes no rational sense if the Government's true aim is to suppress strength wars."[49]

Likewise, while §205(e)(2) bans the disclosure of alcohol content on beer labels, it allows the exact opposite in the case of wines and spirits. Disclosure of alcohol content is permitted in the case of distilled spirits, and required for wines with more than 14 percent alcohol.[50] "If combating strength wars were the goal," the court observed, "we would assume that Congress would regulate disclosure of alcohol content for the strongest beverages as well as for the weakest ones."[51] Finally, the court noted, 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."[52]

Finally, 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.[53] 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 Governments asserted interest in a manner less intrusive to respondent's First Amendment.[54]

Having concluded that §205(e)(2) failed the *Central Hudson* test in two respects-by not directly and materially advanc-ing the government interest and by not being sufficiently tailored to its goal - the United States Supreme Court affirmed the decision of the Court of Appeals and declared §205(e)(2) unconstitutional.

In *Coors Brewing*, then, the United States Supreme Court took a very different approach in reviewing the challenged commercial speech restriction. It carefully delineated the proffered government interest supporting the regulation. It examined the Court of Appeals conclusion that the goal of suppressing strength wars was substantial. It more carefully scrutinized the likelihood the restriction could accomplish its announced objective. 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 regulations. 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. In short, *Coors Brewing* appears to have overcome the principal shortcomings of *Posadas* and *Edge Broadcasting*.

(4) *44 Liquormart, Inc. v. Rhode Island*

In *44 Liquormart, Inc. v. Rhode Island ("44 Liquormart"),*[55] liquor retailers sought declaratory judgment determining that two Rhode Island statutes prohibiting advertisement of liquor prices violated the First Amendment. The Federal District Court, concluding that the advertising ban on prices violated both the third prong of the *Central Hudson* test (because the price advertising ban had no significant impact on alcohol consumption in Rhode Island)[56] and the fourth prong of the *Central Hudson* test (because the advertising ban was more extensive than necessary to serve the asserted state interest, which could be achieved through higher sales taxes or mandating minimum consumer prices), held that the statutes were invalid.[57]

Upon appeal, the First Circuit Court of Appeals reversed,[58] holding that the district court erred when it decided Rhode Island's evidence was unpersuasive, and concluding that there was "inherent merit" to the State's assertion that competitive advertising would lead to lower prices and increased sales.[59]

The United States Supreme Court reversed the First Circuit. While all nine justices agreed to strike down the Rhode Island statutes, they splintered over the reasoning for that conclusion. Justice Stevens wrote the main opinion, parts of which were joined by various other justices. Justices Scalia, Thomas, and O'Connor wrote separate opinions concurring in the judgment. Significantly, the Stevens opinion demonstrates significant lack of commitment to, and the Thomas and Scalia opinions demonstrate significant dissatisfaction with, the *Central Hudson* test. Despite its quiltwork construction, *44 Liquormart* potentially may provide a robust defense of First Amendment protections of commercial speech. *44 Liquormart* is divided into eight parts, as follows:

Part	**Description**
I	Legislative & judicial history of Rhode Island's prohibition on advertising alcoholic beverages
II	Prior procedural history
III	Nature and history of commercial speech protections
IV	Discussion of acceptable regulations on commercial speech
V	Constitutional analysis of Rhode Island's statute prohibiting advertising of alcoholic beverages
VI	Analysis of justifications for alcoholic beverage

	advertisement prohibition
VII	Analysis of 21st Amendment argument
VIII	Judgment concluding Rhode Island statutes violate the First Amendment

The manner in which the justices joined in the eight-part decision can be summarized as follows:

Justice	**I**	**II**	**III**	**IV**	**V**	**VI**	**VII**	**VIII**	**Concur in Judgement**
Stevens	x	x	x	x	x	x	x	x	
Scalia	x	x					x	x	
Kennedy	x	x	x	x	x	x	x	x	
Souter	x	x	x		x	x	x	x	#
Thomas	x	x					x		^
Ginsburg	x	x	x	x	x	x	x	x	
O'Connor								x	#
Rehnquist								x	#
Breyer							x		#
^ Justice Thomas wrote a separate concurring opinion									
# Justice O'Connor wrote a separate concurring opinion in which Justices Rehnquist, Souter, and Breyer joined.									

The commercial speech analysis is contained in parts III through VII of the opinion, in which, as noted in chart above, only four justices joined. In Part III, Justice Stevens notes that advertising has played an important role throughout American history by providing consumers with accurate information about the availability of goods and services, that early commercial speech decisions struck down blanket bans on truthful, nonmisleading commercial speech, and that, while commercial advertising may be more freely regulated than other forms of protected speech (i.e. less than strict review of the regulation is required), commercial speech prohibitions which strike at the substance of the information communicated and do not protect consumers from commercial harms, trigger serious First Amendment concerns and warrant "special care" in their review.[60]

In Part IV, Justice Stevens distinguishes between commercial speech regulations which (1) protect consumers from misleading, deceptive or aggressive sales practices, or require disclosure of beneficial consumer information, or (2) prohibit the dissemination of truthful, nonmisleading commercial messages for reasons unrelated to the preservation of a fair bargaining process. The former consideration requires less than strict review; the latter situation lacks justification for departing from the rigorous review generally demanded by the First Amendment.[61]

In Part V, Justice Stevens observes that, because Rhode Island's price advertising ban not only constitutes a blanket prohibition against truthful, nonmisleading speech about lawful conduct, but also serves an end unrelated to consumer protection, special care must be used in reviewing the restriction to make sure it will directly advance the state's interest "to a material degree," i.e. the advertising ban must "significantly reduce alcohol consumption."[62] Noting that the record lacked evidence demonstrating that an advertising ban would advance Rhode Island's interest in promoting temperance [63] (and therefore that the restriction on commercial speech directly advanced that interest), the court emphasized that restrictions on commercial speech cannot be based on speculation when the restriction is aimed at accurate commercial information for paternalistic means. The court also emphasized that Rhode Island had failed to demonstrate its statutory restriction on advertising was no more extensive than necessary and that "[i]t is perfectly obvious that alternative forms of regulation that would not involve any restriction on speech would be more likely to achieve the State's goal of promoting temperance."[64] Consequently the court concluded that Rhode Island failed to demonstrate sufficient justification for the commercial speech restriction.

In Part VI, Justice Stevens, addressing the deference it must accord the State's asserted interest in imposing restrictions on commercial speech, concludes that "a state legislature does not have the broad discretion to suppress truthful, nonmisleading information for paternalistic purposes that the *Posadas* majority was willing to tolerate."[65] The court also rejects the related "greater-includes-the-lesser" reasoning (i.e. because the government could completely ban the advertised activity, it could ban advertisement for the activity), emphasizing that "it is inconsistent with both logic and well-settled doctrine," and noting that "banning speech may sometimes prove far more intrusive than banning conduct."[66]

While Parts III through VI of Justice Stevens' opinion garnered only four votes, three aspects seem to bode well for protection of commercial speech: (1) the categories for reviewing restrictions on commercial speech are reduced to two, those relating to regulations seeking to achieve an end directly related to consumer protection and those relating to regulations seeking to achieve an end not directly related to consumer protection, (2) regulations falling into the latter category will be subject to more rigorous First Amendment review generally reserved for core First Amendment areas, and (3) the resulting combination of "more rigorous review" with the fourth prong of the *Central Hudson* test (i.e. the restriction must be no more extensive than necessary) essentially dooms advertising prohibitions, because, lesser non-speech alternatives routinely being more efficacious, it is virtually impossible to justify a total ban on advertising. In effect, then, it is possible that the court is getting prepared to abandon the *Central Hudson* test and to accord commercial speech an elevated status.

In her concurring opinion, Justice O'Connor concludes that Rhode Island's advertising ban was constitutional even under the less vigorous *Central Hudson* test.[67] Reaching the same conclusion, Justice Scalia seriously criticizes *Central Hudson* as having "nothing more than policy intuition to support it," laments the absence of alternative frameworks in the litigants' briefs, and invites alternative commercial speech analysis in future cases.[68] Justice Thomas expresses the most blistering indictment of the *Central Hudson* test, determining it was nothing more than a case-by-case balancing test without informing principles and concluding that the regulation of commercial speech cannot be justified any more than regulation of noncommercial speech.[69] Recognizing that the fourth prong of *Central Hudson* can never be fulfilled if an advertising ban is proposed and non-speech alternatives to the advertising ban are effective in achieving the same goal (for example, rationing, price controls, taxing and counterspeech), Justice Thomas recommends the abandonment of *Central Hudson* and a return to *Virginia Pharmacy*.[70]

In short, in *44 Liquormart* the justices struggled with the *Central Hudson* test, and split in the application of its third prong. As noted by one commentator:

> Four justices ruled that under the third prong the government must show that the law directly advances its asserted interest, and held that Rhode Island failed to show that the advertising ban significantly reduced alcohol consumption. Three members of the Court did not agree with this reasoning and were prepared to defer to the assertions of the government in making this assessment. Justices Thomas and Scalia were

> uncomfortable with the *Central Hudson* test, with Justice Thomas preferring to eliminate the *Central Hudson* test and give commercial speech full protection under the First Amendment.[71]

The justices did agree, however, on the application of the fourth prong of the Central Hudson test, and ruled that, when the government seeks to ban commercial speech, (1) the government must show that the speech restriction directly advances its interest and is narrowly tailored to that end, and (2) the government must consider the availability of other, nonspeech-related policies or devices that would more directly accomplish the government's purposes.[72]

The implications of the splintered opinions in *44 Liquormart* are significant. The United States Supreme Court (1) appeared to be increasingly uncomfortable with the *Central Hudson* test, (2) seemed to be increasingly willing to accord commercial speech the same level of protection given to political speech, (3) flirted with a different approach in resolving commercial speech cases by distinguishing between commercial speech restrictions that directly relate to the preservation of a fair bargaining process and those that attempt to achieve a different social end, (4) appeared to be increasingly suspicious of advertising bans, especially when less intrusive alternatives may be more effective in achieving the objective for which the advertising ban is created, (5) seemed to be increasingly willing to demand evidence in the record demonstrating that the commercial speech restriction under review directly advances its intended interest, (6) seemed to be increasingly willing to demand evidence that the government considered the availability of other, nonspeech measures, and (7) seemed to be increasingly less willing to defer to the government's assertion that proposed commercial speech restrictions directly advance the policy for which the restriction is imposed.

(5) *Greater New Orleans Broadcasting Association, Inc. v. United States*

In *Greater New Orleans Broadcasting Association, Inc. v. United States ("Greater New Orleans")*,[73] the United States Supreme Court become much more united in its approach to the *Central Hudson* test, more 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*, an association of Louisiana broadcasters who operate FCC-licensed radio and television stations in the New Orleans metropolitan area, sought to run promotional advertisements for private commercial casinos that are lawful and regulated in Louisiana and Mississippi.[74] According to an FCC official, however, some broadcast signals from Louisiana broadcasting stations may be heard in neighboring states including Texas and Arkansas, where private casino gambling is unlawful.[75]

The broadcasters filed an action for declaratory judgment that restrictions on advertising private, commercial casinos under 18 U.S.C. §1304 and related Federal Communications Commission regulations violated the First Amendment.[76] The District Court, applying the *Central Hudson* test, granted the government's cross motion for summary judgment.[77] The court concluded that the restrictions at issue adequately advanced the Government's "substantial interest (1) in protecting the interest of nonlottery states and (2) in reducing participation in gambling and thereby minimizing the social costs associated therewith."[78] The Court pointed out that federal law does not prohibit the broadcast of all information about casinos, such as advertising that promotes a casino's amenities rather than its "gaming aspects," and observed that advertising for state-authorized casinos in Louisiana and Mississippi was actually "abundant."[79]

A divided panel of the Court of Appeals for the Fifth Circuit agreed with the District Court's application of *Central Hudson*, and affirmed the grant of summary judgment to the Government.[80] The panel majority's description of the asserted governmental interests, although more specific, was essentially the same as the District Court's: (1) assisting states that restrict gambling by regulating interstate activities such as broadcasting that are beyond the powers of the individual states to regulate, and (2) discouraging public participation in commercial gambling, thereby minimizing the wide variety of social ills that have historically been associated with such activities.[81] Further, the majority, relying heavily on *Posadas*, endorsed the theory that, because gambling is in a category of "vice activity" that can be banned altogether, "advertising of gambling can lay no greater claim on constitutional protection than the underlying activity."[82]

While the broadcasters' petition for certiorari was pending in the United States Supreme Court, the United States Supreme Court decided *44 Liquormart.* Having ruled in *44 Liquormart* that the *Central Hudson* test had to be more strictly applied, and having rejected in *44 Liquormart* the argument that the power to restrict speech about certain socially harmful activities was as broad as the power to prohibit such conduct, the United States Supreme Court granted the broadcasters' petition, vacated the judgment of the Court of Appeals, and remanded the case for further consideration.[83]

On remand, the Fifth Circuit majority adhered to its prior conclusion.[84] The majority recognized that at least part of the *Central Hudson* inquiry had "become a tougher standard for the state to satisfy,"[85], but held that §1304's restriction on speech sufficiently advanced the asserted governmental interests and was not "broader than necessary to control participation in casino gambling,"[86] Because the Court of Appeals for the Ninth Circuit reached a contrary conclusion in *Valley Broadcasting Co. v. United States*,[87] the United States Supreme Court again granted the broadcasters' petition for certiorari.[88]

In resolving the broadcasters' appeal, the United States Supreme Court applied the tightened *Central Hudson* test. All parties agreed the message the broadcasters wished to broadcast constituted commercial speech and that those broadcasts would satisfy the first part of the *Central Hudson* test, i.e. the message content was not misleading, concerned lawful activities, and would convey information which can benefit listeners.[89]

With respect to the second part of the *Central Hudson* test - whether the asserted governmental interest served by the speech restriction is substantial - the Solicitor General identified two interests: (1) reducing the social costs associated with "gambling" or "casino gambling," and (2) assisting States that "restrict gambling" or "prohibit casino gambling" within their own borders. The social costs associated with gambling include its contributions to corruption and organized crime, its message of a false but sometimes irresistible hope of financial advancement, and its role in expanding the incidence of compulsive gambling.[90] While the United States Supreme Court agreed those interests were substantial, [91] it also noted that, "[w]hatever its character in 1934 when §1304 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."[92]

With respect to the third part of the *Central Hudson* test - whether the speech restriction directly and materially advances the asserted governmental interest - the United States Supreme Court ruled that the Government cannot hope to achieve its first asserted interest - alleviating casino gambling's social costs by limiting demand - because the operation of §1304 and its regulatory regime is pierced by multiple exemptions and inconsistencies. 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 antigambling policies.[93] Moreover, the court observed, to the extent that federal law distinguishes among 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.[94]

Likewise, the court determined that the government's second asserted interest - assisting states to advance policies that disfavor private casinos - provided no more convincing basis for upholding the regulation than the first. The court indicated that it could not see "how this broadcast restraint, ambivalent as it is, might directly and adequately further any state interest in dampening consumer demand for casino gambling if it cannot achieve the same goal with respect to the similar federal interest."[95] Furthermore, even assuming that the state policies on which the federal government seeks to embellish are more coherent and pressing than their federal counterpart, the court ruled that §1304 sacrifices an intolerable amount of truthful speech about lawful conduct when compared to the diverse policies at stake and the social ills that one could reasonably hope such a ban to eliminate.[96]

Accordingly, the United States Supreme Court determined that 18 U.S.C. §1304 and related F.C.C. regulations violate the First Amendment, and reversed the judgment of the Court of Appeals.

In doing so, the United States Supreme Court appears to have consolidated the gains made in *Coors Brewing*. It carefully delineated the governmental interest the advertising restriction was designed to support. It did not defer to stated government policy declaring that the government interest was substantial and/or was appropriately designed to achieve the government interest. It 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. It 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 able to achieve the policy objective. Finally, *New Orleans Broadcasting* 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 Bre*wing and was unraveled in *44 Liquormart*.

EXPANDING FIRST AMENDMENT PROTECTION FOR GAMBLING AND ALCOHOLIC BEVERAGE ADVERTISEMENTS

As noted above, the United States Supreme Court in both *Posadas* and *Edge Broadcasting* upheld government restrictions on broadcast advertisements for casino gambling and state lotteries. In both instances, the court accepted as true the government's asserted interest in protecting its residents' from the evils of gambling, and ruled that interest was "substantial" because the government's policy declared it to be so. In doing so, the court provided "great deference" to the government's expressly stated policy interests, and did not require the government to provide evidence demonstrating the need for achieving the policy interest. Moreover, the court concluded the restrictions at hand "directly advanced" the policy of protecting residents from the evils of gambling, because the legislature in enacting the restriction had stated the restriction was necessary to achieve the end. The court did not closely analyze the advertising restriction to make sure it was properly designed to achieve its end, and did not carefully assess the impact of alternative means of achieving the same policy ends to satisfy itself that the restriction was no more pervasive than necessary and/or that alternative means were better tailored to achieve the end.

Likewise, the court was not disturbed that the policy at hand was apparently contradicted or undermined by other policies (e.g. permitting casino gambling advertisements targeted at tourists to be seen by Puerto Rico residents and permitting lottery advertisements to be broadcast into nonlottery states from states permitting lotteries). In short, both *Posadas* and *Edge Broadcasting* tolerate restrictions on commercial speech as long as they are accompanied by express statements of government policy supporting those restrictions, even if the announced ends of those policies are undermined by inconsistent government policies or regulations.

In contrast, the United States Supreme Court in *Coors Brewing, 44 Liquormart,* and *Greater New Orleans* appears to have strengthened First Amendment protection of commercial speech. While the court remains willing to conclude that the stated "health, safety and welfare" interest served by the commercial speech restriction is substantial - e.g. protecting residents from the evils of alcohol/gambling, reducing the incidence of alcoholism/compulsive gambling, and minimizing the social costs of alcohol consumption/gambling - the court more carefully analyzed the operation of the restriction at hand, and required the government to provide evidence that the restriction materially advanced the stated policy interest. Likewise, the court examined in greater detail the regulatory landscape in which the restriction operated to satisfy itself that the restriction would in fact achieve its expressed end. Hence, for example, allowing beer brewers to disclose alcohol content in beer advertisements, but prohibiting disclosure of same on beer labels, or allowing extensive advertisements of state sponsored lotteries and tribal casino gambling to be broadcast into states prohibiting such gambling, but prohibiting advertisements to be broadcast within those states, caused the court to question the efficacy of the advertisement restriction because of the irrationality of the total regulatory scheme.

Moreover the court 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.

Finally, the court has expressly abandoned the "greater-includes-the-lesser" reasoning (i.e. because the government could completely ban the advertised activity, it could ban advertisement for the activity), and has emphasized that such a policy is inconsistent with both logic and well-settled doctrine and that banning speech may sometimes prove far more intrusive than banning conduct.

Consequently, it appears that the United States Supreme Court's most recent forays into the constitutionality of restrictions on advertisements for gambling and alcoholic beverages bode well for protection of commercial speech:

(1)	the court may now be willing to examine the advertising restrictions more scrupulously when the restriction seeks to achieve an end not directly related to the inherent fairness of the bargain,
(2)	the court appears to be more willing to require the government to provide evidence that the stated policy end is substantial and that the restriction being evaluated materially and directly advances the stated policy end,
(3)	the court appears to be more willing examine the regulatory landscape in which the restriction operates to make sure the restriction will not be undermined by contradictory or inconsistent policies,
(4)	the court appears to be more attentive to the existence and operations of alternative means to achieve the stated policy end to make sure the restriction being examined is sufficiently tailored to its goal, and
(5)	the court has retreated on the "greater included the lesser" reasoning.

In short, it appears that United States Supreme Court has given greater First Amendment protection to commercial speech promoting gambling and alcoholic beverages.

