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JEWISH PERSPECTIVES ON THE ETHICS OF TAX EVASION

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ABSTRACT

The ethics of tax evasion has been discussed sporadically in the theological and philosophical literature for at least 500 years. Martin Crowe wrote a doctoral thesis that reviewed much of that literature in 1944. The debate revolved around about 15 issues. Over the centuries, three main views evolved on the topic.

This paper begins with a review of the literature and identifies the main issues and summarizes the three main viewpoints that have emerged over the centuries. It then reports on the results of two surveys of members of the Jewish faith who were asked their opinions on the ethics of tax evasion. The results of the two surveys were then compared. Male scores were also compared to female scores to determine if the responses differed by gender.

INTRODUCTION

The vast majority of articles that have been written about tax evasion have been written from the perspective of public finance. They discuss technical aspects of tax evasion and the primary and secondary effects that tax evasion has on an economy. In many cases there is also a discussion about how to prevent or minimize tax evasion. Very few articles discuss ethical aspects of tax evasion. Thus, there is a need for further research, which the present study is intended to partially address.

As part of this study a survey instrument was developed based on the issues that have been discussed and the arguments that have been made in the tax evasion ethics literature over the last 500 years. Similar survey instruments were used to test sample populations in Romania, Guatemala and a few other countries that will be mentioned later in this paper. The present study reports on the findings of a survey that was distributed to undergraduate Orthodox Jewish students at a branch of Touro College in New York. The results of the present study are also compared to the findings of a human values study that touched on the ethics of tax evasion (Inglehart et al, 2004).

REVIEW OF THE LITERATURE

Although many studies have been done on tax compliance, very few have examined compliance, or rather noncompliance, primarily from the perspective of ethics. Most studies on tax

evasion look at the issue from a public finance or economics perspective, although ethical issues may be mentioned briefly, in passing. The most comprehensive twentieth century work on the ethics of tax evasion was a doctoral thesis written by Martin Crowe (1944), titled *The Moral Obligation of Paying Just Taxes*. This thesis reviewed the theological and philosophical debate that had been going on, mostly within the Catholic Church, over the previous 500 years. Some of the debate took place in the Latin language. Crowe introduced this debate to an English language readership. A more recent doctoral dissertation on the topic was written by Torgler (2003), who discussed tax evasion from the perspective of public finance but also touched on some psychological and philosophical aspects of the issue.

Walter Block (1989; 1993) sought in vain to find a justification for taxation in the public finance literature. He examined a number of textbooks but found all justifications for taxation to be inadequate. Leiker (1998) speculates on how Rousseau would have viewed the ethics of tax evasion. Alfonso Morales (1998) examined the views of Mexican immigrant street vendors and found that their loyalty to their families exceeded their loyalty to the government. McGraw and Scholz (1991) examined tax compliance from the perspective of self-interest. Armstrong and Robison (1998) discuss tax evasion and tax avoidance from the perspective of an accounting practitioner and used Rawls' concept of two kinds of rules to analyze how accountants view the issue. Oliva (1998) looked at the issue from the perspective of a tax practitioner and commented on the schism that exists between a tax practitioner's ethical and legal obligations.

There have been a few studies that focus on tax evasion in a particular country. Ethics are sometimes discussed but, more often than not, the focus of the discussion is on government corruption and the reasons why the citizenry does not feel any moral duty to pay taxes to such a government. Ballas and Tsoukas (1998) discuss the situation in Greece. Smatrakalev (1998) discusses the Bulgarian case. Vaguine (1998) discusses Russia, as do Preobragenskaya and McGee (2004) to a lesser extent. A study of tax evasion in Armenia (McGee, 1999e) found the two main reasons for evasion to be the lack of a mechanism in place to collect taxes and the widespread opinion that the government does not deserve a portion of a worker's income.

A number of articles have been written from various religious perspectives. Cohn (1998) and Tamari (1998) discuss the Jewish literature on tax evasion, and on ethics in general. Much of this literature is in Hebrew or a language other than English. McGee (1998d; 1999a) comments on these two articles from a secular perspective.

A few articles have been written on the ethics of tax evasion from various Christian viewpoints. Gronbacher (1998) addresses the issue from the perspectives of Catholic social thought and classical liberalism. Schansberg (1998) looks at the Biblical literature for guidance. Pennock (1998) discusses just war theory in connection with the moral obligation to pay just taxes, and not to pay unjust or immoral taxes. Smith and Kimball (1998) provide a Mormon perspective. McGee (1998c; 1999a) comments on the various Christian views from a secular perspective.

The Christian Bible discusses tax evasion and the duty of the citizenry to support the government in several places. Schansberg (1998) and McGee (1994; 1998a) discuss the biblical literature on this point. When Jesus is asked whether people should pay taxes to Caesar, Jesus replied that we should give to Caesar the things that are Caesar's and give God the things that are God's [Matthew 22:17, 21]. But Jesus did not elaborate on the point. He did not say that we are only obligated to give government 10 percent or 5 percent or any particular percent of our income.

There are passages in the Bible that seemingly take an absolutist position. Romans 13, 1-2 supports the Divine Right of Kings, which basically holds that whoever is in charge of government is there with God's approval and anyone who disputes that fact or who fails to obey is subject to damnation. It is a sin against God to break any law. Thus, Mao, Stalin and Hitler must all be obeyed according to this view, even though they were the biggest monsters of the twentieth century, because they are there with God's approval.

A few other religious views are also addressed in the literature. Murtuza and Ghazanfar (1998) discuss the ethics of tax evasion from the Muslim perspective. McGee (1998b, 1999a) comments on their article and also discusses the ethics of tax evasion under Islam citing Islamic business ethics literature (1997). DeMoville (1998) discusses the Baha'i perspective and cites the relevant literature to buttress his arguments. McGee (1999a) commented on the DeMoville article. A few studies have applied utilitarian ethics and rights theory to particular taxes or particular arguments found to justify certain tax policies in the public finance literature. Tax policies examined in the literature include an examination of whether the ability to pay principle is ethically bankrupt (McGee 1998f) and the related argument of whether discriminatory tax rates are ethically justifiable (McGee 1998g). Both of these arguments seemingly violate the Kantian prescription that individuals should always be treated as ends in themselves, not as a means to an end (Kant 1952abc; 1983). The "paying your fair share" argument is also examined (McGee, 1999c). McGee (2004) also addresses these issues in a book that discusses the various philosophies of taxation.

If one begins with the premise that people should get something in return for their taxes, the argument could be made that there is nothing unethical about evading the estate tax (McGee 1999b), since the government cannot possibly provide any services to the dead. It is interesting to speculate what Kant would say on this issue, since Kant favors a strong rule of law, yet views the use of individuals as means rather than ends to be unethical. Yet the estate tax does precisely that, since it sees dead people as a source of tax revenue and cannot promise them anything in return for their "contributions."

The Social Security tax in the United States might be attacked on utilitarian grounds, since it is a very poor investment compared to the alternatives (McGee, 1999g). The capital gains tax might be criticized on efficiency grounds, since some studies have found that the distortion to the economy that results – what economists call negative externalities – sometimes more than offsets the amount of taxes that are actually collected (McGee, 1999f). If a particular tax actually reduces welfare in society, the argument could be made that evading the tax, and thus reducing the amount

of welfare reduction that would otherwise occur, might actually be an ethical act, from a utilitarian perspective. Evading a tariff would be one example (McGee, 1999d), since tariffs are generally viewed by economists as a negative sum game, a tax measure that is not so much intended to raise revenue as to prevent foreign competition, which feathers the nest of domestic producers at the expense of the general public (McGee, 1994b; 2003).

The present study replicates similar studies that have been made of other groups. The survey instrument used in this study is similar to the survey instruments used in several other studies.

A survey of international business professors found that some arguments justifying tax evasion are stronger than others but none of the arguments were very strong, since most of the professors who responded to the survey were strongly against tax evasion. This survey also found that women were significantly more opposed to tax evasion than were the men (McGee, 2005a). A survey of business and law students in Guatemala reached a similar result. However, the law students felt less strongly about condemning tax evasion on ethical grounds than did the business students and female students were more opposed to tax evasion than were male students (McGee & Lingle, 2005).