ENDNOTES

1 527 U.S. 173, 119 S.Ct. 1923, 144 L.Ed.2d 161 (1999).

2 This regulation was issued pursuant to 18 U.S.C. §1304 which prohibits radio and television broadcasting, by any station for which a license is required, of "any advertisement of or information concerning any lottery, gift enterprise, or similar scheme, offering prizes dependent in whole or in part upon lot or chance, or any list of the prizes drawn or awarded by means of any such lottery, gift enterprise, or scheme, whether said list contains any part or all of such prizes."

3 527 U.S. at ___, 119 S.Ct. at 1936.

4 At least two United States Supreme Court decisions involving commercial speech associated with so called vice activities preceded *Posadas*. In *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 102 S.Ct. 1186, 71 L.Ed.2d 362 (1982), the United States Supreme Court ruled that an ordinance enacted by the Village of Hoffman Estates requiring a business to obtain a license if it sells any items that are "designed or marketed for use with illegal cannabis or drugs," did not violate the First Amendment. The court reached this decision, because: (1) the ordinance regulated the sale of items displayed "with" or "within proximity of" "literature encouraging illegal use of cannabis or illegal drugs," but did not prohibit or otherwise regulate the sale of literature itself, and (2) the ordinance was expressly directed at commercial activity promoting or encouraging illegal drug use. Because that speech proposes an illegal transaction, the court determined that the government

may regulated or ban it entirely. Id. at 496-97, 102 S.Ct. at 1192. Hence the *Village of Hoffman* decision is distinguishable from the cases discussed in this paper, because the ordinance regulated the marketing of illegal drugs.

In *Capital Cities Cable, Inc. v. Crisp ("Capital Cities")*, 467 U.S. 691, 104 S.Ct. 2694, 81 L.Ed.2d 580 (1984), the United States Supreme Court ruled that an Oklahoma requirement that cable television operators in Oklahoma delete all advertisements for alcoholic beverages in out-of-state signals retransmitted by cable to Oklahoma subscribers was unconstitutional. In reaching this decision, the court ruled: (1) that Oklahoma's alcoholic beverages advertising ban to out-of-state signals carried by cable operators in Oklahoma is pre-empted by federal law, Id. at 700, 104 S.Ct. at 2701, and (2) that Oklahoma exceeded its limited jurisdiction of regulating local aspects of cable systems such as franchisee selection and construction oversight, Id. at 702, 104 S.Ct. at 2702. The *Capital Cities* decision is also distinguishable from the cases discussed in this paper, because the regulation in question was preempted by federal law, and the court did not address the commercial speech aspects.

Hence neither the *Village of Hoffman* decision, nor the *Capital Cities* decision is included in the analysis contained in this paper.

5 478 U.S. 328, 106 S.Ct. 2968, 92 L.Ed.2d 266 (1986). Justice Rehnquist delivered the opinion of the court in which Chief Justice Burger and Justices White, Powell and O'Connor joined. Justices Brennan and Stevens filed dissenting opinions in which Justices Marshall and Blackmun joined.

6 *Central Hudson Gas & Electric Corp. v. Public Service Commission (“Central Hudson”),* 447 U.S. 557,

100 S.Ct. 2343, 65 L.Ed.2d 341 (1980). In *Central Hudson*, New York's Public Service Commission, attempting to focus attention on the necessity to conserve fuel oil in the wake of the embargo imposed by the Middle Eastern Arab countries on the importation of petroleum products into the United States, prohibited all advertising by electric companies promoting the use of electricity or appliances which would use more electricity. While the Arab embargo was lifted in 1974, the advertising ban remained in effect. Seeking to have the ban terminated, and arguing that its First Amendment right to advertise was violated, Central Hudson Gas & Electric Corp. asked the state court to declare the advertising ban unconstitutional. The New York Court of Appeals upheld the advertising ban, holding that the continuing need for oil conservation was sufficient to justify the restriction.

The United States Supreme Court reversed, ruling that, under the First Amendment, states cannot prohibit all commercial speech, because accurate information, even if incomplete, is needed by the public. Hence, if the commercial message does not mislead and concerns lawful activity, the government's power to regulate it is limited, depending upon the nature of both the expression and governmental interests served by the regulation. In order to ascertain whether the governmental restriction on commercial speech violates the First Amendment, the court devised the following four prong test:

> 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. at 566, 100 S.Ct. at 2351.

7 478 U.S. at 340, 106 S.Ct. at 2976.

8 *Id*. at 340-41, 106 S.Ct. at 2976.

9 *Id*. at 341, 106 S.Ct. at 2977.

10 *Id*. at 341-42, 106 S.Ct. at 2977.

11 *Id*. at 342-43, 106 S.Ct. at 2977-78.

12 *Id*. at 343, 106 S.Ct. at 2978.

13 *Id*. at 346, 106 S.Ct. at 2979.

14 *See United States v. Edge Broadcasting Co.*, *infra* at n. 15, in which the United States Supreme Court, in upholding federal restrictions on radio broadcast of lottery advertisements by licensees located in a state that does not allow the lottery, did not resort to the power to "ban the activity" includes the power to "ban advertisement for the activity."

15 509 U.S. 418, 113 S.Ct. 2696, 125 L.Ed.2d 345 (1993). Justice White delivered the opinion of the Court with respect to Parts I, II, and IV (in which Chief Rehnquist and Justices O'Connor, Scalia, Kennedy, Souter and Thomas joined), the opinion of the Court with respect to Parts III-A and III-B (in which Chief Justice Rehnquist and Justices O'Connor, Scalia, and Thomas joined), the opinion of the Court with respect to Part III-C (in which Chief Justice Rehnquist and Justices Kennedy, Souter, and joined), and an opinion with respect to Part III-D (in which Chief Justice Rehnquist and Justices Scalia and Thomas joined). Justice Souter filed an opinion concurring in part, in which Justice Kennedy joined. Justice Stevens filed a dissenting opinion, in which Justice Blackmun joined.

16 18 U.S.C. §1304 prohibits radio and television stations from broadcasting "any advertisement of or information concerning any lottery, gift enterprise, or similar scheme, offering prizes dependent in whole or in part upon lot or chance, or any list of the prizes drawn or awarded by means of any such lottery, gift enterprise, or scheme, whether said list contains any part or all of such prizes. Under 18 U.S.C. §1307, however, broadcasters are allowed to advertise state run lotteries on stations licensed to a State that conducts such lotteries, in order to accommodate the operation of legally run lotteries consistent with continued federal protection to nonlottery States' policies.

17 509 U.S. at 436, 113 S.Ct. at 2708.

18 *Id*. at 423, 113 S.Ct. at 2702.

19 *Id*.

20 *Id*. at 424, 113 S.Ct. at 2702.

21 *Id*.

22 956 F.2d 263 (4th Cir. 1992). The United States Supreme Court in *Edge Broadcasting* expressed surprise that the Court of Appeals would summarily conclude that a statutory enactment was unconstitutional in a per curium opinion: "We deem it remarkable and unusual that although the Court of Appeals affirmed a judgment that an Act of Congress was unconstitutional as applied, the court found it appropriate to announce its judgment in an unpublished per curiam opinion." 509 U.S. at 425, 113 S.Ct. at 2703.

23 509 U.S. at 436, 113 S.Ct. at 2708.

24 509 U.S. at 426, 113 S.Ct. at 2703.

25 *Id*.

26 *Id*. at 428, 113 S.Ct. at 2704.

27 *Id*. at 428-29, 113 S.Ct. at 2704.

28 *Id*. at 429, 113 S.Ct. at 2704-05.

29 *Id*. at 429, 113 S.Ct. at 2705.

30 *Id*. at 429-30, 113 S.Ct. at 2705.
31 *Id*. at 433-34, 113 S.Ct. at 2707.
32 *Id*. at 435, 113 S.Ct. at 2708.
33 *Id*. at 436, 113 S.Ct. at 2708.
34 514 U.S. 476, 115 S.Ct. 1585, 131 L.Ed.2d 532 (1995). Justice Thomas authored the opinion of the court in which Chief Justice Rehnquist and Justices O'Connor, Scalia, Kennedy, Souter, Ginsberg, and Breyer joined. Stevens filed an opinion concurring in the judgment.
35 27 U.S.C. §205(e)(2).
36 514 U.S. at 479, 115 S.Ct. at 1588.
37 *Id*.
38 *Id*.
39 *Adolph Coors Co. v. Brady*, 944 F.2d 1543, 1547-1549, 1549-1551, 1554 (1991).
40 *Adolph Coors Co. v. Bentsen*, 2 F.3d 355 (1993).
41 *Id*. at 358-359.
42 512 U.S. 1203, 114 S.Ct. 2671, 129 L.Ed.2d 807 (1994).
43 514 U.S. at 481, 115 S.Ct. at 1589.
44 514 U.S. at 483, 115 S.Ct. at 1590.
45 *Id*.
46 *Id*. at 485, 115 S.Ct. at 1591.
47 *Id*. at 488, 115 S.Ct. at 1592.
48 27 U.S.C. §205(f)(2); 27 CFR §7.50 (1994).
49 514 U.S. at 488, 115 S.Ct. at 1592.
50 *Id*. citing 27 CFR §5.37 (1994) and 27 CFR §4.36 (1994).
51 514 U.S. at 488, 115 S.Ct. at 1592.
52 *Id*. at 488-89, 115 S.Ct. at 1592-93.
53 *Id*. at 490-91, 115 S.Ct. at 1593-94.
54 *Id*.
55 517 U.S. 484, 116 S.Ct. 1495, 134 L.Ed. 711 (1996).
56 *44 Liquor Mart, Inc. v. Racine*, 829 F.Supp. 543, 549 (D.C. R.I. 1993).
57 *Id.* at 554.

58 *44 Liquormart, Inc. v. Rhode Island*, 39 F.3d 5 (1st Cir. 1994).

59 *Id.* at 7.

60 517 U.S. at 494-500, 116 S.Ct. at 1504-1506. Notably Justice Stevens historical analysis of commercial speech decisions begins with *Bigelow v. Virginia*, 425 U.S. 748, 96 S.Ct. 1817, 48 L.Ed.2d 346 (1976), and ends with *Central Hudson*, thereby ignoring sixteen years of commercial speech decisions between *Central Hudson* and *44 Liquormart*.

61 *Id*. at 1507. In establishing only two categories for reviewing commercial speech restrictions, Justice Stevens effectively rejects the notion that all commercial speech regulations should be subject to intermediate review, and raises the review of regulations falling into the second category to "more rigorous review that the First Amendment normally demands."

62 *Id*. at 1509.

63 *Id*. at 1510.

64 *Id*.

65 *Id*. at 1511.

66 *Id*. at 1512. See Jef I. Richards, *Politicizing Cigarette Advertising,* 45 Cath. U. L. Rev. 1147, 1168 (1996), and Martin H. Redish, *Tobacco Advertising and First Amendment,* 81 Iowa L. Rev. 589, 598-599 (1996).

67 *Id*. at 1522.

68 *Id*. at 1515.

69 *Id*. at 1518.

70 *Id*. at 1520.

71 Bernard James, *Can the Federal Government Continue to Ban Truthful, Nonmisleading Broadcasts of Casino Gambling Ads?,* 7 ABA Preview 414, 416, April 12, 1999.

72 *Id*. 517 U.S. at 506-7, 116 S.Ct. at 1509-10.

73 527 U.S. 173, 119 S.Ct. 1923, 144 L.Ed.2d 161 (1999). Justice Stevens delivered the opinion of the Court, in which Chief Justice Rehnquist and Justices O'Connor, Scalia, Kennedy, Souter, Ginsburg, and Breyer, JJ. joined. Chief Justice Rehnquist also filed a concurring opinion. Justice Thomas filed an opinion concurring in the judgment.
74 527 U.S. at ___, 119 S.Ct. at 1928.
75 *Id*.
76 *Id*. at ___, 119 S.Ct. at 1928-29.
77 866 F.Supp. 975, 976 (1994).
78 *Id*. at 979.
79 *Id*. at 980.
80 69 F.3d 1296, 1298 (1995).
81 *Id*. at 1299.
82 *Id*. at 1302.
83 519 U.S. 801, 117 S.Ct. 39, 136 L.Ed.2d 3 (1996).
84 149 F.3d 334 (1998).
85 *Id*. at 338.
86 *Id*. at 340.
87 107 F.3d 1328 (1997), cert. denied, 522 U.S. 1115, 118 S.Ct. 1050, 140 L.Ed.2d 114 (1998).
88 525 U.S. 1097, 119 S.Ct. 863, 142 L.Ed.2d 716 (1999).
89 527 U.S. at ___, 119 S.Ct. at 1930.
90 *Id*. at ___, 119 S.Ct. at 1931.
91 *Id*.
92 *Id*. at ___, 119 S.Ct. at 1932.
93 *Id*. at ___, 119 S.Ct. at 1933.
94 *Id*. at ___, 119 S.Ct. at 1934.
95 *Id*. at ___, 119 S.Ct. at 1935.
96 *Id*.

THE DUTY TO DISCLOSE TO BUYERS OF RESIDENTIAL REAL ESTATE THE PRESENCE OF OFF-SITE LANDFILLS CONTAINING TOXIC AND HAZARDOUS WASTE

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ABSTRACT

The doctrine of caveat emptor, [2] as it applies to disclosure by sellers of real estate and their agents, of matters concerning residential real estate has been eroding since, roughly, the 1960s[3], although it is not dead.[4] Of particular note are the cases of Strawn v. Canuso [5] and O'Leary et al. v. Industrial Park Corporation [6] which expand disclosable matters to include off-site environmental conditions which adversely affect the value and desirability of property. [7]

This article examines Connecticut statutory and common law as it relates to disclosure of off-site landfills containing toxic and hazardous waste, concluding that existing law requires such disclosure by sellers of real estate and the brokers and agents they employ. [8]

Part I of this article discusses the Strawn decision and its impact on the law. Part II discusses O'Leary and the implications for Connecticut common law . Part III reviews existing legislation as it relates to the nondisclosure of off-site environmental conditions. Part IV discusses the common law in Connecticut regarding nondisclosure, including a brief analysis. Part V proposes revised and more comprehensive disclosure legislation.

THE *STRAWN* CASE

In *Strawn* [9] a landfill containing hazardous waste was operated between 1972 and 1978 by the Buzby Brothers on land owned by the Voorhees Township in New Jersey. In 1981 the New Jersey Department of Environmental Protection and Energy (NJDEPE) formulated an "Emergency Action Plan" to clean up the Landfill site. Sampling of the surface water and lake sediments from two nearby lakes revealed "trace" levels of heavy metals and organic pollutants. The same "trace" levels were found in groundwater well samplings. The contamination levels of the soil were unknown, as were the extent of off-site gas migration and the hazard of leachate infiltration. In March 1983 a Site Manager of the NJDEPE's Bureau of Site Management, visited the landfill and the property owned by the Alluvium Development Company (southeast of the landfill property). He did not see or smell contamination on the lake which was part of the Alluvium development, even though sampling of the lake water in 1980 showed high metal concentration in the lake sediment.

Another site visit, in May, 1984, revealed gas leaks in the RCA gas venting system at the landfill, and "a steady stream of liquid flowing into the nearby marsh area and down stream lakes" off the southern face of the Voorhees Township portion of the landfill.

The landfill was visited again in 1985 by officials of the NJDEPE Water Resources Division. Again leachate seeping was observed into one of the downstream lakes. In September, 1986 methane gas migration was detected as far as 100 feet away from the landfill's fence. Investigators suggested repair of the faulty RCA gas venting system, which was not expected to be accomplished until December, 1997.

After residents of the area experienced various medical conditions which they associated with hazardous substances, they petitioned the U.S. Department of Health and Human Services, Public Health Service Agency for Toxic Substances and Disease Registry (ATSDR) to perform a health assessment. The ultimate conclusion of the ATSDR was that the Landfill posed an "indeterminate public health hazard" and that the Environmental protection agency should evaluate the releases of contaminants from the landfill under federal law. One hundred and fifty families living near the landfill brought a class action suit against the developer of the property and the real estate brokerage firm that was the selling agent for the developer.

On appeal from the Appellate Division, the Supreme Court held that

> a builder-developer of residential real estate or a broker representing it is not only liable to a purchaser for affirmative and intentional misrepresentation, but is also liable for nondisclosure of off-site physical conditions known to it and unknown and not readily observable by the buyer if the existence of those conditions is of sufficient materiality to affect the habitability, use, or enjoyment of the property and, therefore, render the property substantially less desirable or valuable to the objectively reasonable buyer. Whether a matter not disclosed by such a builder or broker is of such materiality, and unknown and unobservable by the buyer, will depend on the facts of each case.[10]

The New Jersey Legislature responded to *Strawn* the following year by passing the "New Residential Construction Off-Site Conditions Disclosure Act."[11] The statute requires sellers, who are defined as real estate brokers and salespersons, or builders [12] engaged in the sale of newly constructed residential real estate, to provide purchasers with a notice of the availability of lists of off-site conditions that exist not only within the boundaries of the municipality in which the residential real estate is located but also within any other municipality located within one-half mile of the residential real estate. [13] "Off-site conditions" include (1) The latest Department of Environmental Protection listing of sites included on the National Priorities List pursuant to the "Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. 9601 et seq.;" (2) "The latest sites known to and confirmed by the Department of Environmental Protection and included on the New Jersey master list of known hazardous discharge sites, prepared pursuant to P.L. 1982, c. 202 (C. 58:10-23.15 et seq." [14]

Some effects of the statute [15] are:

1. To limit liability for off-site environmental conditions to real estate professionals, and builders.
2. To limit the kind of property sales covered by the law to "new" sales, thereby exempting the resale of residential real property.
3. To narrow the personal duty of new home builders and real estate professionals to providing "lists" of nine "off-site" conditions, thereby seemingly exonerating them regarding their own disclosures, possibly including acts of fraudulent concealment, as discussed in *Strawn.*.

The Legislature, in passing the Act, which preempts the common law in New Jersey, [16] states in its "Findings" [17] that, in essence, both sellers and buyers have duties when it comes to discovering off-site environmental conditions which affect the value of a residence. Zivitz [18] feels the legislation has taken a step backward in the retreat from caveat emptor as applied to disclosure in residential real estate sales. [19] Judging by the court's opinion in *Strawn*, this would seem to be the case.

The limitation of liability to "professionals" in both *Strawn* and the N.J. statute has little substantive support against the backdrop of the long retreat from caveat emptor [20] in residential real estate sales [21]. Kwong [22] argues that a legal duty to disclose can arise either by virtue of an unequal relationship between parties or by virtue of unequal information between parties. [23] He states that "a duty to disclose can arise when one party is ignorant of the facts basic to the transaction, regardless of the absence of a special relationship between the parties. The actual knowledge standard is superior to the professional status standard because it provides more protection for land purchasers, is more clearly defined, and is more consistent with public policy concerns of justice and fair play." (citations omitted) [24] Kwong believes the *Strawn* court should have based a duty to disclose on the parties' unequal access to information, not just on a professional-layperson relationship. He concludes, quite properly, that "adhering to the duty to disclose material, off-site land conditions does not require a skilled and knowledgeable seller, but merely requires an honest one." (citation omitted) [25]

Plaintiffs in Connecticut have long been successful against non-professional sellers in actions based on unequal information. [26] The professional v. nonprofessional distinction drawn by the N.J. Legislature should not play a part in the adjudication of off-site environmental cases in Connecticut, absent restrictive legislation a la New Jersey. [27]

THE *O'LEARY* CASE [28]

In *O'Leary* the plaintiff/buyer contracted for the purchase of land intending to construct and lease buildings for the storage of herbicides, pesticides and fertilizers for distribution by another company. A town well was located 1700 feet from the proposed site. The town zoning enforcement officer refused to issue a zoning or building permit because the proposed use of the land posed a "significant hazard to the public water supply."[29] The seller refused to return the buyer's deposit, and the buyer brought an action claiming, inter alia, fraudulent misrepresentation as to the seller's statement that the property was suitable for the intended use, and fraudulent nondisclosure of the off-site well. The court found for the plaintiff on both theories. As regards the claim of fraudulent nondisclosure of the town well, the court said the jury's responses to the interrogatories at trial indicated that the jury did, in fact, conclude that the defendant knew of the existence of the well, had a duty to disclose that fact to the plaintiffs, and failed to do so. The court said that:

> The failure to disclose known facts and a request or a circumstance which imposes a duty to speak, forms the essence of fraudulent misrepresentation. *Marchand v. Presutti*, 7 Conn. App. 643, 645, 509 A. 2d 1092 (1986). We find the defendant's contention that the map recorded in the town hall gave the plaintiffs constructive knowledge of the town well to be without merit. The doctrine of constructive knowledge does not apply to serve as a shield of protection from accountability for one who makes false representations to another's damage.[30] (citations omitted) From the evidence produced at trial, the jury could have reasonably found that the defendant's failure to disclose this information induced the plaintiffs to enter into the agreement." [31]

In *O'Leary* the buyers and sellers are engaged in a commercial enterprise, and the transaction does not involve the sale of a residence. [32] The court, however, cites the *Marchand* case, supra, which *does* involve a residential sale. Whether the sellers in a residential real estate transaction are professionals engaged in a business transaction, or non-professionals, seems to have scant relevance to the question of liability for the various classifications of actionable conduct involving nondisclosure, as discussed above, particularly when the matter at issue involves the seller's knowledge, and the duty to notify the buyer. The rule of law in *Marchand*, supra, and in the cases discussed infra which collectively establish standards of liability in residential real estate transactions, are applied irrespective of the status of the sellers or buyers, thereby placing Connecticut squarely in the "disparity of information" school rather that the "disparity of bargaining power" school, as in *Strawn*. *O'Leary* merely applies common law principles of fraudulent misrepresentation and fraudulent nondisclosure, which have historically been applied to on-site conditions involving non-professionals, to professionals involved in off-site environmental matters.

In *Duksa v. City of Middletown et al.* [33] the plaintiff granted the city an easement and right-of-way for a sewer across his farmland in return for the right to tie into the sewer without cost. The City innocently failed to tell the plaintiff that the construction of the sewer would entail building an embankment which cut a portion of the farm in two pieces, was very steep, and could not be climbed or driven over. The city discussed the easement with the plaintiff, but failed to discuss the embankment. The court, citing the common law regarding nondisclosure, granted recision of the contract, and found that the city/defendant had a duty to disclose the embankment. The court said

> It is not necessary to decide whether a city, dealing from a superior bargaining position with an individual citizen, has a duty of "full disclosure." Under the circumstances of this case the city had a duty to disclose at

> least the fact that the sewer would be built in an embankment....." [34]

Thus, whether the transaction is between a professional seller and a non-professional buyer (as in *Duksa*), professionals (as in O'Leary), or non-professional buyers and sellers (as discussed in the cases infra), the common law standards regarding disclosure have been applied without distinction as to the status of the party. The net effect of *O'Leary*, therefore, is to include in the list of disclosable matters off-site environmental threats which would have an adverse effect as to the value or desirability of the property to the buyer.

Of greater concern in *O'Leary* is the nature of the off-site environmental condition. In *Strawn* the environmental condition complained of was the existence of a landfill containing toxic waste which directly caused damage to the plaintiff/buyers. In *O'Leary* the plaintiff/buyer was damaged by the inability to effectively use the purchased premises. The off-site environmental threat was not *to* the buyer, but rather *from* the buyer to the general public which was exposed to possible environmental damage if the plaintiff's client was allowed to use the contract property in the desired manner. This factual distinction, seems irrelative to principles of law involving nondisclosure. In both *Strawn* and *O'Leary* liability for nondisclosure was premised on a <u>duty</u> to disclose. [35] If Connecticut Courts maintain this posture, discussed further in Part IV, they can be expected to evaluate the requirement of disclosure of off-site environmental conditions based on the duty to disclose.

This proposition is reinforced by the Restatement (Second) of Torts @ 551(2)(e) which imposes a duty upon a party to a transaction to disclose to the other "facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts." [36]

Connecticut courts have additionally found that in matters of misrepresentation, for a duty to exist the matter subject to disclosure must be *material*. [37] The Second Restatement of Torts, Section 538, provides that a matter is material if

> (a) a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question; or (b) the maker of the representation knows or has reason to know that its recipient regards or is likely to regard the matter as important in determining his choice of action, although a reasonable man would not so regard it.

The post-*Strawn* New Jersey disclosure Legislation was an effort to "limit the disclosure duties and liability of professional sellers ....and...brokers of new residential real estate." [38] Fear of the extent of off-site conditions which could be included in an overly broad application of disclosure principles seems misguided if concepts of "duty" and "materiality" continue to be fairly employed by the courts, as discussed further below. Regardless, *Strawn* and *O'Leary* imply that off-site conditions pertaining to existing or potential contamination of air or water constitute situations where both "duty" and "materiality" exist. [39] Indeed, it is difficult to imagine a contrary finding when research supports a conclusion that there is an explicit negative effect on property values where the threat of contamination exists, [40] especially after publicity concerning the site. [41] Connecticut courts have found that sellers have a duty to disclose on-site environmental contamination as well . [42]

A legitimate issue in off-site toxic and hazardous waste landfill cases is the reliance by plaintiffs on the potential of *future* environmental contamination, resulting in reduced property values, where sources of contamination have been mitigated. Assume, for example, venting devices are installed at the landfill as they were in *Strawn*, supra. [43] The problem with off-site contamination is that it constitutes an on-going danger to surrounding properties, notwithstanding mitigation. [44] The plaintiff's remedy, either in damages or recission, will be based on a court's assessment of the bargain in light of the plaintiff's failure to disclose the off-site condition. Regardless of the nature or dimension of the damages, it is the *threat* of future air or water contamination which results in a diminution in value to buyers and constitutes the basis of the requirement for disclosure.

The adverse impact of the threat of contamination on land values was discussed in *City of Bristol et al. v. Milano* [45] where the city, by eminent domain, took 31 year easements and certain rights to part of the plaintiff's residential property to facilitate requirements for the closure of the city's landfill. [46] The easements were necessary, in part, to enable installation of well monitoring equipment by the city. The groundwater rights acquired by the city within the "zone of influence" easement area [47] included the right "to release and deposit contaminants and pollution directly or indirectly, into, on or in the groundwaters and subsurface soils and formations within the Zone of Influence Easement Area." [48] In fixing the value of the property, the court awarded damages related to "*stigma*" [49] stating

> The prospective nature and extent of possible contamination of the Milano property and waters will create a reasonable and well-founded public belief in a health hazard and danger for the duration of the easements. The presence of the monotoring wells evidences the risk of contamination. The use of easements for the contamination of groundwaters and subsurface soils within the zone of influence easement areas for up to thirty-one years is an element of damage that must be taken into consideration in fixing the market value of the Milano property after the taking. The depreciation of value in this manner is in addition to the damage resulting from the taking of the limited easements over the Milano land. [50]

CONNECTICUT LEGISLATION

The Uniform Property Disclosure Act [51]

Section 20-327b(a) of the Connecticut General Statutes requires sellers of residential property to provide buyers with a residential property condition report, as follows:

> ......each person who offers residential property in the state for sale, exchange or for lease with option to buy, shall provide a written residential condition report to the prospective purchaser at any time prior to the prospective purchaser's execution of any binder, contract to purchase, option, or lease containing a purchase option.

Included among the matters required to be reported by sellers to buyers is

> (F) Information concerning environmental matters such as lead, radon, subsurface sewage and such other topics as the commissioner of Consumer Protection may determine would be of interest to a buyer. [52]

Thus, the Connecticut Legislature has indicated a specific interest in environmental matters. In creating the disclosure form, the Commissioner of Consumer Protection included only those environmental items specifically mentioned by the statute, i.e. lead, radon and subsurface sewage[53.] It is not imaginable that the existence of a nearby landfill containing toxic and hazardous waste, which poses a threat to drinking water and air quality, as in *Strawn,* would be an environmental matter in which a buyer would not be interested.[54] This is not to say that the Connecticut legislature has specifically covered off-site environmental conditions as disclosable matters. It has not. What the legislation does do is to establish a public policy which embraces environmental concerns, leaving to the courts the issue of whether the common law will apply this policy to off-site environmental conditions. [55]

THE DUTY OF REAL ESTATE BROKERS AND AGENTS[56]

Section 20-327b(d)(2)(C) of the Connecticut General Statutes provides that the Residential Property Condition Report, discussed supra, which sellers furnish buyers, must contain a statement that it:

> ...in no way relieves a real estate broker of his or her obligation under the provisions of section 20-328-5a of the Regulations of Connecticut State Agencies to disclose any material facts. Failure to do so could result in punitive action taken against the broker, such as fines, suspension or revocation of license. [57]

In addition to the foregoing, Section 20-320 of the Connecticut General Statutes invests the real estate commissioner with the power to temporarily suspend or permanently revoke a real estate broker or salesperson's license and/or impose a fine of not more than two thousand dollars if it finds that a licensee has made "any *material* misrepresentation" or "...any false promise of a character likely to influence, persuade or induce, " or has committed "any act or conduct which constitutes dishonest, fraudulent or improper dealings," or has committed "a violation of any provision of this chapter or any regulation issued under this chapter," which includes the regulations supra.

In *Strawn* the court relied on the New Jersey disclosure statute and regulation for real estate brokers which required them to "reveal all information material to any transaction to his client or principal and when appropriate to any other party."[58] The regulation, the court said, was a codification of the "public policy" of the state "which affects both the brokers and general public.....The regulation has special importance to the public interest because it requires the broker to disclose facts which could affect health and quality of life."[59] The public policy of Connecticut, as expressed through its statutes, also recommends the requirement of disclosure of the kinds of conditions present in *Strawn.*

The Connecticut Real Estate Commission is charged with determining the issues of "materiality" and real estate broker/agent culpability under the statute. Their findings regarding "materiality" are accorded great deference by the courts. [60] The Commission has found the following to be "material:"

- the failure to disclose the fact that property was in a flood plain [61]
- a representation that property was serviced by city sewers, when, in fact, it was not, [62] and
- that the agent of a broker "nodded" when a developer erroneously pointed out a property line, under circumstances where the agent did not know where the property line was. [63]

While there is no Connecticut Real Estate Commission case involving an off-site toxic and hazardous waste landfill, reason dictates that if the above matters are considered *material*, surely potential dangers posed to the health and welfare of buyers, involving the air they breathe and the water they drink, as in *Strawn*, must be considered material.[64] Disclosure is required because of the threat or danger posed, and because the matter involves the value or desirability of the property, as in *O'Leary,* supra. This is further illustrated in the *Dlubac* case, supra, where the real estate person was fined $500. In that case the Complainant/buyer argued that the property, located in East Hartford a half mile from the Connecticut River, would not have been contracted for if its location in a flood plain had been known. The Real Estate Commission stated that:

> Whether or not property is in a flood zone is significant, and even though a flood zone may not affect its title, it can affect the property's desirability. [65]

In landfill cases, it is the material impediment involving the *location* of the property, and its proximity to the threat of contamination from the landfill, that affects the value or desirability to the buyer, thereby compelling disclosure by real estate agents. [66] This is the case in every situation where the property in question has been or is potentially subject to adverse environmental conditions, especially those involving air and water contamination created by hazardous waste.

The duty of real estate persons to disclose to buyers is not distinguishable, at the common law, from that of sellers since their conduct is attributable to the sellers or buyers for whom they work under principles of agency law.[67] In addition, the duty is concurrent with that of the sellers since it involves the transaction in which the sellers are engaged.[68]

THE CONNECTICUT UNFAIR TRADE PRACTICES ACT (CUTPA) [69]

CUTPA prohibits "unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce"[70] and covers disclosure issues involving real estate brokers and salespersons, including issues concerning environmental status:

In *Glazer Realty Associates v. Joshua Morris Publishing, Inc. et al*.,[71] the Judicial District of Danbury, ruling on the defendant's motions to strike, held that the plaintiff, whose action was grounded in fraudulent and negligent misrepresentation, had sufficiently pleaded violations of the Connecticut Unfair Trade Practices Act (CUTPA) against a real estate brokerage and agent who allegedly misrepresented to a bank the environmental status of the buyer's land. The court made the following points:

I. Where the defendant/real estate agent allegedly made false and misleading statements to the plaintiff's bank regarding the environmental status of the land, the plaintiff had alleged "immoral, unethical or acts against public policy," under CUTPA, and had satisfied the third prong of the cigarette rule [72] by alleging substantial injury. [73]

II. The plaintiff had stated sufficient facts to allege that the real estate agent was engaged in a trade or commerce when he made allegedly misleading statements to the plaintiff's bank regarding the environmental status of the land. [74]

III. A litigant does not have to allege more than a single act of misconduct in order to bring an action under CUTPA. The court stated that "Here, the defendant is a real estate broker accused of making materially false and misleading statements to the purchaser's lender. This is the type of situation to which CUTPA applies. [75]

IV. It is not necessary that a real estate broker and agent be involved in the business of selling property (as opposed to being agents) in order to constitute involvement in a "trade or business." "Such a requirement would defeat a significant purpose of CUTPA: to protect consumers......" [76]

CUTPA violations have been found against sellers of residential real estate where there was no real estate broker or agent involved.[77] Every state and the District of Columbia has enacted unfair and deceptive practices acts, and most apply to real estate transactions. [78]

THE CONNECTICUT COMMON LAW [79]

In addition to the statutes, supra, Connecticut common law protects purchasers of residential real estate regarding the disclosure of material matters that affect the value and desirability of property.

As the common law has evolved, Connecticut courts have advanced rules of law establishing the liability of sellers and real estate agents regarding disclosure issues, depending on the facts in each case. While courts have categorized misrepresentation cases into three classes: fraudulent, negligent, and innocent,[80] there have been permutations designed, it would seem, to create equitable results. Thus, causes of action have been entertained alleging N*ondisclosure of Material Facts and Silence; Negligent Mis-representation; False Representation and Failure to Make Full Disclosure; Innocent Misrepresentation; Misrepresentation, Con-cealment and Nondisclosure; Fraud; Fraudulent Misrepre-sentation; and Fraudulent Nondisclosure.*[81] Of particular interest are the cases, and rules of law, involving nondisclosure, or silence. [82] To borrow some language from Judge Jon C. Blue of the New Haven Superior Court, the distinctions in the law regarding nondisclosure, as revealed in the following cases, are not as talismanic as some litigators would like to believe.[83]

The case of *Gayne v. Smith* [84] decided in 1926, long before the beginning of the decline of caveat emptor in real estate transactions, [85] establishes the general rule that "the silence of a vendor with reference to facts affecting the value or desirability of the property sold cannot give rise to an action by the vendee to set aside the transaction as fraudulent."[86] The court also said, however, that

> A vendor of property may not do anything to conceal from the vendee a material fact affecting it, or say or do anything to divert or forestall an intended inquiry by him, or deliberately hide defects, for, in so doing, he is not merely remaining silent but is taking active steps to mislead. So the surrounding circumstances may be such that the effect of his silence is actually to produce a false impression in the mind of the vendee, and the making of an agreement or doing of

> some other act may in itself lead the vendee to believe a certain fact exists and so amount to an affirmation of it. So the vendor may stand in such a relationship of trust and confidence to the vendee that it is his duty to make a full disclosure.[87]

In *Franchey v. Hannes,* [88] the defendant/seller discussed the boundaries of property sold to the plaintiff but failed to mention that a pool and garden encroached on neighbor's property. The court, reaffirming the general rule in *Gayne*, said that the physical appearance of the property alone was insufficient to give rise to a duty to disclose. Rather the case came within the widely accepted rule that although a vendor may, under the circumstances, have no duty to speak, nevertheless, if he does assume to speak, he must make a full and fair disclosure as to the matters about which he assumes to speak. "He must then avoid a deliberate non-disclosure."[89] (citations omitted) Since the seller had discussed the boundaries with the plaintiff/buyer, the rule was applied in favor of the plaintiff.

Twelve years after the *Franchey* case, and almost 50 years after *Gayne,* the Supreme Court decided *Duksa v. City of Middletown,*[90] under circumstances similar to those in *Gayne.* Here a seller granted the City of Middletown an easement for a sewer line on his property. The city innocently (unlike *Gayne)* failed to advise the plaintiff that the sewer line would require an embankment seventeen to eighteen feet high cutting a portion of the farm in two pieces. The court, citing *Gayne*, and compatible cases, favorably, nevertheless found for the plaintiff stating that

> Mere nondisclosure....does not amount to fraud. Watertown Savings Bank v. Matoon, 78 Conn. 388, 393, 62 A. 622. To constitute fraud on that ground, there must be a failure to disclose known facts and, in addition thereto, a request or an occasion or a circumstance which imposes a duty to speak.[91]

> ....the Restatement, Restitution, @8, states in comment b, “The unintentional nondisclosure of facts as to which there is a duty of disclosure, as where one forgets to disclose a known fact, has the same effect as an innocent misrepresentation.” A mistake induced by an innocent but material misrepresentation justifies recission. Henry v. Kopf, 104 Conn. 73, 76, 131 A. 412. Restatement Restitution @@28,39. It follows, therefore, that the unintentional nondisclosure of facts as to which there is a duty of disclosure, as in this case, justifies recission.

> It is not necessary to decide whether a city, dealing from a superior bargaining position with an individual citizen, has a duty of “full disclosure.” Under the circumstances of this case the city had a duty to disclose at least the fact that the sewer would be built in an embankment, and thus the plaintiff was entitled to recission or to damages. E & F. Construction Co. v. Stamford, 114 Conn. 250, 158 A. 551. [92]

In *Wedig v. Brinster* [93] the defendant/sellers failed to disclose to their co-defendant/real estate agent, or the buyers, that their septic system emptied into Long Island sound, was in violation of the city code and regulations, and was the subject of investigation by the Department of Environmental Protection. The court found the defendants liable for, inter alia, fraudulent nondisclosure, agreeing with the lower court that the defendants had an affirmative duty to disclose the condition. This was apparently the result of a statement by the real estate agent that the septic system was "okay," even though no representation was made by the defendant/sellers. The court, referring to this as a "guilty knowledge" type of case, cited *Duksa* - "To constitute fraud by nondisclosure or suppression, there must be a failure to disclose known facts and.... a request or an occasion or a circumstance which imposes a duty to speak"[94] ; *Gayne* - "A vendor of property may not do anything to conceal from the vendee a material fact affecting it. A vendor of property may not do anything to divert or forestall an intended inquiry by him, or deliberately hide defects, for, in so doing, he is not merely remaining silent, but is taking active steps to mislead" [95]; and *Egan v. Hudson Nut Products, Inc*. - "The nondisclosure must be by a person intending or expecting thereby to cause a mistake by another to exist or to continue, in order to induce the latter to enter into or refrain from entering into a transaction." [96]

In the 1986 case of *Marchand v. Presutti,*[97] the Appellate Court decided that a defendant/ seller who innocently failed to advise a plaintiff/buyer of prior cellar flooding and drain pipe repair, committed an "innocent misrepresentation" which amounted to a "fraudulent nondisclosure"[98] upon which plaintiffs relied to their detriment. "The crux of a fraudulent nondisclosure is a failure to disclose known facts and.....a request or an occasion or circumstance which imposes a duty to speak. *citing Duksa* and *Wedig.* The court never referred to *Gayne.*.