A survey of Romanian business students (McGee, 2005b) found that respondents often felt tax evasion was ethically justified. Males were slightly more opposed to tax evasion than were women. A survey of German business students also found that respondents were strongly against tax evasion, although some arguments were stronger than others. A comparison of male to female responses was inconclusive, in the sense that it could not be clearly determined which group of respondents was more opposed to tax evasion (McGee, Nickerson & Fees, 2005).

Similar studies have been conducted of Bosnian business and economics students (McGee, Basic & Tyler, 2006), Argentinean business and law students (McGee & Rossi, 2006), Polish business and economics students (McGee & Bernal, 2006), Armenian business students (McGee & Maranjyan, 2006), Ukrainian business & economics students (Nasadyuk & McGee, 2006a) and Ukrainian law students (Nasadyuk & McGee, 2006b).

Several Chinese studies have also been conducted. McGee & An (2006) surveyed business and economics students in Beijing. McGee & Guo (2006) surveyed law, business and philosophy students in Central China. McGee & Ho (2006) surveyed accounting, business and economics students in Hong Kong. McGee, Noronha & Tyler (2006) surveyed business students in Macau.

One finding these studies all have in common is that the moral acceptability of tax evasion depends on the fact situation. Tax evasion is more morally acceptable in some cases than in others. But the findings on the relationship of gender to the ethics of tax evasion are mixed. In some studies females were more strongly opposed to tax evasion than were males, whereas some studies found the gender difference to be statistically insignificant.

One aim of the present study is to discover the views of Orthodox Jews on the ethics of tax evasion. A second goal is to determine whether gender makes a difference for Orthodox Jews. A

third aim is to rank the various arguments that have been put forth over the centuries to determine which arguments are strongest and which are weakest for the Orthodox Jewish community.

THREE VIEWS ON THE ETHICS OF TAX EVASION

Over the centuries, three basic views have emerged on the ethics of tax evasion. These three views have been explored in depth elsewhere (McGee, 2006) but a brief overview is called for.

View One

View One takes the position that tax evasion is always, or almost always unethical. There are basically three underlying rationales for this belief. One reason is the belief that individuals have a duty to the state to pay whatever taxes the state demands (Cohn, 1998; DeMoville, 1998; Smith & Kimball, 1998; Tamari, 1998). This view is especially prevalent in democracies, where there is a strong belief that individuals should conform to majority rule.

The second rationale for an ethical duty to pay taxes is because the individual has a duty to other members of the community (Crowe, 1944; Cohn, 1998; Tamari, 1998). This view holds that individuals should not be freeloaders by taking advantage of the services the state provides while not contributing to the payment of those services. A corollary of this belief is the view that if tax dodgers do not pay their fair share, then law-abiding taxpayers must pay more than their fair share.

The third rationale is that we owe a duty to God to pay taxes, or, stated differently, God has commanded us to pay our taxes (Cohn, 1998; DeMoville, 1998; Smith & Kimball, 1998; Tamari, 1998). This view holds no water among atheists, of course, but the view is strongly held in some religious circles.

View Two

View Two might be labeled the anarchist view. This view holds that there is never any duty to pay taxes because the state is illegitimate, a mere thief that has no moral authority to take anything from anyone (Block, 1989; 1993). The state is no more than a mafia that, under democracy, has its leaders chosen by the people.

The anarchist literature does not address the ethics of tax evasion directly but rather discusses the relationship of the individual to the state. The issue of tax evasion is merely one aspect of that relationship (Spooner, 1870).

There is no such thing as a social contract according to this position. Where there is no explicit agreement to pay taxes there also is no duty. All taxation necessarily involves the taking of property by force or the threat of force, without the owner's permission. Thus, it meets the definition

of theft. Stated as an equation, TAXATION = THEFT. A corollary equation is that FAIR SHARE = 0.

View Three

View Three holds that tax evasion may be ethical under some circumstances and unethical under other circumstances. This view is the prevalent view, both in the literature (Ballas & Tsoukas, 1998; Crowe, 1944; Gronbacher, 1998; McGee, 1998a, 1999e; and according to the results of some of the surveys (McGee, 2005a&b; McGee & Lingle, 2005).

JEWISH VIEWS

Not much has been written on the ethics of tax evasion from the Jewish perspective. The two seminal articles on this topic were written by Cohn (1998) and Tamari (1998). A human beliefs and values survey (Inglehart et al. 2004) gathered some data on Jewish views but the data was never analyzed. One aim of the present study is to analyze this data. But first we will summarize the Cohn and Tamari studies.

Cohn and Tamari reached remarkably similar conclusions although the authors cited different literature to support their positions. Meir Tamari states that there is a moral obligation on society to fund social costs, which are recognized by halakhah (the corpus of Jewish law). This obligation goes beyond funding for defense and infrastructure and includes the needs of the poor, the sick and the old as well as religious study and the religious needs of the community (Tamari, 1998: 169). But the Mishnah Torah Hilkhot Gezeilah Chap. 5 halakhah 11, cited in Tamari at 169, n. 2 states that tax laws may be disregarded where the king usurps power or where the laws are capricious or discriminatory. This view would seemingly allow for tax evasion in some cases. However, Tamari goes on to say:

> Jewish legal literature is clear that non-payment of taxes is theft and is therefore forbidden. This is shown in all the Codes of Jewish law as well as in the responsa literature … The element of theft applies not only to the internal taxes of the community but also to those of the non-Jewish authorities.
>
> Tax evasion is regarded either as theft from other citizens who now have to pay more and from the recipients of the services funded by the tax money, since they now receive less…
>
> However, theft from the public, which is what tax evasion is, is more heinous than theft from private people. This is solely a reflection of the spiritual damage done to the perpetrator since in the former case his atonement is more difficult. The only way one can atone for theft is by returning the stolen goods or money to the original owner. This is far more difficult in the case of public theft since all the owners and beneficiaries are unknown to the perpetrator (Tamari, 1968: 170-171).

In this statement, Tamari turns the traditional "taxation is theft" argument on its head by stating that it is tax evasion that is theft. This position can easily be criticized, at least in cases where the tax is unjust, by those who take a less than absolutist position. They would argue that if a tax is unjust, there is no obligation to pay. The fact that others must pay more if you pay less merely means that the tax collector must steal more from others. That sin is on the head of the tax collector, not those who are able to evade the tax. Tamari does not address this possibility.

Tamari also states that tax evasion is unethical because it must necessarily involve lies and falsehoods, which can lead to corruption in other areas of life as well. According to Tamari, citing Midrash Rabah Kedoshim, telling a lie, even when not under oath, amounts to a denial of the existence of God.

The literature on the ethics of lie-telling could be discussed here, but Tamari does not do it. This literature, going back to Plato and Aristotle, points out that telling lies is not always unethical. For example, if a crazed husband barges into your home shouting "I am going to kill my wife, where is she?" there is no moral obligation to tell him where she is. You can say you don't know, even if you do know.

However, Tamari's point is well-taken. Where lying is rampant in one area, such as in tax evasion, there is a tendency for it to spread into other areas, thus corrupting the society. However, the argument could be made that the blame for that corruption should be placed on those who have made the unjust tax laws (assuming they are unjust), not on those who merely try to protect their property. Tamari goes on to say:

> So even if the tax evasion seems justified morally, because of the high tax rates or waste in the public sector, it seems that these should be combatted by the ballot box, political pressure or a taxpayers revolt, perhaps involving a jail sentence, rather than accepting the unethical effects of tax evasion.

One criticism that political scientists might make of Tamari's position is that a wasteful public sector or a government that has high tax rates cannot easily be changed via the ballot box. The literature that has been generated by the Public Choice School of Economics over the last thirty years or so makes this point clear (Buchanan, 1977, 1985, 1989a, 1989b; Buchanan, Tollison & Tullock, 1980; Rowley, Tollison & Tullock, 1988). Special interests convince the legislature to pass some spending bill that benefits them at the expense of the general public. Every special interest group under the sun tries to influence the legislature to pass laws that benefit them and the legislature often responds favorably. So, as a practically matter, the ballot box is almost useless. In the meantime, Tamari would allow the taxpaying public to continue to be fleeced.