In *O'Leary,* discussed at length, supra, *Gayne* was again ignored. In dealing with the seller's failure to advise the buyer of the off-site town well, the court, citing *Marchand*, supra, restated the rule regarding fraudulent nondisclosure: that the failure to disclose known facts and a request or circumstance which imposes a duty to speak, forms the essence of "fraudulent misrepresentation." [99]

In *Bernard v. Gershman,* [100] the seller failed to fully disclose the extent of problems experienced with the water supply of the residence purchased. The Appellate Court, leaving nothing to chance, recited the general rule that "mere nondisclosure does not amount to fraud," [101] but that "nondisclosure may, however, amount to fraud when there is a failure to disclose known facts under circumstances that impose a duty to speak,"[102] citing *Duksa* and *Wedig.* The court also cited the *Franchey* rule that "once a vendor undertakes to speak on a subject, the vendor must then make a full and fair disclosure as to that subject.[103] The court thereupon found the defendant to have committed classical fraud.[104]

In *Catucci v. Ouellette* [105] a defendant/seller deliberately failed to disclose that the lot purchased by the plaintiff/buyer was not suitable for sewage disposal. The court, citing *Franchey,* found that the trial court had ample support to draw the conclusion of fraudulent nondisclosure by the defendant, even though there was no evidence in the Appellate Court's decision that the defendant made any representations regarding sewage disposal. In this case *Duksa* was not mentioned.

In *LaCasse v. Coldwell Banker et al.*[106] involving an alleged failure to disclose a continuing septic system problem, the court, granting plaintiff's motion to strike defendant's special defenses, distinguished between fraudulent misrepresentation and fraudulent nondisclosure, stating that the former requires an actual misrepresentation, and relies on classical elements of fraud, [107] but "to constitute fraud by nondisclosure or suppression there must be a failure to disclose known facts and ....a request or an occasion or a circumstance which imposes a duty to speak, *citing* Duksa. The court held that the action was grounded in fraudulent nondisclosure. This distinction ignores the *O'Leary* and *Marchand* cases, supra, which, equate the two. [108]

In *Robinson v. Parillo,*[109] the defendant/seller was alleged to have withheld "material information in regard to the grading and drainage of the premises," in violation of a "duty to disclose based upon the effect of said grading and drainage upon the basement and septic systems, of which the plaintiffs had inquired."[110] Denying defendant's motion to strike, the court referred to the general rule in *Gayne* as a "time- honored doctrine of caveat emptor,"[111] but noted that the "harshness of the general rule has been mitigated by limitations and exceptions that have gone a long way toward swallowing up the rule--but not yet all the way."[112] One of the exceptions cited by the court was grounded in the language in *Gayne,* supra, that "A vendor of property may not do anything to conceal from the vendee a material fact affecting it."[113] The court added that "a comparable exception appears in RESTATEMENT (SECOND) OF TORTS 551 (2)(e)."[114] Thus, seventy three years after *Gayne,* the decision is being cited as both the rule and the exception in cases involving nondisclosure.[115]

ANALYSIS

The pattern of case law regarding nondisclosure suggests that the presence a landfill [116] containing hazardous and toxic waste is a material fact giving rise to a duty to disclose by sellers of real estate and their agents.[117] At a minimum, an occasion or circumstance imposing a duty to speak would appear to exist where the plaintiff/homeowner/seller (as in *Strawn)* has experienced adverse physical effects from the toxic materials. Mere knowledge of the existence of such a condition would also appear to be such an occasion or circumstance due to the materiality of the information and the "actual knowledge" standard, which Connecticut courts seem to follow. In addition, where the seller has provided the buyer with a disclosure statement under existing Regulations, it could reasonably be argued that the seller has assumed to speak (at least with respect to potential water contamination), must make a full and fair disclosure, and must avoid deliberate nondisclosure. The question of whether nondisclosure of a contaminated landfill constitutes fraud, [118] fraudulent nondisclosure, fraudulent misrepresentation, or some hybrid seems less important than the direction of the state's public policy[119] and the future of the doctrine of caveat emptor on this issue.

STATUTORY REMEDY

The state of Hawaii has passed comprehensive legislation involving disclosure of property condition. [120] The statute requires a seller's written "disclosure statement" which is defined as a "written statement ....that purports to fully and accurately disclose all material facts relating to the residential real property being offered for sale that: (1) Are within the knowledge or control of the seller; (2) Are disclosed by documents recorded in the bureau of conveyances; or (3) Can be observed from visible, accessible areas." [121] A "material fact" is defined as "any fact, defect or condition, past or present, which materially affects the value of the residential real property being offered for sale." [122] The "Sellers' Real Property Disclosure Statement" offered by the Hawaii Association of Realtors contains a list of 64 items requiring response from the seller including: "(50) Is the property subject to air pollution?" ... (55) Are you aware of any adverse conditions existing in your general neighborhood/area (such as pesticides, soil problems, irrigation, etc.)?"...(56) Is there any additional information you should disclose (examples: history of homicide, felony, or suicide occurring on the property, pending development in the area, road widening projects: zoning changes; etc.)?"[123] A buyer who receives a disclosure statement that fails to disclose a material fact or contains an inaccurate assertion which materially affects the value of the residential real property, and who was not aware of the foregoing failure or inaccuracy, may rescind the contract. [124] The seller's agent retains a duty to disclose to the buyer, seller and their agents, if the agent becomes aware of facts inconsistent with or contradictory to the disclosure statement, or the inspection report of a third party. [125]

Hawaii's approach to disclosure of both off-site and on-site conditions, including environmental matters, constitutes an unqualified rejection of the doctrine of caveat emptor in real estate sales, and should stand as a model for all states endeavoring to finally clear the air of this anachronistic principle.[126]

ENDNOTES

1 Of the Norwalk Bar, professor, Pace University, Lubin School of Business, Licensed Real Estate Broker.

2 The entire expression is "Caveat emptor, qui ignorare non debuit quod jus alienum emit:" Let a purchaser beware, who ought not to be ignorant that he is purchasing the rights of another. Black's Law Dictionary, Sixth Edition (1990).

3 *See* Flavio L. Komuves, "For Sale: Two-Bedroom Home with Spacious Kitchen, Walk-In Closet, and Pervert Next Door," 27 Seton Hall L. Rev. 668 (1997); Discussed in the *Strawn* case, *infra,* note 5, at 52 et seq.; Walton H. Hamilton, Leo Bearman, Jr., *Caveat Emptor in Sales of Realty - Recent Assaults Upon the Rule*" 14 Vand. L. Rev. 541 (1961); Robert Kwong, *Comment: Fraud and the Duty to Disclose Off-Site Land Conditions: Actual Knowledge vs. Seller Status*, 24 B.C. Envtl. Aff. L. Rev. 897, (1997) at 900 et seq.; Timothy J. Muldowney and Kendall W. Harrison, *Stigma Damages: Property Damage and the Fear of Risk*, Defense Counsel Journal, Vol. 62, No. 4, at 535 (Oct. 1995); Lori Polonchak, *Surprise, You Just Moved Next to a Sexual Predator: The Duty of Residential Sellers and Real Estate Brokers to Disclose the Presence of Sexual Predators to Prospective Purchasers*, 102 Dick. L. Rev. 169, 183 (1997); Andrea Adelson, "Homeowner's Assurance," The New York Times, Feb. 15, 1998. For general exceptions to the doctrine *see* 12 Am. Jur. Proof of Facts 2d at 12-103.

4 *See* Alan M. Weinberger, *Let the Buyer Be well Informed? - Doubting the Demise of Caveat Emptor,* 55 MD. L. Rev. 387, 388; Robert Irwin, "Seller Beware," Real Estate Education Company, 1998.

5 140 N.J. 43, 657 A. 2d 420, 1995 N.J. LEXIS 54 (1995).

6 14 Conn. App. 425, 542 A. 2d 333 (1988).

7 This article assumes throughout that the behavior, nature or dimensions of the hazardous and toxic materials contained in the landfill is unknown and not readily observable by the buyer, but known to the seller, as in *Strawn*, note 5, at 65; *See* Robert M. Washburn, *Residential Real Estate Condition Disclosure Legislation*, 44 DePaul L. Rev. 381 (1995) for discussion of the obligations imposed on Purchasers. For a discussion of the "value or desirability" of property, *See* William D. LeMoult, *The Duty of Residential Real Estate Brokers and Salespersons to Disclose Property Condition to Buyers,* 70 Conn. B. J. 435, 456 (Dec., 1996).

8 For discussion of disclosure of off-site conditions, s*ee* Colin Campbell, J.D., "Liability of Vendor or Real Estate Broker for Failure to Disclose Information Concerning Off-Site Conditions Affecting Value of Property," 41 A.L.R. 5th 157 (1997); Elizabeth A. Dalberth, *Unfair and Deceptive Acts and Practices in Real Estate Transactions: The Duty to Disclose Off-Site Environmental Hazards*, 97 Dickinson Law Review 153 (1992). *See* also 36 Am. Jur. Proof of Facts 3d 471, Sec. 9.

9 The facts are drawn from the Supreme Court case, note 5, and the lower court case at 271 N.J. Super. 88, 638 A. 2d 141, 1994 N.J. Super LEXIS 61 (1994).

10 Id. note 5, at 65.

11 Title 46, N.J. Stat. d46:3C-1.

12 Id. at 46:3C-3. A "builder" is defined as "any individual corporation, partnership or other business organization engaged in the construction of new homes." N.J. Stat. @ C.46:3B-2

13 Id. note 11, at 46:3C-8

14 Id. note 11, at 46:3C-3.

15 *See* Andrew Zivitz, "Disclosure Act Reinstates Caveat Emptor; Buyers of Newly Built Homes Bare the Burden of Finding Flaws," The Legal Intelligencer, pg. 7, January 25, 1996.

16 Id. *citing* "Assembly Housing Committee Statement."

17 Id. note 11, at 46:3C-2.

18 Id. note 15.

19 *See* also Stephen L. Kass and Michael B. Gerrard, "Real Estate Brokers' Duty to Disclose Contamination," New York Law Journal, Environmental Section, June 24, 1994.

20 *See* Campbell article, note 8.

21 In my article "The Duty of Residential Real Estate Brokers and Salespersons To Disclose Property Condition to Buyers," 70 Conn. Bar Jnl. 435 (December, 1996) I argue that where the state requires a disclosure statement from sellers, which purports to be a complete summary of disclosable matters, real estate agents and brokers should be relieved of disclosure liability. The disclosure statement in Connecticut is not such a document, and, arguably, does not comply with the spirit of the statutory requirement regarding disclosure of environmental issues that may be of interest to buyers.

22 Id. note 3.

23 Id. at 919, *citing* the Restatement (Second) of Torts @ 551.

24 Id. note 3 at 919.

25 Id.

26 *See*, e.g., Homan v. Daughters of the Holy Spirit, Inc., 3 CSCR 336 (March 11, 1988); Franchey v. Hannes et al., 152 Conn. 372, 207 A. 2d 268 (1965); Duksa v. City of Middletown, 173 Conn. 124, 376 A. 2d 1099 (1977); Papile v. Robinson, 4 Conn. Cir. Ct. 307, 231 A. 2d 91 (1967); Crother v. Guidone, 183 Conn. 464, 441 A. 2d 11 (1981); Miller v. Appleby, 183 Conn. 51, 438 A. 2d 811 (1981); Catucci v. Ouelette, 25 Conn. App. 56, 592 A. 2d 962 (1991); Wedig v. Brinster, 1 Conn. App. 123, 469 A. 2d 783 (1983), cert. denied 192 Conn. 803, 472 A. 2d 1284 (1984); Bernard v. Gershman, 18 Conn. App. 652, 559 A. 2d 1171 (1989).

27 For a discussion of the applicability of disclosure legislation to new construction vs. existing residences *See* Washburn article, note 7, at 448.

28 14 Conn. App. 425, 542 A. 2d 333, 1988 Conn. App. LEXIS 176 (1988).

29 Id. at 428-429.

30 In cases involving hazardous waste landfills, while the landfill itself is sometimes readily visible, it is often quite benign in appearance. Under the surface of the land, however, as in

Strawn and other hazardous waste landfill cases, there is a ferment occurring with a capacity for air and water contamination the dimensions of which could not be assessed even by an astute and probing home buyer. *See Strawn, note 5, infra.*

31 Id. note 28, at 433-434.

32 Defendant's motion for a directed verdict with respect to a CUTPA claim was upheld since there was no evidence before the jury from which it could have found a "nexus" between the defendant's conduct and the public interest. The "nexus" requirement was subsequently eliminated by PA 84-468.

33 173 Conn. 124, 476 A. 2d 1099 (1977).

34 Id. at 128.

35 Id. note 5 at 102, and note 28 at 433. For a discussion of duty to disclose, *see* 37 Am Jur 2d, Fraud and Deceit 177.

36 This language is quoted in *Strawn* in support of the duty to disclose, note 5, at 102. *See* also Marchand v. Presutti, 7 Conn. App. 643, 645, 509 A. 2d 1092 (1986). Since this article involves the issue of disclosure, rules of law concerning <u>nondisclosure</u> are of the most critical concern. Compare *Lingsch v. Savage*, 29 Cal. Rptr. 201, 206 (1963) where the court defined a real estate fraud action for nondisclosure as consisting of : 1. Nondisclosure by the defendants of facts materially affecting the value or desirability of the property; 2. Defendant's knowledge of such facts and of their being unknown to or beyond the reach of the plaintiff; 3. Defendant's intention to induce action by the plaintiff; 4. Inducement of the plaintiff to act by reason of the nondisclosure; and 5. Resulting damage.

37 Harper v. Adametz, 142 Conn. 218; Duksa v. City of Middletown, 173 Conn. 124, 137 (1977); Wedig v. Brinster, 1 Conn. App. 123,132, 469 A. 2d 783, (1983), *cert. denied*, 192 Conn. 803, 472 A. 2d. 1284 (1984); Andrews, et al. v. Caron Brothers, et al., 1992 Conn. Super. LEXIS 870 (1992) where the court, citing *Wedig*, supra, states that "Once a vendor (of property) assumes to speak, he must make a fair disclosure as to the matters

about which he assumes to speak. He must then avoid a deliberate nondisclosure. To constitute fraud by nondisclosure or suppression, there must be a failure to disclose known facts and...a request or occasion or a circumstance which imposes a duty to speak. This duty arises when a vendor of property conceals from the vendee a *material* fact affecting it. A vendor of property may not do anything to conceal from the vendee a *material* fact affecting it, or say or do anything to divert or forestall an intended inquiry by him or deliberately hide defects, for in so doing, he is not merely remaining silent, but is taking active steps to mislead." at 15; *See* also Washburn, at note 7, at 388, Kwong, note 3 at 913, and LeMoult, note 7, at 452. Compare jurisdictions where sellers have a duty to disclose only where the defect or condition (whether or not material) is dangerous or poses a threat to health and safety. *See* Washburn article, note 7 at 390.

38 Assembly Housing Committee Statement reported in Zivitz article, note 15.

39 *See* Alvin L. Arnold and Marshall E. Tracht, "Vendor-Purchaser: Developer and Broker May Be Liable for Failing to Disclose Landfill," Warren, Gorham & Lamont Real Estate Report, Vol. 25, No.2; pg.1. The proposition that Connecticut Courts may follow *Strawn* is supported by LeBoeuf, Lamb, Greene & McRae, L.L.P., "Developers and Real Estate Brokers Beware: Home Buyers with Contaminated Properties Gaining New Rights," Connecticut Environmental Compliance Update, Volume 3, Issue 10 (1995).

40 *See* Robert A. Simons, William M. Bowen and Arthur J. Sementelli, "The Price and Liquidity Effects of UST Leaks From Gas Stations on Adjacent Contaminated Property: Underground Storage Tanks," The Appraisal Journal, No.2, Vol. 67, pg. 186 (1999); Bill Mundy, "The Impact of Hazardous Materials on Property Value: Revisited," The Appraisal Journal (October 1992b), at 463; B. Christensen,

"Can Pollution Contaminate Value?," The Real Estate Appraiser and Analyst (Fall/Winter 1987) at 53; John D. Dorchester, Jr. "Environmental Pollution: Valuation in a Changing World," The Appraisal Journal (July 1991) at 289; Alan K. Reichert, Michael Small, and Sunil Mohanty, "The Impact of Landfills on Residential Property Values," The Journal of Real Estate Research, v. 7, No. 3, (1992) at 297; Gerald E. Smolen, Gary Moore, and Lawrence V. Conway, "Hazardous Waste Landfill Impacts on Local Property Values," The Real Estate Appraiser (April, 1992) at 4; Michael B. Gerrard, "Fear and Loathing in the Siting of Hazardous and Radioactive Waste Facilities: A Comprehensive Approach to a Misperceived Crisis, 68 Tul. L. Rev. 1047, 1109, *citing* Kusum Ketar, "Hazardous Waste sites and Property Values in the State of New Jersey, 24 Applied Econ. 647, 647-648 (1992); Gary H. McClelland et al. , "The Effect of Risk Beliefs on Property Values: A Case Study of a Hazardous Waste Site, 10 Risk Analysis 485, 491-96 (1990); R. Gregory Michaels & V. Kerry Smith, "Market Segmentation and Valuing Amenities with Hedonic Models: The Case of Hazardous Waste Sites," 28 Urb. Econ. 223, 223-29 (1990); Arthur C. Nelson et al., "Price Effects of Landfills on House Values, 68 Land Econ. 359, 364 (1992); V. Kerry Smith & William H. Desvousges, "The Value of Avoiding a LULU: Hazardous Waste Disposal Sites, 68 Rev. Econ. & Stat. 293, 293 (1986); Gerald E. Smolen et al., "Hazardous Waste Landfill Impacts on Local Property Values," Real Est. Appraiser, Apr. 1992, at 4, 8-9; Dana Milbank, " Back in Love Canal, Neighborhood Spirit Isn't Going to Waste, Wall St. J., Sept. 25, 1992, at A5G (reporting that the sale of homes in reinhabited Love Canal take place at about 20% below market value).

41 Id. Gerrard article, note 40 at 1109, *citing* Janet E. Kohlhase, "The Impact of Toxic Waste sites on Housing Values, 30 Urb. Econ. 1, 1-2 (1991).

42 Andrews v. Caron Brothers, 1992 Conn. super LEXIS 870, citing *Wedig v. Brinster* infra. Motion to strike denied. Proceedings on other grounds 1992 Conn. Super LEXIS 2007.

See also Jane Masey Draper, "Vender's obligation to disclose to purchaser of land presence of contamination from hazardous substances or wastes", 12 ALR 5th 630.

43 Id. note 5, at 50. Notwithstanding the installation of a venting system for methane gas, leaks occurred releasing contaminants, including benzene and other volatile organic compounds.

44 *See, e.g.,* note 5 at 63.

45 45 Conn. Supp. 605, 1998 Conn. Super LEXIS 3540 (1998).

46 The city's action resulted from orders of the commissioner of environmental protection. Id. at 18 and 25.

47 The "zone of influence" was defined in the consent order closing the landfill as "the area of soil and groundwater within which the treatment of the leachate discharge by soil and mixing of leachate with groundwater occurs, and could reasonably be expected to occur, and therefore, within which some degradation of groundwater quality has occurred or is anticipated to occur." Id. note 45, at 14.

48 Id. note 45, at 14 et seq.

49 The court defined *stigma* as a "fear that the property has an unknown element of risk attached to it owing to its history." At 24. The court cited Northeastern Gas Transmission Co. v. Tersana Acres, Inc, 144 Conn. 509, 134 A. 2d 253 (1957) where the court fount that "A well-founded public belief in danger from the proximity of a gas transmission line is a proper element of damages" *citing* Northeastern Gas Transmission Co. v. Lapham, 19 Conn. Supp 468, 473, 117 A. 2d 441 (1955). For a discussion of the reasons for public opposition to hazardous waste and nuclear waste facilities, *see* Gerard article, note 40, at 1137 et seq. Gerard states that according to several public opinion polls, hazardous, radioactive and nuclear waste facilities are all lumped together as the most feared land uses.