Serving a jail sentence rather than evade unjust taxes seems a bit extreme, especially if one has to support a family. Those who believe it is never unethical to evade taxes might argue that it is not unethical to hide money from a thief, even if the thief would spend the money wisely. How can it be unethical to hide money from a corrupt government that squanders the money it raises from tax collections?

Another criticism that non-absolutists might make is the belief that individuals have some duty to "society." The problem with this view is that "society" does not exist. Society is just a convenient collective term that describes a collection of individuals who share certain things in common, like geographic location, language (maybe) and culture (maybe). All obligations are individual in nature. Individuals owe obligations to other individuals, not to some collective term. Another criticism non-absolutists might make of Tamari's argument is that he ignores property rights. They would argue that the State does not have an unlimited claim on the property of taxpayers. There is a limit. The State does not own all the assets, merely allowing individuals to keep and use some of them, an argument Adams (1993: 217) discusses in relation to Louis XIV's view that the king owns everything.

Individuals own assets. Before the State can spend money it first has to take it from those who have earned it. Tamari does not discuss this point. If Tamari's position can be summed up in a single sentence, it would be that tax evasion is always unethical, even where the government is corrupt. But Tamari is not alone in this belief. The empirical studies cited elsewhere in this paper show that there is strong support for this view. It could also be pointed out that the Mormon (Smith & Kimball, 1998) and Baha'i (DeMoville, 1998) positions are similar to those of Tamari.

Gordon Cohn, the other Jewish author, arrives at the same conclusion using different arguments and citing different Jewish sources. For Cohn, tax evasion is unethical for four reasons:

> The *Halachic* (Jewish legal) perspective on paying taxes has four components. First, there are laws related to a citizen's duty to follow his country's statutes. This is called *dina damalchusa dina*. Second, laws prohibit lying. Third, a Jewish person may not do anything which could discredit the religion. This is known as *Chillul Hashem*. Finally, since it is essential for a Jewish person to perform the maximum number of mitzvos (commandments and good deeds), he is required to refrain from any activity which could result in confinement in a place where Judaism cannot be properly practiced, e.g., jail. (Cohn 1998: 182)

Secularists or political philosophers might criticize all of these reasons. Cohn's first argument is that there is a duty to follow the laws of one's country. Political philosophers might argue that while there may be a duty to follow just laws, strong arguments have been made that there is a duty to disobey unjust laws. They might cite Martin Luther King, Mahatma Gandhi, Thoreau and other advocates of civil disobedience to support their view. Thus, the argument could be made that one cannot categorically say that one must obey all the laws of the country where you live because some laws may be unjust. Certainly it would not be unethical to disobey some of the laws of Nazi Germany. One may even have a duty to disobey such laws. If unjust laws (like segregation in the United States, for example) were not openly disobeyed, they might never be changed.

Cohn does not discuss this possibility in his article. However, in all fairness, it must be mentioned that it was not Cohn's intent to delve into issues of political philosophy. His focus was on the Jewish literature.

Cohn points out that there are laws prohibiting lying, although the moral prohibition against lying is not absolute (Cohn 1998: 184-185). Others have also pointed out that lying is not always unethical. Plato discusses this point both in *The Laws* and *The Republic*. It is not unethical to tell an enraged husband that you do not know where his wife is. It is not unethical not to tell a thief that you are hiding $20 in your shoe. And it is not unethical not to disclose the fact that you have unreported income if the tax collector is not morally entitled to the funds. Cohn does not address any of these possibilities, since his intent was to discuss the Jewish literature on the topic, not to apply the literature to specific fact situations.

The view that a Jewish person may not do anything that would discredit the religion is a strongly held belief, one that permeates both the Jewish literature and Jewish culture. Some political philosophers (Hayek, 1976) would challenge this view, since it is based on the premise that someone can owe a duty to a group or to a group of ideas. They would argue that duties can be owed only to individuals. Again, Cohn does not address this issue, since it is an issue of political philosophy rather than religion.

The view that one must not do things that might result in a jail term runs contra to one of Tamari's suggestions, that one should protest unjust taxes even if it means a jail term, rather than evade the tax in question. The argument could be made that it might also be possible that more mitzvos could be performed in jail than out of jail, since the jail population has more needs unfulfilled than the general population.

Cohn points out that the Jewish literature states that "the king owns the country and therefore everyone is required to give him a portion of their income as rent." (Cohn, 1998: 182) Political philosophers might criticize this statement for a number of reasons.

First of all, most countries don't have kings anymore. Even if we concede that a modern government might assume the power that kings formerly had, it does not follow that tax evasion is always unethical because the king (or the government) is not entitled to all the income or property of the people living under the government's protection. At most, they are only entitled to a portion of it. When tax collections exceed this portion, tax evasion may be justified. Cohn does not address this possibility, although he does state that "In cases where the king or leader is not legitimate, *dina damalchusa dina* could not suffice to forbid tax evasion." (Cohn, 1998: 183).

Cohn also states that "Continuing to live in a country is an implicit agreement to abide by its rules." (p. 183) Political philosophers would find at least two reasons to challenge this statement. For one thing, it may not be possible to leave a country if you disagree with its rules. You may not have the financial resources to leave. You may not be able to find another country willing to admit you due to immigration restrictions. Or the country in which you live might not allow you to leave. Thus, political philosophers might reasonably conclude that it cannot be said that you must obey the rules of the country in which you live because of some implicit agreement.

The second point political philosophers might raise is that it is possible that an individual may not agree with the rules of any country. Yet it is a physical necessity that the individual must

live somewhere. Even with free immigration and emigration and sufficient financial resources to live anywhere, it is quite possible that an individual would choose to live in the country that violates his rights the least. So it cannot be said that the individual in question consents to the laws of the country of residence. He may have chosen the country in question because it is the least evil of a number of possible choices.

Cohn states that "…someone living in a society where there is an illegitimate dictatorship should still pay taxes in order to avoid prison."(p. 187). It makes sense to pay taxes in such cases, since the alternative could be very unpleasant. But the question could be raised whether there is an ethical duty to pay taxes in such cases, or should taxes be paid to avoid the extreme discomfort that might result from the nonpayment of taxes. It is a well established principle of philosophy that where there is no choice there is also no morality. It is only possible to be moral where there is also the opportunity to be immoral. Thus, in some cases at least, paying taxes to an evil dictator is not a question of ethics.

Tamari and Cohn's seminal articles make a contribution to the English language literature because they expose readers of English to the Jewish religious literature on the issue of tax evasion. If their work could be criticized, it could be because they do not also include the political philosophy literature in their discussion. But such criticism would be unfair because it was not their intent to do so. Besides, much of the political philosophy literature was written by gentiles, which would have taken their articles too far afield of their intent, which was to discuss the Jewish religious literature. More work could be done to explore Jewish views on the ethics of tax evasion. Survey research is one avenue that could be used. One such survey that has already been conducted is the Human Beliefs and Values Survey (Inglehart et al. 2004), which collected a lot of data on many different value issues. That survey is discussed below.

Human Beliefs and Values Survey

The Human Values and Belief Surveys (Inglehart et al. 2004) collected responses to scores of questions from 200,000 people in 81 societies representing 85 percent of the world's population. The survey differed by country. Not all questions were asked in all countries. One question was:

> Please tell me for each of the following statements whether you think it can always be justified, never be justified, or something in between: Cheating on taxes if you have a chance. [Question F116]

The range of responses was from one to ten where one (1) represented "never justifiable" and ten (10) represented "always justifiable." The survey included 324 Jews from more than 40 countries. The survey did not break down the results by age, gender or education. It also did not distinguish which branch of Judaism respondents came from, although it is probable that a large percentage of the Jews who lived in countries other than the United States were mostly Orthodox,

since there are not many Reform or Conservative Jews outside the United States. However, some of the responses from Jews outside the United States might not be religious Jews.

Many of the countries either did not include any Jews in their sample or included only a few. Only four countries had a sample that included more than 20 Jews. Although Israel was included in the survey, the question on tax evasion was not asked in Israel.

The range of scores for the overall study and for the four countries that included more than 20 Jews in the survey is listed in Table 1.

Table 1: Jewish Responses
Range of Scores (%)
(1 = never justifiable; 10 = always justifiable)

Score	%				
	Total Sample	France	Georgia	Tanzania	USA
1	56.4	33.8	55.6	82.9	48.7
2	12.9	17.9	12.5	2.4	15.7
3	8.5	19.2	11.1	2.4	10.0
4	5.5	-	5.6	2.4	4.3
5	6.2	14.4	8.3	2.4	-
6	2.2	-	1.4	-	6.3
7	1.0	4.3	1.4	-	1.6
8	1.5	4.3	1.4	-	2.8
9	1.5	-	1.4	-	4.3
10	4.2	6.0	1.4	7.3	6.3
Sample Size	324	21	72	41	50
Mean	2.49	3.24	2.33	1.90	3.00
Standard Deviation	2.412	2.665	2.056	2.447	2.912

The most frequent response is one (1), meaning that tax evasion is never justified. For the sample as a whole more than half (56.4%) gave this response. The percentage for Tanzania was the highest at 82.9%. The lowest was France, with a 33.8% score.

The mean scores are also uniformly low. From a range of 1 to 10, the overall sample mean was 2.49. The Tanzanians had the lowest mean (1.90), indicating the most opposition to tax evasion. The French had the highest mean at 3.24. However, with a range of 1 to 10, even a score of 3.24 indicates that there is not much support for tax evasion. Chart 1 shows the relative means.

Another comparison worth making is the relative scores of various major religions. The total sample size for this question was 82,589. The sample included both major and minor religions. The highest response rate for the "never justifiable" option was given by Hindus at 81.6%, followed by Muslims (77.9%), Buddhists (75.0%), Protestants (61.4%), Roman Catholics (60.0%), Jews (56.4%) and Orthodox (51.7%). Table 2 shows the scores for the full range of responses for the major religions.

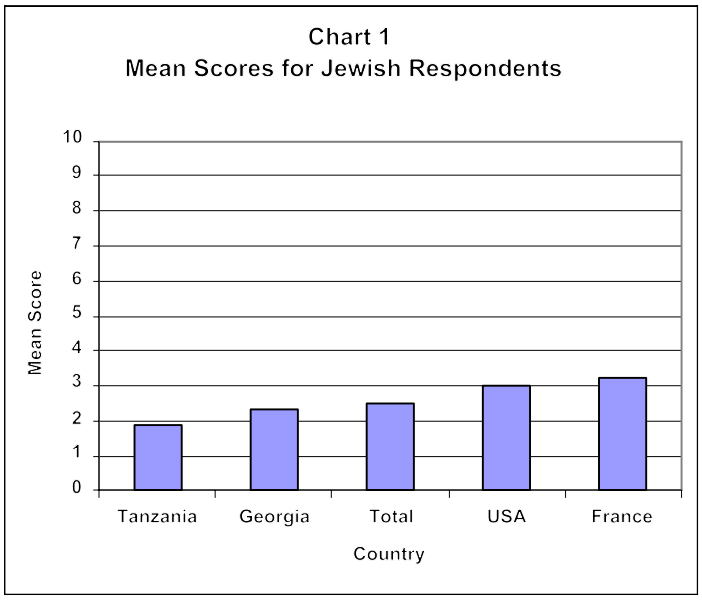


Table 2: Comparative Responses to Question F116
Range of Scores (%)
(1 = never justifiable; 10 = always justifiabl)e

Score	%							
	All Religions	Jewish	R. Cath.	Muslim	Prot.	Orthodox	Buddhist	Hindu
1	64.5	56.4	60.0	77.9	61.4	51.7	75.0	81.6
2	9.5	12.9	10.4	5.9	12.4	12.0	10.6	0.8
3	6.8	8.5	7.7	3.9	8.2	8.7	4.8	5.1
4	3.8	5.5	4.5	2.1	4.1	5.4	2.2	0.1
5	5.6	6.2	6.6	3.3	5.1	7.9	3.5	2.1
6	2.3	2.2	2.8	1.3	2.2	3.4	1.3	0.4

Table 2: Comparative Responses to Question F116
Range of Scores (%)
(1 = never justifiable; 10 = always justifiabl)e

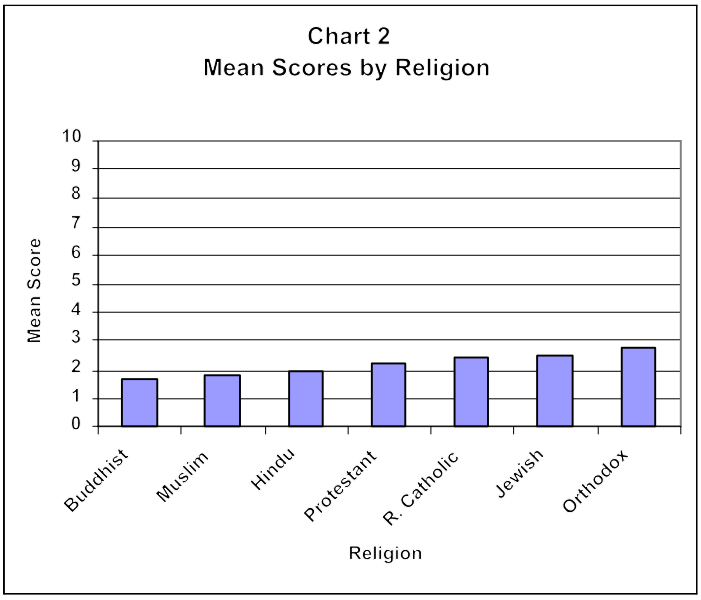
Score	%							
	All Religions	Jewish	R. Cath.	Muslim	Prot.	Orthodox	Buddhist	Hindu
7	1.9	1.0	2.2	1.1	1.7	3.0	0.6	3.1
8	1.8	1.5	2.0	1.1	1.5	3.1	0.4	0.4
9	1.0	1.5	1.0	0.8	0.8	1.7	0.2	0.2
10	2.8	4.2	2.9	2.5	2.4	3.1	1.4	6.2
Sample Size	82,589	324	31,964	17,063	12,535	8,601	1,764	1,644
Mean	2.25	2.49	2.40	1.83	2.22	2.76	1.68	2.00
Std Deviation	2.249	2.412	2.307	2.011	2.128	2.489	1.609	2.470

The "never justifiable" responses provide one indication of the relative views on tax evasion but they do not tell the whole story. Another important score to examine is the mean, since that will tell us what the average view is. Table 3 ranks the mean scores from lowest (never justifiable) to highest.

Table 3: Ranking of Mean Scores for F116
(1 = never justifiable; 10 = always justifiable)

Rank	Religion	Mean Score
1	Buddhist	1.68
2	Muslim	1,83
3	Hindu	2.00
4	Protestant	2.22
5	Roman Catholic	2.40
6	Jewish	2.49
7	Orthodox	2.76

The range of means is 1.68 to 2.76. When one considers that the range of possible scores is 1 to 10, one must conclude that tax evasion is frowned upon by all the major religions. Chart 2 illustrates the relative low scores. As can be seen, the mean scores do not differ by much. Thus, it can be concluded that all the major religions do not think highly of tax evasion.



Question F116 discussed above was generic and theoretical. In substance it asked do you approve of tax evasion in general or not. But responses might differ if one asked a more specific question. The survey did that. Question F131 asked:

> Please tell me for each of the following statements whether you think it can always be justified, never be justified, or something in between: Paying cash for services to avoid taxes. [Question F131]

It was thought that getting into specific situations might result in higher scores, meaning that tax evasion in particular cases might be more acceptable than tax evasion in general. An analysis of the scores for this question will make it possible to determine whether this initial belief is justified.