50 Id. note 45, at 26. For a discussion of damages in hazardous and nuclear waste landfill cases *see* Gerard article, note 40, at 1109 et seq.

51 Conn. Gen. Stat. 20-327b.; *See* Washburn article, note 7, at 407 et seq., for a discussion of disclosure statutes in other jurisdictions.

52 C.G.S. Section 20-327b(d)(2)(F).

53 Regulations Concerning Property Condition Disclosure, Section 20-327b-1, at items 7,30,31 and 32.

54 In *Strawn* the court states: "We know that the physical effects of abandoned dump sites are not limited to the confines of the dump. For example, in Ayers v. Township of Jackson, 106 N.J. 557, 535 A. 2d 287 (1987), toxic pollutants from a landfill contaminated the water supply of residents of nearby homes. In Citizens for Equity v. New Jersey Department of Environmental Protection, 126 N.J. 391, 599 A. 2d 507 (1991), we invalidated a regulation of the New Jersey Department of Environmental Protection that prohibited an award of value-diminution damages to owners of property located more than one-half mile from the landfill area. Implicit in that regulation was the recognition that even without physical intrusion a landfill may cause diminution in the fair market value of real property located nearby." at 63

55 The statute does not preempt the common law. Under Section 20-327c, the only penalty for failure of a seller to provide the disclosure report is a fine of $300. As stated infra, buyers in Connecticut have full recourse to the common law in determining matters involving disclosure in a real estate transaction. This is not true in all States. *See* e.g. Washburn article, note 7, at 432 et seq.

56 Data from the National Association of Realtors indicates that approximately 81% of all homeowners use a real estate broker to assist in selling their home. Thus, the conduct of these agents with respect to disclosure (or nondisclosure) issues concerning landfills containing toxic waste is of legal significance to both themselves, and their clients. NATIONAL ASSOCIATION OF REALTORS, "Targeting Home buyers and Sellers" (1995 Ed.). *See* Washburn article, note 7, at 395, for a discussion of the obligations imposed on Brokers generally. Since the laws of agency apply between sellers of real estate and their brokers and salesperson, the conduct of the latter is

attributable to the former. *See* Wasco, Perrelli and Connecticut Real Estate Commission v. Shove, 1988. LeMoult article, note 7, at 435; Baskin v. Dam, 4 Conn. Cir. Ct. 702, 239 A. 2d 549 (1967); Matthew M. Collette, *Sub-Agency In Residential Real Estate Brokerage: A Proposal To End The Struggle With Reality,* 61 S. Cal. L. Rev. 399 (1988). For Connecticut cases regarding the agency relationship *see* note 67, infra.

57 Section 20-328-5a of the Regulations provides that: "A licensee shall not misrepresent or conceal any material facts in any transaction."

58 Id. note 5 at 106.

59 Id. note 5, at 107.

60 *See* Gaetano v. Connecticut Real Estate Commission, No. CV 950551484, Superior Court, New Britain, (1996).

61 In the Matter of Dlubac Century 21 Reale, Realtors, Docket No.: RE 4365, (1995).

62 Wasco, Perrelli and Connecticut Real Estate Commission v. Shove, 1988.

63 In the Matter of Anne Papastathis, William Raveis Real Estate, 1995.

64 *See* Dalberth article, note 8, at 170, arguing that off-site environmental hazards are material matters, citing the Restatement (Second) Torts, Section 548(2)(a) (1976), and the Federal Trade Commission Act definition that a material fact is one that "if known by the prospective purchaser would influence the decision of whether to purchase," *citing* Connor v. Merrill Lynch Realty, Inc., 581 N.E. 2d 196 (Ill. App. Ct. 1991) *appeal denied,* 587 N.E. 2d 1012 (1992); Homsi v. C.H. Babb, Co., 409 N.E. 2d 219 (Mass. 1980). *See* Thomas D. Larson, *To Disclose Or Not To Disclose: The Dilemma Of Homeowners and Real Estate Brokers Under Wisconsin's Megan's Law*, 81 Marq. L. Rev. 1161, 1183 (1998) where the author discusses issues of seller and broker duty to disclose under statutes substantively related to Connecticut law, concluding that "a (Wisconsin) court would likely determine that both the seller and broker have an independent duty to disclose to prospective homebuyers any known on-site or

off-site defect that will materially affect the value of the property or the health and safety of prospective purchasers."

65 Id. note 61.

66 The importance of the location of real property, as it affects materiality, value and desirability, cannot be overstated. *See* Serena Williams, *When Daylight Reveals Neighborhood Nightmares: The Duty of Builders and Developers to Disclose Off-Site Environmentsl Conditions*, 12 J. Nat. Resources & Envtl. L. 1 (Spring, 1997); The *Strawn* court, supra, recognized that "Location is the universal benchmark of the value and desirability of property", adding that a " jury will decide whether the presence of a landfill is a factor that materially affects the value of property." At 66. The United States Environmental Protection Agency has a web site, at www.epa.gov/ttn/uatw/intro_wtl.html, entitled "Choosing Where You Live: A Consumer Self Help Guide to the U.S. and U.S. Territories" which states in its Introduction: This guide addresses the environmental concerns of air quality, water quality, waste management and others, that affect the physical and psychological health of a person. Our physical and psychological health can be affected by our surroundings. These surroundings include water, air, soil, noise, traffic congestion, climate, and population density. These are some of the factors that need to be taken into consideration when determining where to live." Included in the list of factors discussed in the report are sections on "Odor Sources (Industrial and Agricultural)," "Trash and Hazardous Waste Incineration," and "Superfund and Brownfields Sites;" *See* Stephen L. Kass and Michael B. Gerrard, "Real Estate Brokers' Duty to Disclose Contamination," New York Law Journal, (June 24, 1994) at 3.

67 Wedig v. Brinster, 1 Conn. App. 123, 469 A. 2d 783 (1983). *See* "Sub Agency In Residential Real Estate Brokerage: A Proposal to End the Struggle with Reality, 61 S. Cal L. Rev. 399 (1988); Baskin v. Dam, 4 Conn. Cir Ct. 702, 239 A. 2d 549 (1967); Dixon v. Kane, No. CV 900168043 S, 1990 Conn. Super Lexis 1568 (Stamford-Norwalk, October 18, 1990).

68 *See* Wedig v. Brinster, note 37.

69 Conn. Gen. Stat. Section 42-110a.

70 Id.

71 1997 Conn. Super LEXIS 105 (1997).

72 See FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 244-45 n.5 (1972). The criteria are: Whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the common law, or otherwise - whether, in other words, it is within at lease the penumbra of some common law, statutory, or other established concept of unfairness; (2) whether it is immoral, unethical, oppressive or unscrupulous; (3) whether it causes substantial injury to consumers {(competitors or other businessmen)}

73 Id. at 18-19.

74 Id. at 18.

75 Id. at 23.

76 Id. at 26.

77 *See* Catucci v, Ouelette, 25 Conn. App. 56, 592 A. 2d 962 (1991); *See* also Gladstein v. Smithlin, No. CV 93 030 56 59, 1994 Conn. Super Lexis 2225 (Bridgeport, September 6, 1994). *See* also the Dalberth article, note 8, at 167, arguing that state unfair and deceptive acts and practices statutes should be extended to include recognition of environmental hazards as material facts that must be disclosed to potential purchasers before a sale of land occurs. She states that "a carcinogenic environmental hazard could contaminate drinking water and adversely affect a family to a much higher degree than a cracked foundation of a house. These grave health risks necessitate that courts protect the consumer involved in this type of transaction from marketplace abuse."

78 *See* Dalberth article, note 8, at 153.

79 *See* William D. LeMoult, *The Duty of Residential Real Estate Brokers and Salespersons to Disclose Property Condition to Buyers,* 70 Conn. B.J. 435 (December, 1996). This article concludes that real estate brokers and salespersons should not have a duty of disclosure under conditions where there is in place a disclosure statute for sellers which purports to cover the field of disclosable matters. The Connecticut Statutes and

Regulations concerning disclosure do not purport to preempt the common law, nor should they, owing to an inadequacy of scope and accountability. For a contrasting point of view, where the author believes that real estate brokers should inspect property for environmental contamination, *See* Sarah Waldstein, "A Toxic Nightmare On Elm Street: Negligence and the Real Estate Broker's Duty In Selling Previously Contaminated Residential Property," 15 B.C. Envtl. Aff. L. Rev. 547 (1988).

80 *See*, e.g., Farrah et al. v. Acker , Jr. et al., 199 Conn. Super. LEXIS 1612, (1998), at 14, (Hartford) in a case involving lead paint where the defendants were found on the facts to be not liable.

81 *See* LeMoult article, note 7, at 438 et seq.

82 As mentioned supra, since this article concludes that a landfill containing hazardous and toxic waste is a disclosable matter in Connecticut, matters concerning nondisclosure or silence of a seller or real estate professional are of paramount importance.

83 *See* Robinson et al. v. Parillo et al., 1999 Conn. Super. LEXIS 935, 1 (1999).

84 104 Conn. 650, 134 A. 62 (1926).

85 *See* note 2 regarding the decline of caveat emptor.

86 Id. note 84, at 652. In this case, the defendant/seller of property instructed the town clerk, who later represented the seller, not to reveal to the plaintiff/buyer that the Bridgeport Hydraulic Company had, by special charter, the right to condemn the property sold. The court, nevertheless, found for the defendant under the general rule.

87 Id. The court failed to explain why this language was inapplicable. It seems fair speculation that the court was then wedded to notions of caveat emptor.

88 152 Conn. 372, 207 A. 2d 268 (1965).

89 Id. at 378.

90 173 Conn. 124, 127, 376 A. 2d 1099 (1977).

91 *Citing* Ceferatti v. Boisvert, 137 Conn. 280, 283, 77 A. 2d 82; Behrmann v. Behrmann, 110 Conn. 443, 446, 148 A. 363; Egan v. Hudson Nut Products, Inc., 142 Conn. 344, 347, 114 A. 2d 213.

92 Id. note 90, at 128-129.
93 Id. note 37.
94 At 127.
95 At 652.
96 142 Conn. 344, 347-348, 114 A. 2d 213 (1955).
97 7 Conn. App. 643, 509 A. 2d 1092 (1986)
98 Every representation of an untrue fact regarding a specific subject is a nonrepresentation of a true fact as to the same subject. Thus, "fraudulent" or "innocent" misrepresentation and "fraudulent nondisclosure" are two sides of the same coin. The rules of law concerning the former, however, are more stringent owing, perhaps, to perceptions of truth and reliance. The rules of law are modified, therefore, when there is no representation whatever. Here, the law requires considerations of "materiality" and "occasions or circumstances which impose a duty to speak." Consider, for example, a buyer of property who is unaware of the insidious leaching of hazardous waste emanating from a landfill located, say, a quarter mile away, and beyond the view of the buyer, and which has been closed for several years. Can it reasonably be expected that the buyer will ask if , e.g., the property is exposed to possible air or water contamination from volatile organic compounds? If the buyer is thoughtful or intelligent enough to pose the question, and the seller, or real estate agent, says "no," the rule in *Franchey* should apply. But if the question is never posed, and the seller, aware of the potential danger, merely remains silent, although the deception is undiminished, focus shifts to the buyer's duties of investigation or inquiry, which again seems related to notions of truth and reliance. Thus the requirements of "materiality" and "occasions or circumstances which impose a duty to speak." In other words, unless the matter is significant and important to the transaction, i.e., would affect the value or desirability of the property to the buyer, and would reasonably be perceived as such, there is really no need for the seller to say anything, or the buyer to expect it; i.e. no duty to speak arises. Thus, the seller's duty is presumably heightened where

he or she has suffered some adverse physical effects from the environmental condition.

99 Id. note 28, at 433.

100 18 Conn. App. 652, 559 A. 2d 1171 (1989).

101 Id. At 656.

102 Id.

103 Id.

104 Id. at 657. The court recited the elements of fraud as (1) a false representation made as a statement of fact, (2) that is untrue and known to be untrue by the party making it, (3) made to induce the other party to act on it, and (4) that the latter did so act on it to his injury, *citing* Miller v. Appelby, supra. It is not clear what facts particular aspect of the facts the court relied on in arriving at it's decision.

105 25 Conn. App. 56, 592 A. 2d 962 (1991).

106 1998 Conn. Super LEXIS 475.

107 *See* note 104.

108 The cases are not consistent in the selection of legal principles concerning representations or disclosures, and nonrepresentations or nondisclosures, whether they be negligent, innocent or fraudulent, and it is not possible for this article to reconcile them . The courts are consistent, however, in their refusal to allow sellers to hoodwink buyers, and vice versa.

109 Id. note 83.

110 Id. note 83, at 3. It is not clear from the facts whether there was an alleged nondisclosure, partial disclosure, or some hybrid.

111 Id. note 83, at 5. The court goes on to characterize the doctrine saying that it "found its full flowering in a much-cited statement by a Victorian jurist, uttered at the height of unimpeded robber baron capitalism, that, 'Mere nondisclosure of material facts, however morally censurable....would in my opinion form no ground for an action in the nature of an action for misrepresentation.' Peek v. Gurney, 6 L.R.-E.&I. App. 377, 403 (H.L. 1873) (Cairns, L.). Given this rule, Professor Haskell pithily said that , "Our law offers greater protection to the purchaser of a...dog leash than it does to the purchaser of a

house." Paul G. Haskell, *The Case for an Implied Warranty of Quality in Sales of Real Property*, 53 Georgetown L.J. 633, 633 (1965).

112 Id. note 83, at 6, *citing* 2 Fowler V. Harper, Fleming James, Jr. & Oscar S. Gray , THE LAW OF TORTS 471 (2d Ed. 1986).

113 Id. note 83, at 7.

114 Id. at 8.

115 It is dubious that the defendant in *Gayne* would be successful today in light of *Duksa* and its progeny.

116 The proximity of the landfill is, of course, an important factual issue. *See*, e.g. Gerald E. Smolen, Gary Moore, Lawrence V. Conway, "Hazardous Waste Landfill Impacts on Local Property Values," Real Estate Appraiser, (April, 1992), and other articles, note 40, showing that the closer a property is to a hazardous waste landfill, the greater the diminution in value.

117 It seems incongruous that real estate brokers or salespersons employed by a seller have a duty to disclose all matters "material" to a real estate transaction, but their principals, the sellers, may incur liability, under some circumstances, only with a showing of some element of fraud. In this connection, *see* LeMoult article, note 7 at 454 et seq.

118 In *Gibson v. Capano*, 241 Conn. 725, 699 A. 2d 68, 1999 Con. LEXIS 222 (1997) the Supreme Court held that "parties to a contract for the sale of real property are free to disclaim responsibility for known environmental risks. Indeed, the agreed upon contract price for the property typically reflects an allocation of the *known* risks that attend the ownership of property. In addition, in the absence of a claim of mistake, *fraud* or unconscionability, a clause disclaiming reliance by the buyer on the seller's representations is a valid contract term." (emphasis supplied)(citations omitted) While the meaning of the term "fraud" would occupy the court's attention in a landfill case involving nondisclosure, it is dubious, in light of the body of common law and statutes concerning disclosure, the court would find boilerplate contract language controlling where the circumstances involved the insidious nature of contamination attendant with hazardous and toxic waste landfills, where the sellers knew of

the condition and failed to reveal it to innocent purchasers, thereby impacting on the value or desirability of the property.

119 "Public policy" may be defined as the "constitution, statutes and common law of the state," Alabama Bank of Montgomery v. First State Insurance Company, Inc. et al., 899 F. 2d 1045, 1990 U.S. App. LEXIS 6744 (1990), or may be considered in a broader context as "Community common sense and common conscience, extended and applied throughout the state in matters of public morals, health, safety, welfare, and the like; it is that general and well-settled public opinion relating to man's plain, palpable duty to his fellow men, having due regard to all circumstances of each particular relation and situation," Blacks Law Dictionary, 6th Ed. (1990), *citing* Hammonds v. Aetna Cas. & Sur. Co., D.C. Ohio, 243 F. Supp. 793, 796. This article refers only to the former, although the requirement of disclosure under circumstances discussed herein recommends debate on the latter.

120 Mandatory Seller Disclosures In Real Estate Transactions, Title 28, HRS @ 508D-1 et seq. (effective 7/1/95). For an analysis of provisions of the law *see* Kenneth M. Nakasone, *Seller Beware: New Law Protects Hawaii Home Buyers,* 18 Hawaii L. Rev. 981 (1996).

121 Id. at Sec. 508D-1. The Hawaii disclosure statement is not required by statute or regulations.

122 Id.

123 Excluded from the requirement of disclosure is the fact that (1) An occupant of the residential real property was afflicted with acquired immune deficiency syndrome (AIDS) or AIDS related complex, or had been tested for human immunodeficiency virus; or (2) The residential real property was the site of an act or occurrence that had no effect on the physical structure or the physical environment of the residential real property, or the improvements located on the residential real property. At Section 508D-8.

124 At Section 508D-6. See the section for additional provisions.

125 As stated in my article, *n*ote 7, at 457, I respectfully disagree concerning the requirement of disclosure by real estate agents where there is a mandatory and <u>comprehensive</u>

disclosure statement furnished by the seller, such as Hawaii's. The agent should have no responsibility to read or be responsible for the disclosure statement and its contents. Rather, the statement should be annexed to, and made a part of, the contract, and inaccuracies, nondisclosures and the like should be treated under principles of contract law. This result would relieve the courts of the burden of "he said, she said" litigation, and recognize the essential function of real estate agents and brokers: to provide a market for the sale of real property, and negotiate a mutually acceptable price.

126 As stated in my article, *n*ote 7, at 457, I respectfully disagree concerning the requirement of disclosure by real estate agents where there is a mandatory and comprehensive disclosure statement furnished by the seller, such as Hawaii's. The agent should have no responsibility to read or be responsible for the disclosure statement and its contents. Rather, the statement should be annexed to, and made a part of, the contract, and inaccuracies, nondisclosures and the like should be treated under principles of contract law. This result would relieve the courts of the burden of "he said, she said" litigation, and recognize the essential function of real estate agents and brokers: to provide a market for the sale of real property, and negotiate a mutually acceptable price.

POPULATION-BASED MEDICINE RECOMMENDATIONS FOR MAMMOGRAPHY SCREENING MAY BE DANGEROUS FOR THE INDIVIDUAL PATIENT

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ABSTRACT

Objective: Several research studies in recent years have concluded that mammograms for women under age 50 are not "cost effective." The purpose of this study is to estimate the number of cases of breast cancer that were diagnosed by mammography when the patient was under the recommended age for this test.

Methods: Study questions were developed and 605 charts of women with breast cancer were audited in one surgeon's office in Northeastern Pennsylvania. Several descriptive and bivariate analyses were performed to examine the relationship between use of mammography screening and recommended age groups as well as other explanatory factors for the study population.

Results: Of the 605 women included in the study, only 7.3 percent did not have a mammography. Approximately 20 percent of the breast cancer cases diagnosed by mammography were for women under 50. The Chi-square analyses indicated that women less than 50 years of age were approximately 2.6

times more likely to have had a mammography than those who are about 50 (p <0.05). In fact, 69 percent of women under age 50 with mammography underwent this procedure without having any family history of breast cancer.

Conclusion: The results of this study suggest that on an individual basis screening for this population annual mammograms may be an important public health concern. Mammography is appropriate and effective in women under age 50 and that for the individual patient this screening test may be very important. Patients need to be made aware of the fact that even though national agencies recommend ages for cost effective screening strategies for mammography they may not be appropriate for each individual patient.

INTRODUCTION

Breast cancer is the most commonly diagnosed cancer and the second leading cause of cancer death among women in the United States (American Cancer Society, 1995). An estimated figure for new invasive cases among US women during 1998 was 175,000. Of this group, about 43,900 women were expected to die from the disease (Centers for Disease Control and Prevention, 1999). Breast cancer incidence rates for women have increased about 2 percent a year since 1980, but recently have leveled off at about 110 per 100,000 women (American Cancer Society, 1995). Most of the recent raise in rates is believed to be due to marked increases in mammogram utilization, allowing the detection of early stage breast cancers.

There is controversy regarding the ages at which women should undergo mammography and necessary frequency of such testing. The American Cancer Society and ten other national organizations issued a consensus statement about breast cancer screening guidelines in 1989. This consensus statement supported mammographic screening every one to two years between the ages of 40 and 49 years with annual screening beginning at age 50 years. In contrast, the American College of Physicians and the United State Preventive Services Task Force maintained that regular screening should be initiated at age 50, and mammography should only be considered among younger women at increased risk of disease (White, Urban & Taylor, 1993). More recently, The American College of Obstetricians and Gynecologists (ACOG) and the National Cancer Institute recommended that a women in her forties with no risk factors have a mammogram at least once every two years and yearly after the age of 50 (ACOG, 1997). American Cancer Society, however, continues to recommend annual mammograms for a woman in her forties (American Cancer Society, 1997).

During the past decade, several studies have documented the effectiveness of screening mammography in the reduction of mortality from breast cancer among women aged 50-70 years (Morrison, 1989; White et al., 1993). Despite the fact that breast cancer screening has been recommended by major medical organizations for some time now, only approximately half of the women in the United States receive screening at the recommended intervals (Worden et al., 1999). Among factors inhibiting regular mammograms are lack of physician recommendation and health insurance coverage, knowledge gaps, physicians' or patients' knowledge or attitudes about some aspects of breast cancer screening, insufficient clinical or community support for education and reminders about screening, and a perception that screening is not necessary for women without symptoms of breast disease (Worden et al., 1999; Lipkus et al., 2000).

In the current environment of scarce resources for medical care and increasing concern about the health care costs it is important to consider the cost effectiveness of mammography screening programs. The purpose of this study is to estimate the number of cases of breast cancer that were diagnosed by mammography when the patient was under the recommended age for this test.

QUESTION ONE:	Is the use of mammogram screening an effective diagnostic tool for women under the age recommended by population-based screening guidelines?
QUESTION TWO:	Should the insurance company or the physician and patient determine the age and frequency of mammography screening?

METHODS

The data for this study were drawn from medical records of 605 women with breast cancer in one surgeon's office in Northeastern Pennsylvania. Most reports of mammography utilization in the literature have typically relied on a woman's self-report. Several studies have indicated that women tend to over-report mammography use and inaccurately recall the timing of their mammograms compared to the medical records (Lazovich et al., 1999). The use of medical record data to measure trends in mammography utilization in the general population has been limited.

In this study, we used the audited charts of 605 women to estimate the number of cases of breast cancer that were diagnosed by mammography when the patient was under the recommended age for this test. The data set consists of a set of basic health and demographic questions, and some other supplemental questions on specific health problems and symptoms. Several descriptive and bivariate analyses were performed to examine the relationship between use of mammography screening and recommended age groups as well as other explanatory factors for the study population.

RESULTS

Descriptive statistics for the study variables are presented in Table 1. As can be seen from the table, of the 605 women included in the study, two-thirds were 50 years of age or older, with a mean age around 62. Only 7.3 percent of the women did not have a mammography. About 20 percent of the women reported having a history of breast cancer in their families.

Table 1. Descriptive Statistics (n = 605)

Variables	Number in Sample	Percentage/ Mean
Age	605	61.6
Less than 50	147	24.3%
50 and older	458	75.7%
Had a mammography		
Yes	559	92.4%
No	44	7.3%
Family history of breast cancer		
Yes	121	20%
No	484	80%

Tables 2-4 summarize the results of the bivariate analyses. Approximately 20 percent of the breast cancer cases diagnosed by mammography were for women under 50. In a crosstabulation, the Chi-square test indicated that women less than 50 years of age were approximately 2.6 times more likely to have had a mammography than those who are about 50 ($p < 0.05$). Further analyses revealed that, in fact, 69 percent of women under age 50 with mammography underwent this procedure without having any family history of breast cancer.

Table 2. Mammography Findings			
	Dichotomous Age Variable		
	< 50 years	50 years plus	Total*
Findings			
Positive	120	389	509
Negative	27	68	95
Total	147	457	604

Chi-square = 1.343 ($p < 0.511$)
* Total does not add up to 605 because of the missing data.

Table 3. Mammography Utilization			
	Dichotomous Age Variable		
	<50 years	50 years plus	Total*
Had a mammography			
Yes	140	419	559
No	6	39	44
Total	146	458	603

Chi-square = 10.403 ($p < 0.015$)
* Total does not add up to 605 because of the missing data.

Table 4. Mammography Utilization for Women < 50			
	Family History of Breast Cancer		
	Positive	Negative	Total
Mammography			
Yes	43	97	140
No	1	4	5
Total	44	103	147

DISCUSSION

Health spending has reached the point of diminishing marginal social benefit. Population-based medicine, evidence-based medicine, and cost-benefit analysis are all being utilized to increase productivity and eliminate flat of the curve medicine. While the use of these tools may make sense for the aggregate population their use may pose hazards for the individual patient.

There is a belief, in many cases supported by extensive research, that many procedures in health care do not provide benefits commensurate with their costs. Health policy decisions will always produce secondary effects which may pose dangers for the individual patient.

CDC (1999) reports that decreases in breast cancer mortality can be partially attributed to earlier disease detection and treatment due to greater use of screening. The CDC recommends that initiatives to encourage women to receive initial screening should continue. The CDC (1999) also reports that half of the women who had mammograms received them as part of a routine medical care that is influenced by population-based guidelines. Over 30 percent indicated that their physician or other health professionals were influenced by national guidelines. Those women who never had a mammogram were more likely to report that they didn't believe they needed one and their physician had not recommended this screening test.

The results of this study suggest that on an individual basis screening for this population annual mammograms may be an important public health concern. Mammography is appropriate and effective in women under age 50 and that for the individual patient this screening test may be very important. Patients need to be made aware of the fact that even though national agencies recommend ages for cost effective screening strategies for mammography they may not be appropriate for each individual patient.

This study supported the original hypothesis that the age and frequency of mammography screening should be determined by the physician and patient not by population-based guidelines advocated by national agencies. Population-based medicine should not be telling individual patients how much to spend on health care screening tests.

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ADDING INSULT TO TAXPAYER INJURY, SCOPE OF APPELLATE REVIEW: EITHER WAY YOU LOSE

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ABSTRACT

I. R. C. §6662(b)(2) of the Internal Revenue Code of 1986 imposes a 20% penalty upon understatements of tax which are considered substantial understatements. A safe haven for taxpayers exists if the taxpayer has substantial authority for the position taken on the tax return. The Ninth Circuit Court of Appeals ruled in Estate of Kluener v. Comm., 154 F.3d 630 (9th Cir., 1998), that the term "authority" as used in the statue encompasses factual evidence as well as legal sources of authority. This ruling has also added to the confusion of the Appellate Courts procedures regarding the scope of review of the cases heard. Appellate Courts have used both de novo and clearly erroneous standards of review.

INTRODUCTION

The income tax system in the United States is a self-reporting system which relies upon the individual taxpayer to self-report their items of income and deductions. Congress has attempted to increase compliance as related to the reporting of income by taxpayers who are engaged in a trade or business, including partnerships, corporations and nonprofit organizations

(I. R. C. §§ 6041-6050S (1999)). Congress has furthered its reporting obligations upon certain payers who are required to substantiate their deductions by requiring informational returns to be submitted for items such as mortgage interest payments, Form 1098, and for contributions to Individual Retirement Accounts, Form 5498 (I. R. C. §§ 6041-6050S (1999)).

While the Congress has instituted various statutory reporting requirements, taxpayers can still take aggressive positions when the taxpayer wishes to chance the "audit lottery" (Predmore). The audit lottery permitted a taxpayer to underreport tax liability with the potential downside of interest due on any underpayment following an Internal Revenue Service audit. To make the penalty for playing the "audit lottery" (Predmore) more severe, Congress has enacted a variety of accuracy related penalties which will levy a penalty of 20% on the unpaid tax balance in addition to any interest due on the assessment (I. R. C. §6662(a) (1999)). The broadest of the penalties and one which can be impacted by any taxpayer's position not covered by the other accuracy related penalty is for the substantial understatement of income tax (I. R. C. §6662).

CURRENT STATUTE AND COURT INTERPRETATIONS

The Internal Revenue code permits the imposition of the 20% accuracy related penalty if there is a substantial understatement of tax (I. R. C. §6662(d)(1) (1999)). A substantial understatement exists if the underpayment of tax exceeds the greater of : (1). 10% of the tax required to be shown on the tax return; or, (2). $5,000 ($10,000 for corporations other than S Corporations or personal holding corporations) (I. R. C. §6662(d)(1) (1999)).

Taxpayers can reduce or eliminate the penalty by demonstrating that a portion or all of the understatement of tax is not substantial. This occurs by showing that the taxpayer position was: (1). based upon substantial authority (I. R. C.

§6662(d)(2)(B)(i) (1999) and Treas. Reg. §1.6662-4(d)); or, (2). adequately disclosed (I. R. C. §6662(d)(2)(B)(ii)(l) (1999) and Treas. Reg. §1.6662-4(e)).

Subsequent to the Revenue Reconciliation Act of 1993, the adequate disclosure standards have become increasingly difficult for taxpayers and practitioners to comply with. The current standards require a disclosure (Treas. Reg. §1.6662-4(f)) of the position on Form 8275-R (Regulation Disclosure Statement) which must be accompanied by a reasonable basis for the item or the position taken on the tax return (I. R. C. §6662(d)(2)(B)(ii)(ll) (1999) and Treas. Reg. §1.6662-4(e)). Increasing the standard of disclosure to a "reasonable basis" for the position from what had been a basis in a position which was not frivolous will create "new considerations which factor into the disclosure decision". (Predmore, 22)

The substantial authority exception to substantial understatement penalty occurs by analyzing the law and applying it to the relevant facts facing the taxpayer. (Treas. Reg. §1.6662-4(d)(2)) The standard which must be met is the likelihood that a taxpayer's position will prevail is somewhere between the "more likely than not" (greater than a 50% likelihood of prevailing) and the reasonable basis standard. (Treas. Reg. §1.6662-4(d)(2)) The determination of whether substantial authority is present is: (1). Weighting of authorities supporting and contrary to the taxpayer's position; (2). Consideration of the relevant persuasiveness and the type of document providing the authority; and, (3). Determining whether the authorities considered are included within the enumerated list within the regulations. (Treas. Reg. §1.6662-4(d)(3)(iii))

Using the standards set forth in the regulations can produce authorities which both support the taxpayer's position and are contrary to that same position. Since the determination of the presence of or lack of substantial authority is made using an objective standard it is not what a taxpayer believes relative to the existence of substantial authority but what will be decided using the preceding three evaluation techniques. It is this evaluation which causes the substantial authority standard to be a “controversial and elusive concept” (Jones, 1185) when applied by the taxpayer, Internal Revenue Service and Courts.

The circuit courts have reviewed Tax Court decisions using both the “de novo” and “clearly erroneous” standards for review. (Jones, 1185) Commenting upon the Tax Court’s application of the substantial authority standard, the Eleventh Circuit in *Osteen v. Commissioner* observed the Tax Court position “as it seems to do in most cases, gives little explanation as to why there is substantial authority in one case, but not in another”. (*Osteen)* While reviews have occurred at the appeals court level, the Supreme Court has yet to review the standard. It is the lack of guidance with from the Tax Court on an enumerated standard which causes taxpayers difficulty in planning for tax positions. Considering the new standards for disclosure of a taxpayers position and the difficulty in determining what substantial authority will be accepted upon audit, the “audit lottery” maybe what a taxpayer will attempt to play.

The Eleventh Circuit had the opportunity to review the substantial authority standard in *Osteen v. Commissioner*. At the appeals level, the Court upheld the Tax Court’s position regarding the deductibility of expenses in a horse breeding operation yet reversed the Tax Court regarding the substantial understatement penalty. While providing an exhaustive review of each of the nine relevant factors utilized to determine whether an undertaking rises to the level of a trade or business , the Tax Court did not do the same with the substantial understatement penalty. (Treas. Reg. §1.183-2(b)) In this case the Tax Court, upon rendering its decision saying “The record before us does not convince us that the petitioners engaged in their horse breeding activity with an actual and honest objective of making a profit. Therefore, petitioners are not entitled to take deductions for business expenses and depreciation in excess of income.” *(Osteen)* When evaluating the issue of substantial authority the

Tax Court, in three paragraphs, summarized the applicable statutory requirement and concluded "Based upon the discussion above, we are convinced that there was not substantial authority for the petitioners' position." *(Osteen)* The confusion comes from the lack of any guidance on the part of the Tax Court in the reasoning behind its decision. Upon appeal the Eleventh Circuit found this same failing in the Tax Court with the lack of a consistent, and workable test which could be used to determine when a penalty should or should not be imposed. *(Osteen, 359)* This leaves the taxpayer with a dilemma whenever there is a "winner take all" tax issue to be decided.

While the Eleventh Circuit noted "Nobody argues, however, not even the government, that because the taxpayers lose on the factual issue, they must lose on what would seem to be a legal issue". *(Osteen, 358)* This creates a scenario where upon Appeals Courts reviewing a "winner takes all" case, whoever prevails gets the entire expense either allowed or disallowed and then the Court must decide the substantial authority issue. In *Osteen* the court followed the clearly erroneous standard of review and found that the only time there is substantial authority is when under this standard a reversal could be obtained. *(Osteen, 358)*

The Fifth Circuit had the opportunity to review a Tax Court decision subsequent to the Eleventh Circuit review of *Osteen*. In *Streber v. Commissioner,* 138 F. 3d 216 (5th Cir. 1998) the Fifth Circuit utilized the logic developed in *Osteen* to find the taxpayers had substantial authority for their positions. The Streker case once again involved a "winner take all" situation where the Court was faced with one factual issue: when a gift was made to the taxpayers daughters. (*Streber, 223)* Had the gift been received in one year the daughters would be liable for the tax otherwise the father would be liable for the tax. (*Streber, 223)* The Tax Court concluded that the daughters were liable for the tax as a result of their ownership of certain notes received as a gift from their father which required a decision on the applicability of the substantial understatement penalty. (*Streber,* 95,601) The Tax Court once again set forth the requirements of §6661 (now §6662) and with no analysis of the law and application to the facts ruled in favor of the Commissioner. (*Streber, 9*5,601) In making such ruling they stated: "We assume that, in defense to respondent's determinations of additions to tax, the daughters rely exclusively on our determining no deficiencies in tax liability. We have determined such deficiencies. The daughters have failed to carry their burden of proof." (*Streber, 9*5,601) In rendering such a decision the Tax Court once again failed to delineate any clear test or set of facts from what a taxpayer can draw guidance.

Upon appeal to the Fifth Circuit, the Court found that the Internal Revenue Service had failed to show that the principle set forth by the Eleventh Circuit in *Osteen* was inapt in the case at hand. *(Streber, 222)* The Court also found fault that "the government makes no effort to assert that the only rational tax treatment of the transaction was as a gift made before 1985". *(Streber, 222)* Had the government shown such a fact, there would have been no basis to prevail under a "clearly erroneous" standard as had been addressed in *Osteen*. In doing this the Court was moving toward a consideration of factual authority in making a determination of the existence of substantial authority.

A dissenting opinion in *Streber,* written by Circuit Judge King, takes exception to the use of fact based evidence and ignores the rationale of Osteen. Judge King put forth that the majority erred in reviewing factual evidence in reaching its conclusion regarding substantial authority. *(Streber, 228)* In setting forth this opinion Judge King cites Treas. Reg. 1.6661-3 as substantiation of the position that "substantial authority does not contemplate substantial evidentiary authority." *(Streber, 228)* In reaching this conclusion he looks at the exclusive list of authorities in the regulations and finds that these are all legal sources which can be interpreted as meaning 6661 "contemplates only substantial legal authority." *(Streber, 228)* The use of factual evidence in support of a position as substantial authority could lower the standard of review from "clearly erroneous" to ability to survive summary judgement. Using a lesser standard would mean that a taxpayer would need to find some evidence in support of their position. The ramifications of this position could mean "when a taxpayer's entitlement to a particular tax benefit hinges upon facts that will be elucidated by witness testimony, the taxpayer need only lie about the facts that would entitle him to the benefit in order to shield himself from liability for a substantial understatement penalty resulting from his improperly claiming the benefit." *(Streber, 228)*

FACTUAL EVIDENCE AS LEGAL AUTHORITY?

The Fifth Circuit entered its decision regarding *Streber* on April 15, 1998 with a desenting opinion cautioning the use of factual evidence as a consideration in substantial authority. On September 9, 1998 the Sixth Circuit decided *Estate of Kluener v. Commissioner*,154 F. 3d 630 (6th Cir. 1998), which brought forth factual evidence as a consideration in establishing substantial authority.

In establishing the standard of review to utilize in a substantial understatement penalty case, the Sixth Circuit had a case of first impression. (*Kluener, 637)* The Court recognized that several circuits had addressed the issue in the context of §6661, the predecessor to §6662, and had used both the "clearly erroneous" and "de novo" standards of review. (*Kluener, 637)* Since this was a case of first impression the Court, stating that no cases in other circuits had reviewed a case addressing §6662, chose to use de novo review in the evaluation of law and clearly erroneous when reviewing the underlying factual findings. (*Kluener, 637)* The rationale behind the Courts decision came from an interpretation of the regulations under §6662 which state "The substantial authority standard is an objective standard involving an analysis of the law and application of the law to relevant facts." (Treas. Reg. 1.6662-4(d)(2) (1997) and 154 F. 3d 630, 637 (6th Cir. 1998)) Since this represents an objective standard, it would accompany a legal issue which requires no deference to the lower court rendering de novo review appropriate in regard to the evaluation of applicable law and its application to the underlying facts. The standard of review for the underlying facts would be clearly erroneous. (Kluener, 637)

Once the Court determined the standard of review, it considered what precise meaning it would place upon "substantial" and whether or not "authority" includes both factual evidence as well as legal sources. (Kluener, 637) In making the evaluation, the Court looked to *Osteen* since it found that case had addressed both issues finding "the court criticized the substantial authority test for ignoring factual evidence." (Kluener, 638) The *Kluener* Court overcame the argument that Treas. Reg. §§1.6662-4(d)(2), 1.6662-4(d)(3)(i), and 1.6662-4(d)(3)(iii) (1997) represent an inclusive list of legal authorities by arguing the list restricted the inclusion of legal authorities but did not restrict the inclusion of factual evidence since "two provisions command us to examine relevant facts, whereas nothing explicitly precludes us from examining them." (Kluener, 638) The Court also found policy concerns and practical jurisprudence to require the inclusion of factual evidence within the definition of authority. (Kluener, 639) Failure to consider the factual evidence would de facto mean imposition of the substantial understatement penalty while nothing in the regulations supports this end and in evaluating legal authority a review of the factual evidence is required to determine the applicability of the legal authority. (Kluener, 639)

The Court in *Kluener* did not endorse the *Osteen* decision in its entirety. It disagreed on the analysis of "substantial" by the *Osteen* Court to require a reasonable basis for inclusion in the definition. (Kluener, 639) The Court interpreted the regulations on substanial authority to require "a taxpayer to present considerable or ample authority, whereas Osteen requires him to present only some evidence." (Kluener, 639) In making this determination the Court referenced both *Streber* and Treas. Reg. §1.6662-4(d)(2) (1997).