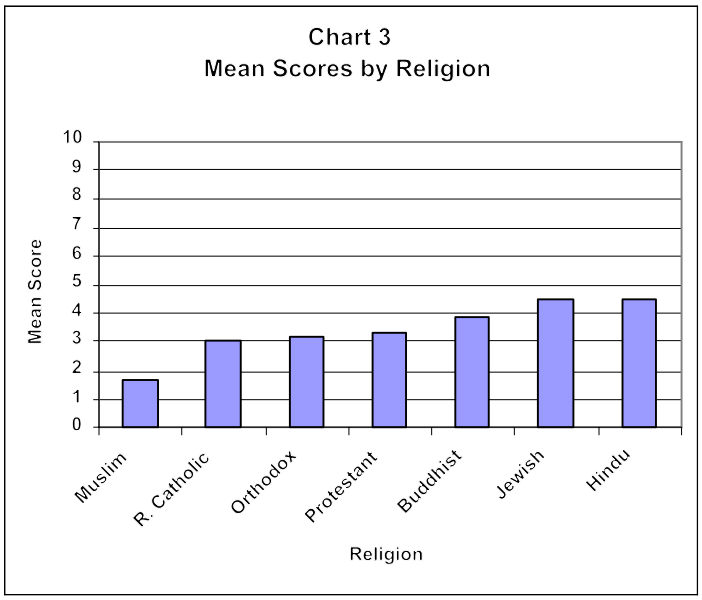
Table 4 does that. It shows the scores for each of the ten possible responses for each of the major religions. It also shows the mean scores and the sample size for each religion. Question F131 was asked to 27,256 individuals, of which 56 were Jewish. The Jews in this sample came from 13 different countries. Because of the small sample size for any one particular country the authors did not think it would be worthwhile to show the scores for each of the 13 countries.

Table 4: Comparative Responses to Question F131 Range of Scores (%) (1 = never justifiable; 10 = always justifiable)								
Score	%							
	All Religions	Jewish	R. Cath.	Muslim	Prot.	Orthodox	Buddhist	Hindu
1	45.1	20.0	44.9	81.2	34.8	47.1	19.9	25.5
2	10.3	8.5	10.5	5.4	12.3	9.0	9.4	5.0
3	10.6	13.3	10.5	3.6	14.3	9.2	3.6	8.6
4	6.6	9.6	6.8	1.8	8.2	5.5	18.1	5.1
5	11.0	16.1	11.1	3.0	12.8	10.4	44.0	26.8
6	4.2	4.4	4.3	1.5	4.7	4.0	-	-
7	3.7	9.5	3.7	0.9	4.0	4.0	-	15.3
8	3.4	10.6	3.2	0.8	4.3	4.0	-	-
9	1.6	3.7	1.5	0.6	1.4	2.4	0.1	7.8
10	3.5	4.3	3.5	1.2	3.2	4.4	4.9	5.9
Sample Size	27,256	56	14,469	1,430	5,603	4,550	20	15
Mean	3.07	4.50	3.06	1.64	3.35	3.16	3.91	4.52
Std Deviation	2.253	2.746	2.543	1.703	2.500	2.724	2.149	2.932

Table 5 compares the mean scores for each religion for questions F116 and F131. As can be seen, the mean scores have increased for six of the seven religions. The only religion that showed a decrease in mean score was Muslim.

Table 5: Comparison of Mean Scores			
Religion	F116	F131	Incr. or (Decr.)
Buddhist	1.68	3.91	2.23
Hindu	2.00	4.52	2.52
Jewish	2.49	4.50	2.01
Muslim	1.83	1.64	(0.19)
Orthodox	2.76	3.16	0.40
Protestant	2.22	3.35	1.13
Roman Catholic	2.40	3.06	0.66
All Religions	2.25	3.07	0.82

Chart 3 graphs the mean scores by religion for question F131. As can be seen, all the scores are still low, although some scores are higher than others.



THE PRESENT STUDY

The present study builds on the prior study although the authors were not aware of the Human Beliefs and Values Study when they started their study. The present study also replicates a few other studies, which were mentioned above.

Methodology

The survey instrument used in the present study was very similar to the instrument used in the Romania (McGee 2005b), Guatemala (McGee & Lingle, 2005), Argentinean (McGee & Rossi, 2006) and other empirical studies.

The survey consisted of eighteen (18) statements that generally began with the phrase "Tax evasion is ethical if…" and included a seven-point Likert scale. Those who agreed strongly with the statement were instructed to select one (1) as their response. Those who disagreed strongly were instructed to select seven (7) as a response. The statements reflected the three views on the ethics of tax evasion that have emerged in the literature over the last 500 years.

Respondents consisted of undergraduate students in a branch of Touro College in New York. Respondents were all Orthodox Jewish. Many of the male students had rabbinical training. Many

of them also studied Jewish law extensively in high school. Most of the female students had a strong high school background in Jewish studies as well as post high school education. The group was highly knowledgeable about Jewish law.

One hundred and seven usable responses were received. Table 5 gives the breakdown by gender.

Table 5: Responses by Gender	
Male	65
Female	40
Unknown	2
Total	107

Hypotheses

The following hypotheses were made:

H1: The average respondent will believe that tax evasion is ethical sometimes. This hypothesis will not be rejected if the average score for at least 2 of the 18 statements is more than 2 but less than 6.

H2: Scores will be lower [tax evasion will be more acceptable] when the statement refers to government corruption. This hypothesis will not be rejected if the score for Statement 11 is lower than the scores of at least 12 other statements.

H3: Scores will be lower [tax evasion will be more acceptable] when the statement involves a human rights issue. This hypothesis will not be rejected if the scores for S16, 17 and 18 all rank in the top six [are among the 6 lowest scores].

H4: Opposition to tax evasion will be strongest [scores will be highest] in cases where it appears that taxpayers are getting something in return for their money, or where there is a perception that there is a duty to other taxpayers to pay taxes, even if there may not be a duty to the government. This hypothesis will not be rejected if the scores for S5, 7, 9 and 15 all have scores that are among the highest 9 scores.

H5: Scores will be lower [there will be more sympathy to tax evasion] where there is a perception that the taxpayer is being treated unfairly. This hypothesis will not be rejected if the scores for S1, 3, 11 and 14 are all among the lowest 9 scores.

H6: Women will be more strongly opposed to tax evasion than males. This hypothesis will not be rejected if female scores are higher than male scores for at least 12 of the 18 statements.

Survey Findings

Table 6 lists the 18 statements and the average scores received for each statement. A score of one (1) indicates strong agreement with the statement. Seven (7) indicates strong disagreement. An average score or 2 or less would indicate that tax evasion is always, or almost always ethical. An average score of 6 or more would indicate that tax evasion is never or almost never ethical. Scores averaging more than 2 but less than 6 would indicate that tax evasion is sometimes ethical. As can be seen from Table 6, the average score for all statements is less than six (5.57) and the scores for 9 of the 18 statements are also less than 6, which indicates the average respondent believes tax evasion to be ethical sometimes.

H1: The average respondent will believe that tax evasion is ethical sometimes. This hypothesis will not be rejected if the average score for at least 2 of the 18 statements is more than 2 but less than 6.

H1: Cannot be rejected.

Table 7 ranks the eighteen statements from most acceptable to least acceptable. Scores ranged from 3.12 to 6.57, indicating that there are circumstances when tax evasion can be ethically justified. Respondents believed that the strongest case for tax evasion was in cases where a Jew is living in Nazi Germany. Surprisingly, however, the score for that statement was not even close to 1.0, which indicates there is a belief, even among Jews, that there is some duty to pay taxes even to Hitler.