In rendering its decision in *Kluener*, the Sixth Circuit adds to the legal authority examination set forth in the regulations and examination of the factual evidence both to determine the applicability of the legal authority and as its own authority for the position. In its holding this two prong approach is utilized to reverse the imposition of the accuracy related penalty: "Considerable factual evidence indicates that he transferred the horses for a valid, non-tax business purpose." (Kluener, 639) and "With this factual background, substantial legal authority supported Kluener's tax treatment ." (Kluener, 639)

CONCLUSION

Taxpayers and practitioners faced with the question of the existence of substantial authority or the need to disclose a tax position to avoid the substantial understatement penalty are faced with a difficult decision with these two options. With no clearly workable test having been set forth by the Tax Court on the definition of "substantial authority," the Internal Revenue Service can be aggressive in its imposition of the penalty.

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INFORMATION PRIVACY AND THE E-BUSINESS MODEL

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ABSTRACT

The e-business model was made possible by the influence of the technological advances on the collection of information and the ease and accuracy with which the information is made available to the market participants. Various e- business firms have set up data banks not only for their use, but also for reselling to other users. This activity has raised issues about privacy of information and privacy protection as individuals sought ways to safeguard against unauthorized and abusive use of information collected about them. The purpose of this paper is to examine the issues of information privacy protection in the framework of the e-business model especially as it pertains to College students, to examine the concept of self-regulation by e-business firms and to comment on the proposed regulatory actions.

INTRODUCTION

Revolutionary changes in the computer and telecom-munications industries especially the Internet have increased the volume of information that is available for use as a potential weapon and as an economic resource. Numerous communications firms have estimated the dollar value of e-commerce just in the United States at over $43 billion in 1998 and their forecast place the volume to over $ 1.4 trillion by 2003, (see www.headcount.com). This number does not include e-business where the volume of transactions is much higher than e-commerce. The technological advances have led to structural shifts in almost all sectors of the economy and they have facilitated the creation of numerous Internet based industries that are challenging other traditional firms for customer dollars.

The U.S with its dynamic computer and information sectors has been the leading force in this new era. The U.S edge is traceable to a wide range of sources: the prevalence of entrepreneurial risk taking, the size and affluence of the domestic market, the sheer size of the leading U.S. corporations, and the awareness of the potential returns to R&D expenditures. Thousands of Internet based companies have emerged capitalizing on their ability to handle information and to reduce the barriers between consumers, and suppliers and producers. In the process they have helped to redefine the relationships among these market participants.

Digital data are cheap, easy to copy and to include in sophisticated and dynamic data pages with low cost global access. The data exchange systems and information networks have increased the mental maps of the decision makers by providing them with detailed characteristics of the market participants. As a result a new business model has emerged in which information is an essential commodity that facilitates the creation of personalized catalogues and the segmentation of the market in order to engage in cross marketing and cross promotional activity.

THE E-BUSINESS MODEL

The new Internet based business model takes many different formats: Auction, name your price, group buying, comparison shopping, online mall, reverse auction, selling below cost, managing execution risk, shopping enabler, info-intermediary and bot price comparison. It differs substantially from the old business model in many respects: short term objectives, cost structure, pricing strategies, customer service, the application of the exclusion principle, and profitability.

Business firms utilizing this model seek to aggregate buyers and sellers through the use of new technology, through new content, and new commerce ideas in order to facilitate both the decision making process and the subsequent delivery of products or services. They represent vortex businesses whose success depends on their ability to understand the way a purchase decision is made and the logistical structure of the industry that they serve. To achieve their goal they analyze and deliver to the business community information collected on the sites including chat rooms, message boards and surveys. The substantial network externalities and the increasing returns to scale associated with these companies makes aggregation easier as success leads to additional customers, additional products, additional suppliers and additional customers. More specifically there are economies of scale arising from: data centers, web programming, and centralized promotional campaigns to draw and to attract customers. There are multiple sources of revenue: revenue from repeat customer purchases, referral revenue, growth revenue, and revenue from renting the customer base to advertisers or third party sellers.

The traditional business model is based on the decision of business firms on what to produce with minimum input from the customer. The interactive nature of the Internet based model reduces the barriers of communications, streamlines and modernizes the supply line and the customer input. It provides a low cost extremely efficient way of attracting customers, handling purchase orders, and displaying merchandise. Although there is excess capacity associated with back up systems and higher costs from stressing of the system due to higher volume of traffic, there is an overall reduction in the costs of doing business. The lower costs have reduced the barriers to entry and have increased the number of competing firms. In the process, the vertically linked supply chains between manufactures, wholesalers and retailers are being replaced with horizontal structures that offer access to a wider choice of suppliers. In this model single transactions will trigger multiple transactions across the supply line and will probably increase the intensity with which firms will pursue both economies of scale and economies of scope firms.

Technological innovations have enabled e-firms to target the specific registered uses and purchases of customers and to capture behavioral data, thus creating sophisticated data files. Various smart programs called cookies, web-bugs or ID cards enable data base managers to not only identify which computer was connected to what site, but also to track users across all the sites on which their ads appear. Personal information given to an Internet site could easily be cross referenced with the information collected through the smart programs to generate a very detailed personal dossier and behavioral patterns which facilitates individual knowledge driven marketing.

The increased flow of information enhances consumer choice but it also often overwhelms the potential buyer who ends up gravitating to a well-known site. As the size of the site increases, the site experiences increasing returns, which enhances the reputation and the use, which attracts even more customers and it becomes even more valuable. Recent Wall Street Journal reports on evidence collected by the Forrester Research firm indicates that 10% of the sites receive 82% of the usage, while less known sites attract a much smaller customer traffic.

The survival and the efficiency of the companies who have built their strategies on this model depend on their ability to provide and to process information among the various participants without any excess interference. There are three types of new risk associated with the e-business firms: Strategic Competitive, Strategic Adjustment, and Operational.

Strategic Competitive risk

relates to new forms of competition, which reduce the geographic barriers and deprive local firms of any locally based monopoly power.

Strategic Adjustment risk results from misjudging the degree to which e-commerce will replace more traditional forms of commerce.

Operational risk is the result of the exposure of the electronic marketplace to technological failure including the inconvenience of customers to fraudulent transactions by hackers. These types of risk vary under alternative assumptions and it is difficult to estimate the dollar value given a lack of long history or results and the changing legal and regulatory environment.

CURRENT PRIVACY PROTECTION

The technological advances have outpaced the regulatory advances and have led to concerns over privacy of information. The U.S political, social, and economic fabric has been woven with the philosophy of the free flow of information, and private enterprises have benefited from that flow. The U.S citizen has recently come to view privacy as a loyalty ingredient. Furthermore, the private property laws are ill suitable for handling claims on information. The US Privacy Protection Act of 1974 is relevant to information keeping practices of the federal agencies only. The FCC established as part of the 1996 Telecommunications Act strict " opt-in" privacy provisions, under which a consumer has to give his consent before his calling data can be used as part of a marketing campaign for additional services and products. The majority of the business firms have expressed their preference for the " opt-out " approach, which costs less and has greater revenue potential. It gives firms the right to exchange information both internally and with third parties unless the consumer expressly forbids it.

Although the " opt-out" policy, currently pervasive among the most popular Web sites gives the consumer a choice, rather than no choice at all, the complexity of the web tracking systems and the difficulty of making an informed choice is indicative of the privacy issues facing the consumer. Consider for example Yahoo's privacy protection statement: it is two pages long, it has multiple links to other pages and it does not pertain to the policies of the network of the advertising affiliates who have their own policies. There are other examples of potentially critical situations. Consider the following: an offshore company called Public Data, based in British West Indies buys public records in bulk and displays them on line in a database searchable for as little as 3 cents per search. The database includes criminal records, voter registration, indexes to court records and driver's license records.

The Bill of Rights has no explicit privacy laws. There are various State laws that govern the privacy of information, but there is no overriding federal statute. The matter of fact is that the Web technology is designed to collect information about users silently and automatically.

Most of the ongoing discussion regarding privacy of information has focused on the natural person. Extending the privacy rights of the natural person to cover the legal person (corporation) would have a major impact on business-to-business transactions. Consider how the corporations are using the Internet: (a) to link to customers and suppliers as well as other parties, (b) to bypass other companies in the value added chain, (c) to develop and deliver new products to current and to new customers, and to (d) dominate and control the use and the access by setting the rules and the policies of the game.

Here are three complicated information disclosure situations. (1) Publication of the existence and nature and/or licensing of all databases held by corporations/organizations on each other. (2) Giving rights to corporations to inspect, challenge, demand corrections and deletion of data about them on other corporate files. (3) Giving them rights to limit dissemination and/or use on them for purposes of which they have not been notified.

The fear of regulation has prompted companies to self regulate. Intel modified its plans to imbed an identifying signature on its Pentium III chips, over 500 companies adhere to the standards of TRUSTe, which certifies the privacy standards of Web sites, and major U.S corporations back the ONLINE PRIVACY ALLIANCE. Furthermore, there is an increased effort by private corporations to benefit from the increased attempt to safeguard information as it is evident in the number of newly created companies whose sole purpose is to audit web sites on privacy concerns including: Better Business Bureau, and the Better Web owned and run by Price Water House Coopers. New innovations include filtering software, which identify privacy preferences and screens out transmission, which do not comply with the set standards. In the near future the possibility of an info-mediary might become a reality.

THE SURVEY

If e-firms are in fact concerned with the privacy and the protection of information collected on their customers, which is essential to their own success they would seek to implement measures to safeguard that privacy and to ensure the trust. In the absence of any such measures and in the presence of abuses, the government would be pressured to introduce regulatory reforms. These reforms would most definitely have a negative impact on both the growth and the success of the e-business model. In order to investigate the measures instituted by the private sector the following survey was conducted utilizing College students. Two key assumptions were made: 1) College students use the Internet at a higher rate than the rest of the population, and 2) College students are not as careful or as concerned with the privacy of their information. The second assumption contradicts previous survey results obtained from the general public which demonstrated that 92% of consumers are concerned (67% are "very concerned") about misuse of their private information online, but it is more in line with the findings of Professor Alan Westin, publisher of the journal Privacy and American Business. His research on privacy divides the consumers in three categories: Privacy Fundamentalists (25%), Privacy Unconcerned (20%) and the rest, the Privacy Pragmatists (55%). The pragmatists volunteer their personal data, but after answering four basic questions: What are my benefits? What are the risks? Are there any safeguards? Do I trust you? His conclusion is that if people are given a choice they become more privacy pragmatists. In this survey the assumption made is that students would be willing to offer information by registering in numerous sites especially if they stand to receive free items.

Sixteen categories of www sites were selected representing a variety of businesses. 100 individual sites represent these categories. They are reported in a consolidated format in Table 3 at the end of the manscript. Each of the categories were represented by at least five web addresses. The addresses were

tested for use by randomly selecting 100 students in a small College. A gender mix of 50% male, 50% female was sought. The only requirement for participating in the survey was that students should have access to computers connected to the Internet. For the site to be included in the results the students should have visited the site at least once. Multiple visits were not counted. The results regarding the use were calculated on a weighted average % base and are presented in Table 1. The use by category indicates that students preferred sites that matched their spending patterns and
preferences. The sites with the highest degree of use were: books, music and film, travel, fun and sports.

TABLE 1 WEB-SITE USE (%)

CATEGORY	WEIGHTED AVERAGE
Auction, Collectibles, Collecting	52%
Books, Music and Film	90%
Calculators and Computer Buying	58%
Car Buying	63%
College Planning/Scholarships	59%
Fun	70%
Health, Insurance, Finance	40%
Mall Shopping	48%
Sports	64%
Travel	72%

Following the selection and having documented a use pattern, the various selected sites were visited and the display or lack of display of a privacy clause by each site was recorded. The results presented in Table 3, indicate that 57% of the sites did not display a privacy clause, while 43% did. The leading category in displaying a privacy clause was, calculators and computers followed by the health insurance and finance categories, while the auctions, collecting, and collectibles category, books, music and film category, and the travel category did not display a privacy clause for most of the selected sites. Table 2 presents the intensity of reading the privacy note. There is substantial variation in the percentage of web-site visitors who read the privacy clause between the general public and the selected sample of student visitors.

TABLE 2
VISITORS WHO READ THE PRIVACY NOTES IN %

	STUDENT AUDIENCE	GENERAL PUBLIC*
Sometimes	29%	59%
Always	12%	38%
Never	59%	5%

* Information was obtained from the WSJ (2-28-00)

These results seem to indicate that the e-firms do not place a great deal of importance on the privacy of their customers. Not much more could be derived from these results at the present time, without further inquiry in the form of an expanded sample and/or the specific objective of the e-firms. It is possible that the sites that do not display any privacy clauses are startups, eager to increase the number of registered visitors and the data collected about these visitors. Furthermore, computer type-sites are the leaders in the privacy protection campaign, and the FIRE related sites are required by regulatory agencies to protect the privacy of their customers.

CONCLUSIONS

This survey paper sought to examine the concept of self-regulation as it pertains to privacy issues within the e-business model and to raise awareness on the upcoming legislation covering consumer information. Given the key role of information to the success of the firms that are established under this business model, it would seem logical for these entities to initiate actions which will protect the privacy of information and to ensure its uninhibited flow.

The current proposals of the Federal Trade Commission would require consumer –oriented commercial web sites to comply with the following four widely accepted fair information practices; (1) Notice- Web sites would be required to provide consumers clear and conspicuous notice of their information practices including what information they collect, how they collect it and how they use it. (2) Choice-Web sites would be required to offer consumers choices as to how their personal information is used beyond the use for which it was provided. (3) Access- Web sites would be required to offer consumers reasonable, access to the information a web site has collected about them including a reasonable opportunity to review information and to correct inaccuracies or delete information. (4) Security- Web sites would be required to take reasonable steps to protect the security of the information they collect from consumers.

The results of the February and March 2000 Federal Trade Commission Survey of commercial site information practices show that almost 97% of the sites collect an email address or some type of personal identifying information and although there have been improvements on the posting of at least one privacy disclosure, they do not meet all of the specified protection criteria. As it was pointed out earlier in this paper, the actual experience of the consumer in pursuing the “opt-out” provision is very cumbersome and difficult to implement. It is not the intention at the moment to offer specific recommendations about social policy although it would seem that the proposals are rather stringent and unachievable. It is the intention to point out that sometimes the speed of the technological innovation exceeds the rate of change of the institutional framework including the judicial, and presents problems that need to be addressed in a timely manner. Consider for a moment the new technologies that utilize personal video recorders like Replay TV and TiVo and the increased online music. These will enable marketers to monitor what has been watched and listened to, further complicating the privacy issues, while they custom make products like new records and videos.

The complexity of modern society and the interdependencies among the members do not leave too much room for regulation or halting of the flow of information. Any action taken by the government should not include any unachievable requirements for confidentiality, security, and data quality. The issues of information privacy will not be resolved any time soon and they will continue to present enormous public policy challenges, simply because the technological changes are outpacing the introduction of new legislation. Furthermore, both the legislative and the judicial branches of government are not conducive to technological change.

Table 3
Selected Web-sites

1. Auctions, Collectibles, Collecting Privacy Clause

YES	NO
www.auctions.amazon.com	www.auctions,cnet.com
www.auctions.yahoo.com	www.classicwatch.com
www.ebay.com	www.heritagecoin.com
www.etoys.com	www.linn.com
	www.mobilia.com
	www.ubid.com

	www.winebid.com
	www.chammer.com
	www.icollector.com
	www.newel.com
	www.southebys.com

TABLE 3 Continued	
2. Books, Music and Film (Privacy Clause)	
YES	**NO**
www.amazon.com	www.books.com
www.bibliocity.com	www.cdnow.com
www.ubl.com	www.everycd.com
www.tablature.com	www.facets.com
www.mp3.com	www.netflix.com
www.cduniverse.com	www.reel.com
www.mymusiccard.com	www.olga.net
www.chapters.ca	www.audiogalaxy.com
www.columbiahouse.com	www.findsongs.com
www.jandr.com	www.muze.com
	www.edconnection.com
	www.virginmega.com

	www.gohastings.com
	www.muzicdepot.com

TABLE 3 Continued	
3. Calculators and Computer Buying (Privacy Clause)	
YES	**NO**
www.money.com	
www.moneycentral.com	
www.quicken.com	
www.buy.com	
www.outpost.com	
www.pconnection.com	
www.shopping.com	
www.gateway.ca	

TABLE 3 Continued	
4. Car Buying (Privacy Clause)	

YES	NO
www.kbb.com	www.acsorm.com
www.carpoint.msn.com	www.autobytel.com
	www.autoconnect.com

TABLE 3 Continued	
5. College Planning/Scholarships (Privacy Clause)	
YES	**NO**
www.usnews.com	www.collegeboard.com
www.fastweb.com	www.collegequest.com
	www.kaplan.com
	www.playsite.com

TABLE 3 Continued	
6. Fun (Privacy Clause)	
YES	**NO**
www.artmuseum.com	www.culturefinder.com
	www.earth.com
	www.imagineradio.com
	www.playsite.com

TABLE 3 Continued	
7. Health Insurance, Finance (Privacy Clause)	
YES	**NO**
www.healthanswers.com	www.intelhealth.com
www.medscape.com	www.taxprophet.com
www.uebmd.com	www.fairmark.com
www.insweb.com	www.rothira.com
www.insute.com	www.willyancy.com
www.turbotax.com/taxcenter	www.quotesmith.com

TABLE 3 Continued	
8. Mall Shopping (Privacy Clause)	
YES	**NO**
www.bluefly.com	www.bottomdollar.com
www.sears.com	www.walmart.com

	www.webmarket.com

TABLE 3 Continued	
9. Sports (Privacy Clause)	
YES	**NO**
www.pga.com	www.espn.com
	www.nba.com
	www.nfl.com
	www.sportingnews.com

TABLE 3 Continued	
10. Travel (Privacy Clause)	
YES	**NO**
www.expedia.com	www.biztravel.com
www.priceline.com	www.itn.com
www.travelocity.com	www.previewtravel.com
	www.travelquest.com

	www.trip.com
	www.cheaptickets.com
	www.buyit.com

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Center for Democracy and Technology at: http://www.opt-out.cdt.org

WHAT YOU NEED TO KNOW ABOUT B2B ELECTRONIC MARKETPLACES AND ANTITRUST ISSUES

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ABSTRACT

Electronic marketplaces, or business-to-business (B2B) exchanges for selling and procuring goods and services online, have been exploding in number during the past year. Estimates are that the dollar volume of B2B exchanges will increase to $6 trillion by 2005. There is tremendous potential for efficiency in these arrangements, but just like more traditional marketplaces, these also have the potential to raise antitrust concerns. It is imperative that industry leaders as well as educators, are aware of antitrust issues associated with B2B marketplaces in order to take a proactive role to minimize potential antitrust problems, to avoid costly law suits (or even possible dissolution and associated sunk costs), and to ensure competitive forces are at work for the ultimate benefit of consumers. Accordingly, this paper will identify potential antitrust issues associated with B2B marketplaces and provide preliminary guidelines that can be taken to guard against anti-competitive practices.

INTRODUCTION

In the past year, several industry-sponsored exchanges, so called web “megahubs,” have emerged in such industries as auto, aerospace, and the airlines. On 25 February, General Motors, Ford and Daimler Chrysler announced plans to form an integrated B2B exchange for purchasing supplies through a single global portal called Covisint. The Aerospace Defense Exchange (ADE), collaboration among Boeing, Lockheed, Martin, Raytheon, and BAE systems, was announced in June of 2000. Collectively, ADE companies make purchases totaling $70-$100 billion a year, involving more than 37,000 suppliers. One other example to illustrate the magnitude of some of these B2B marketplaces is the planned Orbits travel site, collectively owned by five major airlines. The U.S. Justice Department (DOJ) has expressed concern about the Orbits venture because of concerns that the airlines might jointly refuse to share fare data with independent rivals such as Travelocity and Expedia (Business Week, 2000). B2B marketplaces have the potential to greatly increase business efficiencies by, among other things, streamlining and automating standard business practices such as searching for, identifying, negotiating with, ordering and receiving from, and then paying an input supplier. At the same time, some suppliers, consumer groups, and the Federal Trade Commission (FTC) have expressed concerns over potential antitrust issues surrounding these marketplaces that may, in fact, diminish competition.

The paper will begin by defining a few basic B2B electronic marketplace concepts, of course realizing that these concepts have multiple and evolving definitions. Next, some of the more relevant antitrust issues related to B2B marketplaces will be articulated. Finally, some preliminary steps will be outlined that businesses can take to help avoid having federal antitrust enforcers swoop in.

BASIC B2B CONCEPTS

To better understand the context for B2B antitrust issues, some basic definitions and descriptions of the following B2B marketplace concepts will be presented in this section: buyer-controlled B2B, seller-controlled B2B, independent B2B, indirect and direct materials, catalogue and auction models, and horizontal and vertical marketplaces and network effects.

As its most basic level, B2B marketplaces refer to electronic systems that allow multiple buyers and sellers to carry out sales and procurement activities over the Internet (Federal Trade Commission, 2000). Primarily buyers, sellers, or independent owner/operators of the sites can own B2Bs. In a buyer-controlled B2B, big industry market leaders (e.g., Big Three automakers) usually co-own a significant portion of the venture and share in its profits. In a seller-driven B2B, several suppliers band together to sell certain products or services. The sellers may be owners having an equity stake in the venture, or merely have membership in the exchange. An example of a seller-driven B2B would be the proposed Orbix venture where the airlines would be considered “sellers” of air travel. In an independent owner/operator site (hereafter referred to as an “independent” B2B), the site is owned and operated by a neutral third party who essentially functions as an exchange broker for buyers and sellers. An example of an independent would be *www.paperexchange.com* where multiple buyers and sellers meet electronically to carry out sales and procurement activities. The “independent” collects membership dues and takes a fee for each transaction.

Commerce between businesses involves two broad categories of goods and services-indirect and direct materials. Indirect inputs, also know as operating materials, are used for maintenance, repair, or operation (MRO), and they do not become part of the finished product. An example of this would be the purchase of office supplies. Direct materials, by contrast, are raw materials or components used directly in the manufacturing process. An example of this would be airplane engines. The purchases of indirect materials typically account for a large number of transactions, but a relatively lesser dollar value for each transaction. In contrast, direct materials typically account for fewer transactions, but the dollar value of each tends to be much greater. To date, most B2B marketplaces involve the sale and purchase of indirect materials (e.g., paperclips), because marketplace owners are understandably concerned about antitrust concerns raised by the FTC and European Commission. As Alice Miles, who is an auto industry executive on the Covisint planning team, says, “Until we have their (FTC) clearance, we can’t undertake these (big ticket direct materials) transactions.”

At present, there are two basic models of B2B marketplaces-a catalog model and an auction model. New business processes, including supply-chain management, will be engineered in the future on the evolutionary B2B road, but for now we will limit our discussion to the two most prevalent models. In a catalog model, the traditional purchasing function is replaced by an automated one. Multiple suppliers submit their catalogs in electronic formats, standardized to something called the UNSPSC (United Nations Standard Products and Services Code). A purchasing agent, who is usually a registered member of the B2B marketplace, then shops/searches for items, selects them typically by placing them into electronic shopping carts, secures the necessary approvals, and automatically generates purchase orders that would then be sent to a central B2B marketplace or exchange. The central exchange then automatically sends out orders to the suppliers for them to fulfill. In theory, both buyers and suppliers gain efficiencies. The buyer benefits from having access to multiple suppliers, reducing the speed (and costs) associated with processing requisitions, and shortening the time frame to search through multiple supplier catalogs. The supplier side gains efficiencies by being able to process orders faster and cheaper, and actually opens up markets to new customers for them, where they could not previously have had access because of the prohibitively expensive technology.

A B2B auction model works similar to a common B2C auction site like-eBay, only on a much larger scale. In an auction model, the B2B exchange would typically auction off industrial commodity items to buy and sell. For example, in a buyer-controlled B2B, a participating buyer (such as one of the Big Three Automakers) would list that they want to purchase 1,000 car axles of a certain specification by such and such date. Suppliers then bid on fulfilling that order, according to price, delivery schedule, and other terms. Typically, the identity of bidding suppliers is kept anonymous. The actual auction may take place within a given time period, suppliers may be pre-qualified and other restrictions may be placed on participants. In a seller-controlled B2B, the B2B exchange would typically auction off industrial commodities like steel, plastic resins, energy and chemicals. For example, a seller-member of a plastics exchange indicates that they have 2,000 tons of grade X plastic resin to sell. Buyers of plastic resins for injection molding machines then bid to purchase this material. In an independent B2B exchange, the owner/operator acts like a centralized auction broker of goods and services for both buyers and sellers. Finally, there are hybrid B2B sits in which participants are considered to be both buyers and sellers of products and services. For example, Raytheon can be considered a *seller* of airplane parts to Boeing, but it can also simultaneously be a *buyer* of subcomponents for its own manufacturing purposes.

In the antitrust world, horizontal restraints refer to collaborative agreements among competitors within an industry at the same level in the chain of distribution (Mann & Roberts, 1999). For example, an agreement among manufacturers, among wholesalers, or among retailers would be horizontal. A vertical restraint, on the other hand, is an agreement among parties who are not in direct competition at the same distribution level. Thus, an agreement between a manufacturer and a wholesaler is vertical. In the B2B world, the terms horizontal and vertical marketplaces have particular meanings, albeit different from the antitrust definitions. Horizontal marketplaces typically help buyers (who may be competitors) purchase a wide variety of products. They also may (or may not) serve many different industries. By contrast, vertical marketplaces tend to serve particular industries such as homebuilding, transportation, or electronics.

The network *effect* basically suggests that a B2B marketplace is going to be more efficient if it includes a larger number of the market participants, thereby leading to potential monopolistic (or at least oligopolistic) control of a market by a few dominant B2Bs. For example, tremendous efficiencies were gained by the widespread adoption of the Microsoft Windows operating system in the form of reduced support and development costs. However, such network effects arguments were also at the heart of Justice's antitrust suit against Microsoft. Proponents of the network effect argue that efficiencies are gained through standardization of the technology platform. On the other side, opponents arguing against the economic benefits of the network effect suggest that such standardization stifles innovation, and therefore make competition less likely in that it thwarts new entrants into a marketplace. With this basic background in place, the next section will turn to a discussion of antitrust issues that have surfaced in the B2B marketplace literature.

ANTITRUST ISSUES AND B2B

The authors assume readers are familiar with basic antitrust laws, including the Sherman Antitrust Act, Clayton Act, Robinson-Patman Act, and Federal Trade Commission (FTC) Act. For a basic primer on antitrust law, consult Mann and Roberts (1999, pp. 893-915). It needs to be emphasized that there is comparatively little actual *case* law on antitrust, particularly as pertains to B2B marketplaces. The courts, DOJ, and FTC at the time of this writing are still in a fact-finding exploratory stage of development concerning B2B marketplaces and have not issued any formal guidelines as to what constitutes specific anticompetitive practices. One could argue that traditional antitrust laws apply the same to any B2B transactions, regardless of whether they are electronic or manual, and in this respect the pertinent laws are no different for B2B electronic marketplaces than they are for traditional marketplaces. However, the near real-time nature of data exchange, the transparency of pricing, and the network effect (which are all at the core of B2B marketplaces) makes them potentially vulnerable to intentional (or unintentional) anti-competitive collaboration. In this next section, the authors identify recurring antitrust issues or themes found in the B2B literature (see Reference section). The following possible antitrust issues, and the resulting questions they pose for owners of B2B marketplaces, are meant to be a representative rather than exhaustive listing.

1.	Purpose or Motivation?
2.	Effects?
3.	Rules of Participation?
4.	Ownership versus Membership
5.	Market Share Thresholds
6.	Network Effects and Impact on Innovation
7.	Screen Bias
8.	Information Sharing or Collusion?
9.	International Law

Purpose or Motivation

Owners of a B2B exchange must be able to satisfactorily answer the question that will inevitably be posed by the court, which is, "*Why* are you doing something? What is your intent in forming this exchange? If the B2B's answer is something like, "to increase efficiencies in purchasing and thereby lower prices (or at least stabilize them) to end-consumers," then this may be an acceptable response provided this assertion can indeed be supported with appropriate factual evidence. Alternatively, if the B2B's response is "the development of B2B marketplaces are expensive so it's a way for us to share development costs among competitors," then a likely follow-up response by the courts could be "that is not a very convincing argument since any single major player has demonstrated in the past that it has had access to sufficient capital to afford large IT expenditures...furthermore, why aren't you then "joint-venturing" on all other research and development initiatives to share costs?" Yet another response by a B2B could be, "we want to collectively squeeze the hell out of supplier prices (or raise prices to buyers) and thereby increase our margins and resulting profits," then the courts could view this as a form of price fixing among either buyers or sellers. These hypothetical dialogues simply illustrate that the *rule of reason* often used by the courts in antitrust cases usually involves an examination of intent or implied purpose in actions. The courts will want to know what you (the B2B) really want to accomplish by this action and what is the least restrictive way you can do it? The related question of, "Who is disadvantaged?" by this practice is also likely to be posed.

Effects

The *effects* issue examines the effects of a given B2B's actions on price and output. Do actions of an industry-led B2B marketplace drive prices up and/or drive down output (restrict supply)? For example, if a B2B exchange owned by competing airlines formally or implicitly agrees to restrict the number of flights available between Seattle and Anchorage in order to drive up prices, then a potential price-fixing flag would go up. The courts will ask, "What is the effect of their actions on prices and supply?" Similarly, if members of a supplier-led B2B were to exchange data in such as way that led them to implicitly agree to restrict the availability of semiconductor components and thereby raise prices (i.e., called supply- or price-signaling), then this would also raise red flags. It should be noted that the *effects* concern rests on establishing a correlation (if not causation) between actions and subsequent effects. Since we are only in the top half of the first inning in the B2B world, such ultimate effects may not be evident until some time after B2B actions occur.

Rules of Participation

What are the rules for inclusion (and exclusion) of membership in an exchange? What do members have to put in and agree to? Are there purchasing minimums? Are there non-compete agreements for membership? Can a member bid *outside* the exchange, or do membership rules exist that prevent outside purchasing? Who *can't* get in and why not? Again, B2B owners are going to have to satisfactorily explain to the courts or governing bodies, *why* (motivation) then have such rules. To the extent that what a given B2B is really trying to do is get rid of the unruly, or squash independent B2B upstarts, they may not be able to do that. Perhaps the most heated real-world controversy of this general issue centers on the car exchange, Covisint. The Big Three automakers, owners of Covisint, aim to become not just the primary way that the car market's suppliers sell their wares to the Big Three, but eventually the preferred place for suppliers to trade with their own partners. The problem lies in the way Covinsint persuades its suppliers to participate. Some suppliers in the industry claimed that the car makers implied that suppliers have no choice; if they want to do business with the car makers, they must do it though the exchange-or not at all. True, there is no law prohibiting buyers from asking suppliers to work the way they want, be it by fax or web auction. But some critics allege that the car makers also put pressure on suppliers not to work with other exchanges (i.e., in effect making membership inclusion contingent upon agreeing to an *exclusive*, no *outside*-buying agreement). Such actions could be considered unfair restraint of trade. Both Covisint and the Aerospace Exchange now claim they no longer require that their suppliers forsake other exchanges or do all trading with their own suppliers on the main exchanges. As one economist points out (Economist, 2000), even if the bug buyers had been able to start their exchanges on grossly one-sided terms, the exchanges would probably have collapsed under their own weight...the same criteria that create an attractive marketplace-transparency, balanced with protection of commercially sensitive information, fair and enforced rules and efficient operations-tend also to run counter to monopolistic abuse. Good exchanges tend to be self-regulating.

A given B2B can disclaim any intentions to have any "exclusives," yet have an agreement where the forming members are asked not to become members of other exchanges for some period of time. For example, one rule of inclusion for membership in the Aerospace Exchange might be that forming members not become member of other exchanges such as the European Aerospace Exchange for at least one year. It is important to note that forming members are not banned from *purchasing* through other "outside" exchanges. Rather, they are simply asked not to form or make equity investment in competing exchanges. This practice may be justifiable in the sense that other contributors to the exchange venture may need reassurance that one of the partners is not going to go off and start pushing for another exchange.

Joint Ownership Versus Common Membership

Common membership, on the one hand, brings industry expertise together in the development of marketplaces and to this extent is valuable. There is, however, a difference between common *membership* and common *ownership*. The latter raises antitrust questions that the former does not. Ownership implies an equity stake in the B2B marketplace, whereas membership does not. If everyone in the industry owns the venture and shares the profits, it could be very hard for a rival venture to get going and compete away monopoly profits.

Market Share Thresholds

If the collective buying power of a given B2B marketplace represents less than 20 percent (depending on the market) of an industry's total buying power, then the exchange is generally permissible under antitrust laws. Given that no exchange currently even begins to approach 1% of its respective industry's revenue, such fears may be premature. On the other hand, if we are to accept the premise behind the network effects that suggests that market efficiencies will eventually result in only a few dominant B2B exchanges, then a market share threshold barometer may become more salient.

If members of a B2B marketplace exceed a 20 percent market share, then there may be a tendency by the owners to limit further participation for fear of exceeding the threshold. Within the 20% market share screen, owners consider themselves within a "safe harbor." Ironically, one interesting follow-up question is, "Does a market share threshold have the unintended consequences of excluding further participation (i.e., exclusion of new entrants or fringe rivals) and thus indirectly contribute to anti-competitive practices?

Network Effects and Innovation

The central concern here is that if an industry-led B2B exchange were to gain a dominant market share (through, for example, network effects), then innovation would be discouraged because all players would be forced to adhere to the dominant player's prescribed technology standards. On the pro-competitive side, however, technology standards promote economic efficiencies, especially in the area of reducing support costs, and thereby have the potential to lower end-consumer costs. One school of thinking further suggests that the innovation issue is a non-issue since innovations that are going to be relevant to B2B marketplaces will occur across exchanges; that is, the technology that is developed in one particular industry can be translated into other, and so there is going to be a lot of competition. Global competition in electronic marketplaces will also spur innovation.

Screen Bias

In a B2B marketplace, screen bias refers to a situation in which the owners of an exchange display their own prices or terms in a more favorable light than those of their non-participating exchange competitors. For example, if the proposed Orbit airline B2B were to display their own prices to travel agents in some biased way, relative to the prices of non-member exchange competitors, then this would be viewed suspiciously by regulators. Again, the question of intent (*why?*) applies here. "Why did you update your own member exchange prices before you updated non-member exchange prices? Did you need to?" These are illustrative of the kinds of questions that will be raised.

Information Sharing or Collusion?

The central issue here is figuring out what types of information might be shared in a B2B that might facilitate collusion, price signaling, or price "coordination." According to Jon Baker at the Washington College of Law at American University (FTC hearing, 2000), one way to distinguish between good and bad information sharing is to look where the information is going; that is, the direction of information flow. In one DOJ case against the airlines, the sellers (the airlines) had a way of sharing information to a central repository that was largely unavailable to the buyers (travel agents and the consuming public). They then used the information exchange to negotiate agreements among themselves on price. In other words, the sellers were putting a contingent price out to be viewed by their rivals first, and then they had the opportunity to pull those prices back if their rivals did not act a certain way. If information sharing is mainly about sharing *among rivals* or even more rapid information exchange among rivals than it is *between seller and buyers*, then a red flag ought to go up. Related issues of purpose (why) and effects (on prices and output) must also be considered when deciding issues of price collusion and information exchange. If a given B2B marketplace is asked, "Why they want to share this data," they will often conclude that, in fact, they do not really need to exchange this information.

International Law

The basic question here is, "Okay, so you told me our B2B marketplace is legal here in the United States, but is it legal in Germany?" The FTC needs to clarify and coordinate impending B2B marketplace rules and try to harmonize these rules with their counterparts in the European Union, Asia, Latin America and elsewhere. If not, then we are at risk of creating entry barriers in global markets.

GUIDELINES TO MINIMIZE ANTITRUST PROBLEMS

In this next section, we offer a few guidelines to minimize antitrust problems that should hopefully be considered *during* the early formation of a B2B marketplace, rather than a reactive and costly rework (or possible dissolution) of a site *after* it has been launched.

1. Be very clear to articulate *why* you want to do something in a B2B exchange. What is your intention? The "why" question can be applied to practices ranging from "Why are you forming the exchange in the first place," to "Why are you including or excluding membership participation the way you do?' and "Why are you sharing that information among your competitors?"

2. Erect technology firewalls to discourage sharing of price sensitive information among competitors. Of

course, regulators will always ask the question, "Yeah, but do you trust firewalls?" No technological fix can ever guarantee security of information, but the absence of erecting a firewall could call "good faith" efforts into question.

3. Experts generally recommend generating code names or numbers to disguise members' identities during the bidding process (Nash, 2000). Also don't forget to shield from public view other identifying data, such as location of the bidder. If such efforts are taken to keep the bidding process anonymous, then it is less likely that the specter of price collusion among competitors could be raised.

4. Post bids immediately to let other bidders react quickly, suggests Mark Plotkin, an antitrust lawyer with Covington & Burling (Nash, 2000). That way, competitors are less likely to claim they were shut out of a potential deal.

5. Take steps to insure that the direction of information flow is primarily between buyers and sellers, not among competitors first. This is one reason that advocates argue for third-party independent B2B exchanges where all bidder and seller data are managed by an independently owned central exchange. Perceived neutrality of the B2B marketplace is essential for all players to feel comfortable with the bidding process. Nevertheless history has shown us that price-fixing

can, and does, occur among so-called neutral third parties (e.g., NASDAQ and large auction houses).

6. Make sure that members in a given B2B exchange can shop elsewhere (*outside* the exchange).

7. Examine if there is a link between member rules and prices and output decisions. There is not supposed to be a link between rules and profits.

8. Is there a boot screen display bias? Who is disadvantaged? If the answer is, ultimately the end-consumers are disadvantaged in the form of higher prices, then get rid of the bias.

9. To avoid the appearance of collusion, industry chat rooms should be constantly monitored. Even innocent conversations can spark antitrust trouble. Mark Plotkin (Nash, 2000) provides the following example: "Imagine the Vermont dairy framers. Someone posts, 'I was the one who supplied milk to Ben and Jerry's at 67 cents per gallon. I'm pretty sure we can get at least 75 cents if we all agree." This is inappropriate behavior.

10. Does the collective buying power of a given B2B marketplace represent more than 20% (depending on the market) of an industry's total revenue?

Even if the B2B exceeds this "safe harbor" threshold, this does not necessarily mean it is anti-competitive *per se* especially if it results in lower prices for consumers, which is a good thing.

CONCLUSION

The lists of possible antitrust issues and guidelines identified in this paper are not intended to be exhaustive. Rather, they illustrate at least some of the issues and questions that owners and developers of B2B exchanges need to be asking themselves *now* - not *later* when it is in the courts. B2B marketplaces can be a powerful force to encourage competition, but they can also result in potentially anti-competitive practices. In the final analysis, the FTC is not likely to interfere much with B2Bs while these institutions are still emerging, unless they do something really stupid! Then, too, whenever there are losers in an industry (as surely there will be in B2B marketplaces), then the potential for litigation exists and nothing said in this paper can prevent that from happening.

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