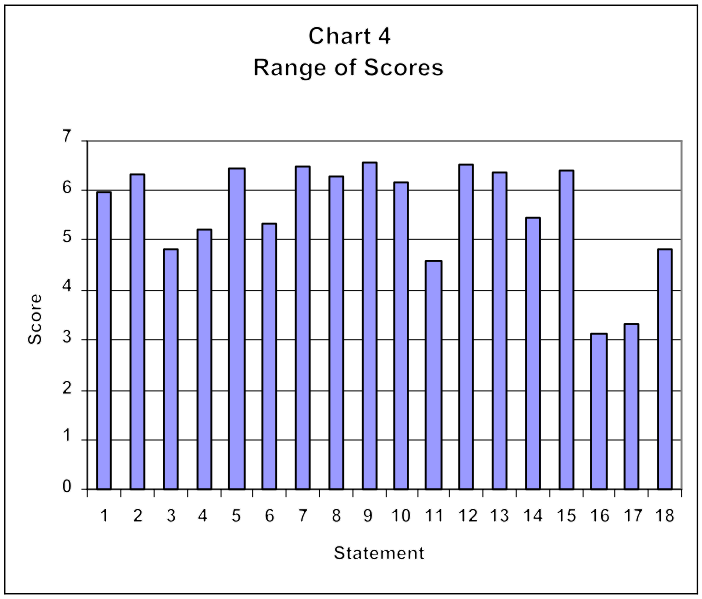
Such a relatively high score (3.12) might come as a surprise to a political scientist or philosopher, since there is a whole body of literature that argues that the duty to the state is both limited and conditional, but some Jews the authors have spoken to do not think it is an unreasonable score. Some of the comments made in the comment section of the survey shed some light on the

rationale for the belief that there is some duty to pay taxes to the state even in cases where those in charge of the state are evil.

Table 6: Summary of Responses
(1 = strongly agree; 7 = strongly disagree)

S#	Statement	Score
1	Tax evasion is ethical if tax rates are too high.	5.95
2	Tax evasion is ethical even if tax rates are not too high because the government is not entitled to take as much as it is taking from me.	6.34
3	Tax evasion is ethical if the tax system is unfair.	4.84
4	Tax evasion is ethical if a large portion of the money collected is wasted.	5.24
5	Tax evasion is ethical even if most of the money collected is spent wisely.	6.44
6	Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of.	5.34
7	Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects.	6.49
8	Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me.	6.28
9	Tax evasion is ethical even if a large portion of the money collected is spent on projects that do benefit me.	6.57
10	Tax evasion is ethical if everyone is doing it.	6.19
11	Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends.	4.61
12	Tax evasion is ethical if the probability of getting caught is low.	6.54
13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust.	6.38
14	Tax evasion is ethical if I can't afford to pay.	5.46
15	Tax evasion is ethical even if it means that if I pay less, others will have to pay more.	6.39
16	Tax evasion would be ethical if I were a Jew living in Nazi Germany in 1940.	3.12
17	Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background.	3.30
18	Tax evasion is ethical if the government imprisons people for their political opinions.	4.81
	Average Score	5.57

Chart 4 shows the average scores for each statement.



One reason given for paying taxes even to Hitler might be summarized by the phrase "the law is the law." This view has a long history in both the Biblical and secular literature. Although it is no longer the prevailing view, a number of people still subscribe to it.

One might also justify payment of taxes to Hitler on cost-benefit grounds or on the basis of duty. Even Hitler must raise taxes to pay for streets, legitimate government services and pensions, so something is due even to an evil dictator. The authors are not saying they subscribe to this line of reasoning but are merely asserting it as one possible explanation for why the Jew in Nazi Germany statement had a score higher than 1.0.

The view that Jews owe some taxes to Hitler was found to be a widespread view in the other surveys as well. Although the international business academic survey (McGee, 2005a), the Romania survey (McGee, 2005b), the Guatemala survey (McGee & Lingle, 2005), the German survey (McGee, Nickerson & Fees, 2005), the Armenia survey (McGee & Maranjyan, 2006), the Bosnia survey (McGee, Basic & Tyler, 2006), the Poland survey (McGee & Bernal, 2006) and the Ukraine surveys (Nasadyuk & McGee, 2006a & 2006b) all ranked that statement as among the strongest reasons to justify tax evasion, none of them gave it the lowest possible score, or even close to the lowest possible score. Human rights statements, including the Nazi statement, were not included in the various China surveys.

The next strongest argument to support tax evasion, with a score of 3.30, was the statement: "Tax evasion is ethical if the government discriminates against me because of my religion, race or

ethnic background." The third ranking statement was: "Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends." The score for this statement was 4.61, more than a full point higher than the 3.30 score for the second statement. Chart 5 shows the range of scores from lowest to highest.

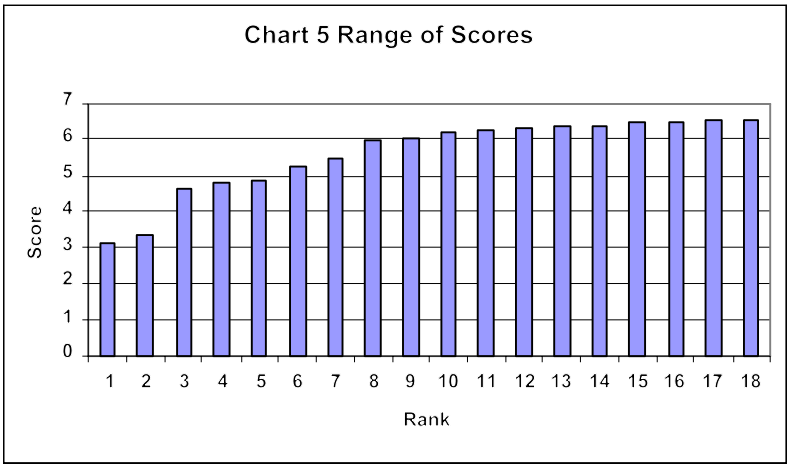


Table 7: Ranking
(1 = strongly agree; 7 = strongly disagree)

Rank	Statement	Score
1	Tax evasion would be ethical if I were a Jew living in Nazi Germany in 1940. (S16)	3.12
2	Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background. (S17)	3.30
3	Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends. (S11)	4.61
4	Tax evasion is ethical if the government imprisons people for their political opinions. (S18)	4.81
5	Tax evasion is ethical if the tax system is unfair. (S3)	4.84
6	Tax evasion is ethical if a large portion of the money collected is wasted. (S4)	5.24
7	Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of. (S6)	5.34
8	Tax evasion is ethical if I can't afford to pay. (S14)	5.46
9	Tax evasion is ethical if tax rates are too high. (S1)	5.95
10	Tax evasion is ethical if everyone is doing it. (S10)	6.19
11	Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me. (S8)	6.28

Table 7: Ranking
(1 = strongly agree; 7 = strongly disagree)

Rank	Statement	Score
12	Tax evasion is ethical even if tax rates are not too high because the government is not entitled to take as much as it is taking from me. (S2)	6.34
13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust. (S13)	6.38
14	Tax evasion is ethical even if it means that if I pay less, others will have to pay more. (S15)	6.39
15	Tax evasion is ethical even if most of the money collected is spent wisely. (S5)	6.44
16	Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects. (S7)	6.49
17	Tax evasion is ethical if the probability of getting caught is low. (S12)	6.54
18	Tax evasion is ethical even if a large portion of the money collected is spent on projects that do benefit me. (S9)	6.57

H2: Scores will be lower [tax evasion will be more acceptable] when the statement refers to government corruption. This hypothesis will not be rejected if the score for Statement 11 is lower than the scores of at least 12 other statements.

H2: S11's score is lower than the score for 15 of the 18 statements. H2 cannot be rejected.

H3: Scores will be lower [tax evasion will be more acceptable] when the statement involves a human rights issue. This hypothesis will not be rejected if the scores for S16, 17 and 18 all rank in the top six [are among the 6 lowest scores].

H3: S16, 17 and 18 rank 1, 2 and 4, respectively, well within the top 6 scores. H3 cannot be rejected.

H4: Opposition to tax evasion will be strongest [scores will be highest] in cases where it appears that taxpayers are getting something in return for their money, or where there is a perception that there is a duty to other taxpayers to pay taxes, even if there may not be a duty to the government. This hypothesis will not be rejected if the scores for S5, 7, 9 and 15 all have scores that are among the highest 9 scores.

H4: The ranks for S5, 7, 9 and 15 were 15, 16, 18 and 14, respectively, well within the bottom half. H4 cannot be rejected.

H5: Scores will be lower [there will be more sympathy to tax evasion] where there is a perception that the taxpayer is being treated unfairly. This hypothesis will not be rejected if the scores for S1, 3, 11 and 14 are all among the lowest 9 scores.

H5: The scores for S1, 3, 11 and 14 were 9, 5, 3 and 8, respectively, all within the lowest 9 scores. H5 cannot be rejected.

Some of the studies mentioned above found that females were more firmly opposed to tax evasion than males whereas other studies found no statistically significant difference. Table 8 compares the scores of male and female respondents. Females had higher scores in all 18 cases.

Table 8: Comparison of Male and Female Scores
(1 = strongly agree; 7 = strongly disagree)

S#	Statement			Score Larger by		P value
		Male	Female	Male	Female	
1	Tax evasion is ethical if tax rates are too high.	5.75	6.23		0.48	0.173
2	Tax evasion is ethical even if tax rates are not too high because the government is not entitled to take as much as it is taking from me.	6.20	6.53		0.33	0.2777
3	Tax evasion is ethical if the tax system is unfair.	4.27	5.73		1.46	0.001506
4	Tax evasion is ethical if a large portion of the money collected is wasted.	4.88	5.80		0.92	0.03115
5	Tax evasion is ethical even if most of the money collected is spent wisely.	6.28	6.69		0.41	0.04416
6	Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of.	5.02	5.77		0.75	0.1393
7	Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects.	6.34	6.70		0.36	0.2926
8	Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me.	6.11	6.53		0.42	0.1333
9	Tax evasion is ethical even if a large portion of the money collected is spent on projects that do	6.43	6.78		0.35	0.08842

Table 8: Comparison of Male and Female Scores
(1 = strongly agree; 7 = strongly disagree)

S#	Statement			Score Larger by		P value
		Male	Female	Male	Female	
	benefit me.					
10	Tax evasion is ethical if everyone is doing it.	5.92	6.62		0.70	0.04259
11	Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends.	3.96	5.71		1.75	0.0001188
12	Tax evasion is ethical if the probability of getting caught is low.	6.40	6.74		0.34	0.2481
13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust.	6.25	6.56		0.31	0.3155
14	Tax evasion is ethical if I can't afford to pay.	5.22	5.84		0.62	0.08176
15	Tax evasion is ethical even if it means that if I pay less, others will have to pay more.	6.18	6.70		0.52	0.1385
16	Tax evasion would be ethical if I were a Jew living in Nazi Germany in 1940.	2.69	3.95		1.26	0.01719
17	Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background.	2.93	4.00		1.07	0.01514
18	Tax evasion is ethical if the government imprisons people for their political opinions.	4.48	5.43		0.95	0.01789
	Average Score	5.29	6.02		0.73	

Wilcoxon tests were made for each statement comparing and male and female scores to determine the statistical significance. Nonparametric tests like the Wilcoxon test are preferred to parametric tests because they do not assume that the distribution is normal. The differences in scores for S3 and 11 were statistically significant at the 1 percent level. Differences for S4, 5, 10, 16, 17 and 18 were statistically significant at the 5 percent level. Differences for S9 and 14 were statistically significant at the 10 percent level.

H6: Women will be more strongly opposed to tax evasion than males. This hypothesis will not be rejected if female scores are higher than male scores for at least 12 of the 18 statements.

H6: The female scores were higher than the male scores for all 18 statements. In 4 cases the female scores were more than a full point higher than the male

score. The probability that this distribution could happen by chance is very low. H6 cannot be rejected.

Chart 6 compares the male and female scores.

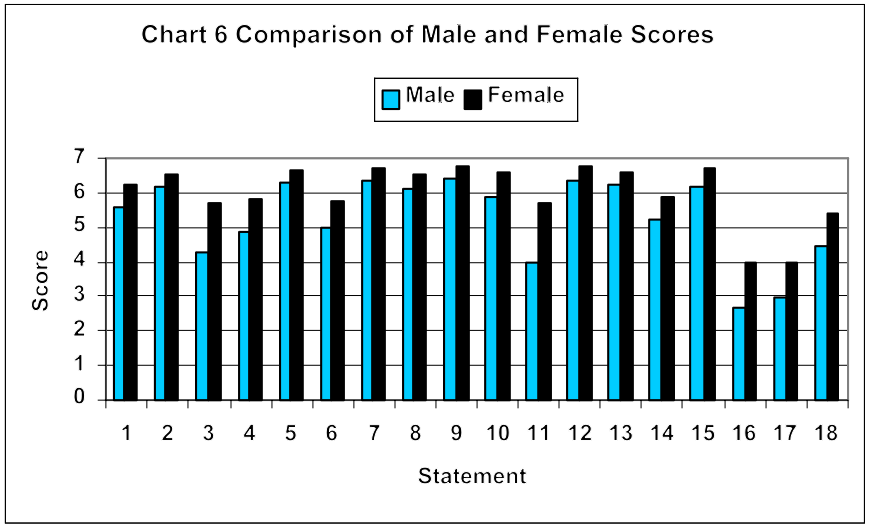


Table 9 shows the average scores for 15 studies. They are ranked from most opposed to least opposed to tax evasion. The table shows that Orthodox Jews are more opposed to tax evasion than any other group except international business professors. The second numerical column shows the score for the Jewish-Nazi statement for each study. The last column shows where the Jewish-Nazi statement ranked. For example, in the international business professor study the Jewish-Nazi statement ranked second, meaning that only one other statement showed stronger support for tax evasion. The Jewish-Nazi statement was not included in all surveys.

Table 9: Ranking of Studies on the Basis of Opposition to Tax Evasion
(7 = most opposed; 1 = least opposed)

Rank	Study	Avg. Score	Jewish Stmt. Score	Jewish Stmt. Rank
1	Int'l Bus. Profs. (McGee 2005a)	6.15	4.23	2
2	Jewish (present) study	5.57	3.12	1
3	Argentina (McGee & Rossi 2006)	5.4	4.1	1
4	Guatemala (McGee & Lingle 2005)	5.2	4.0	2

Table 9: Ranking of Studies on the Basis of Opposition to Tax Evasion
(7 = most opposed; 1 = least opposed)

Rank	Study	Avg. Score	Jewish Stmt. Score	Jewish Stmt. Rank
4	Hong Kong (McGee & Ho 2006)	5.2	-	-
6	German (McGee, Nickerson & Fees 2005)	4.94	3.59	2
6	Macau (McGee, Noronha & Tyler 2006)	4.94	-	-
8	Bosnia & Herzegovina (McGee, Basic & Tyler 2006)	4.91	4.89	9
9	Poland (McGee & Bernal 2006)	4.7	3.9	5
10	Romania (McGee 2005b)	4.59	4.50	9
11	Armenia (McGee & Maranjyan 2006)	4.54	-	-
12	Ukraine (Nasadyuk & McGee, 2006b)	4.42	4.13	8
13	China – Beijing (McGee & An 2006)	4.4	-	-
14	Ukraine (Nasadyuk & McGee, 2006a)	4.31	3.67	8
15	China – Hubei (McGee & Guo 2006)	4.3	-	-

If any pattern can be seen from Table 9 it would be that countries that are in transition from central planning to a market economy have less opposition to tax evasion than do other countries. This might be because they have less respect for the rule of law and also because their country has not yet developed a strong rule of law.

CONCLUDING COMMENTS

The purpose of this study was to learn the views of educated Orthodox Jews on the ethics of tax evasion. This goal has been achieved. This study replicates several other studies and reaches the same basic conclusions – that some arguments supporting the concept that tax evasion is ethical are stronger than others; and that none of the arguments supporting tax evasion on ethical grounds are very strong.

This study ranks the various arguments that have evolved over the last 500 years and also finds that women are significantly more opposed to tax evasion than are men, which confirms some

of the other studies. The present study also analyzes for the first time the data on tax evasion under Judaism that were gathered from the Human Beliefs and Values Survey.

If one were to summarize the results of this study in a few words one might say that Orthodox Jews believe that tax evasion is ethical in some cases, although the view that tax evasion is justifiable is generally frowned upon. Orthodox Jews are more strongly opposed to tax evasion than all but one of the other groups surveyed to date.

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SAME SEX MARRIAGE, CIVIL UNIONS, AND EMPLOYEE BENEFITS: UNEQUAL PROTECTION UNDER THE LAW - WHEN WILL SOCIETY CATCH UP WITH THE BUSINESS COMMUNITY?

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ABSTRACT

After the 2004 Presidential election, America was proclaimed to be a nation of red and blue states, with red states purportedly disfavoring same sex marriage and civil unions, and blue states seemingly more tolerant. Election day polling convinced most of America that the feelings on same sex relationships run deep, given that one in every five voters cited "moral values" as their top priority in determining their vote. But what was left out of the polls and post-election hype was this: American businesses, including most of the Fortune 500, have been providing increasing benefits to same sex couples for years, even in the red states.

Will the attitude of society catch up to the business community? And will new laws, including those banning civil unions, become a factor in where businesses choose to locate, or perhaps even inspire the business community to promote more tolerance toward same sex relationships and encourage the broader society to follow its lead? This paper examines the history of same sex benefits, civil unions, and same sex marriage, comparing the attitudes of the business community with those of society at large.

THE BUSINESS RESPONSE TO REQUESTS FOR SAME-SEX BENEFITS

"Same-sex marriage may seem revolutionary, but for American business, the idea truly is evolutionary." (*Same-Sex Marriage: What's at Stake for Business).* In 1990, Lotus, now a division of IBM, became the first publicly traded company to offer "spousal equivalent" benefits to the partners of lesbian and gay employees. (*Id.*) By 2000, the nation's Big Three automakers announced that they would offer full health benefits to same-sex domestic partners of their half million employees. (*Auto Firms to Provide Same-Sex Benefits*). United Airlines, American Airlines, and U.S. Airways also provide same-sex benefits. (*Id.*) Two hundred and eleven Fortune 500 companies - including almost three-fourths of the top 50, have begun providing same-sex benefits. (*Same-Sex Marriage: What's at Stake for Business?*)

Today more than 7,400 companies offer equal benefits to same-sex partners of their employees. (*Id.*) Those companies, however, may find themselves in legal limbo as states pass

conflicting laws regarding same-sex couples. For example, since marriage for same-sex couples became legal in Massachusetts, many companies in Massachusetts are now requiring that same-sex couples be married in order to obtain benefits. (*Unmarried Same-Sex Couples Lose Health Benefits in Mass.*). "The businesses say that if gays and lesbians can now be legally married, then they should no longer be entitled to special health benefits not available to unmarried, opposite-sex couples." (*Id.*) Companies argue that if homosexuals have the same options as heterosexuals to marry, then the same rules should be applied. (*Id.*)

Another issue in Massachusetts is whether to give same-sex spouses the benefits provided by company policy or state law – with the exception of where state law is preempted by ERISA, a federal statute. (*The Ripple Effect of Same-Sex Marriages in Massachusetts*). Moreover, while Massachusetts employers are attempting to provide the same health and life insurance coverage for same-sex spouses as for heterosexual spouses, the Defense of Marriage Act ("DOMA") prohibits Massachusetts from giving same-sex couples certain benefits. (*Id.*) For example, because of DOMA, the federal benefit allowing employers and employees to pay health insurance premiums with pre-tax dollars is not available to same-sex spouses. (*Id.*) . As a result, DOMA is federal legislation that prohibits the United States government from applying 1,138 rights and responsibilities related to marriage of same-sex couples and does not compel any state to recognize same-sex rights legitimate in other jurisdictions. (*An Overview of Federal Rights and Protections Granted to Married Couples*). Employers are now struggling to revamp their payroll systems to treat same-sex spouses as spouses on the state level and unmarried partners on the federal level. (*Id.*)

STATE LAWS DEALING WITH SAME-SEX ISSUES: DISCRIMINATION, CIVIL UNIONS, MARRIAGE, & ADOPTION

In order to get an overview of state attitudes toward same-sex issues, a review of state anti-discrimination laws is warranted. Discrimination against sexual orientation and gender identity in employment is prohibited in seventeen states (*Laws and Regulations about Discrimination based on Sexual Orientation and Gender Identity*).

When the issue is narrowed to relationship recognition (i.e. marriage licenses, civil unions, and spousal rights to unmarried couples), the number of states recognizing such rights becomes much smaller. The only state to issue marriage licenses is Massachusetts. (*Relationship Recognition in the U.S*). The U.S. Supreme Court declined to hear a challenge by conservative groups to Massachusetts' status as the only state that sanctions same-sex marriage. (*High Court Won't Review Mass. Gay Marriage Law*). Two states, Vermont and New Jersey, permit civil unions that include state-level spousal rights to same-sex couples within the state.(*Marriage and Relationship Recognition in the U.S.)* Two states provide some spousal-like rights to unmarried couples: Hawaii and Maine. "In 2006, the New Jersey Supreme Court ruled that same-sex couples have a constitutional right to receive the same state-level benefits, protections and obligations as opposite-

sex married couples. As a result of the ruling, the New Jersey Legislature voted in late 2006 to offer civil unions to same-sex couples." (*Marriage & Relationship Recognition*). Civil unions are also permitted in Connecticut (*Id*.) Finally, only one state, California, has a statewide law that provides almost all of the state-level spousal rights to unmarried couples. (*Id.*)

While the numbers of states that have passed laws supportive of same-sex issues is small, the number of states passing laws to prohibit same-sex marriage is growing. Currently, thirty-eight states have passed legislation in response to passage of DOMA that defines marriage as between a man and a woman, and does not honor marriages between same-sex couples from other jurisdictions. (*Statewide Marriage Laws*). Three states have gone even further, amending their state constitutions to declare marriages between same-sex couples void or invalid: Alaska, Nebraska, and Nevada. (*Id*.). Four states had marriage laws predating 1996 (and DOMA), that define marriage as only between a man and a woman: Maryland, Oregon, Wisconsin, and Wyoming. (*Id.*) Finally, four states and the District of Columbia have no explicit provisions prohibiting marriages between same-sex individuals: Connecticut, New Mexico, New York, Rhode Island, and D.C. (*Id.*)

A common issue for same-sex couples who want to start a family is the issue of adoption. At present, eight states and the District of Columbia allow second-parent adoption by same-sex couples, either by law or court interpretation: California, Connecticut, D.C., Illinois, Massachusetts, New Jersey, New York, Pennsylvania, and Vermont. (*Stepparent Adoption Laws).* An additional eighteen states permit second-parent or stepparent adoptions by same-sex couples in some jurisdictions. (*Id.*) Four states have court rulings that do not allow second-parent or stepparent adoption by same-sex couples: Colorado, Nebraska, Ohio, and Wisconsin. (*Id.*) The remaining twenty-three states have no published court decisions on same-sex second-parent or stepparent adoption. (*Id.*)

Some states have, or are now attempting, to pass amendments to their state constitutions to prohibit same-sex marriage. A state constitutional amendment attempting to ban same-sex marriage went before voters in Massachusetts in 2007. It was defeated *(Bid to Ban Gay Marriage Fails in Massachusetts*). Eleven states voted in November, 2004, to ban gay marriage, including Michigan. (*Passage of Prop 2 May Spur Legal Fight*). The day after Michigan voters okayed passage of Prop 2, banning gay marriage, officials from the University of Michigan, Michigan State University, and Wayne State University announced that they would continue to provide insurance and other benefits to partners of gay employees. (*Id.*) The backers of Prop 2 claim that the amendment makes it illegal for public institutions to grant benefits on the sole basis of sexual preference. (*Id.*) Michigan's amendment bans not only gay marriages, but also "similar unions." (*Id.*) Opponents say that the amendment is so poorly worded that it may be amenable to challenge. (*Id.*).

CONSTITUTIONAL ISSUES: THE RIGHT TO PRIVACY AND THE FOURTEENTH AMENDMENT EQUAL PROTECTION CLAUSE

In 1965, the U.S. Supreme Court overturned an 1879 Connecticut law making it illegal to use contraceptives or disseminate information about contraception. (*Griswold v. Connecticut*). This was the beginning of the fundamental right to privacy. Though the actual words "right to privacy" appear nowhere in the U.S. Constitution, the Supreme Court viewed the "penumbra" of the Bill of Rights as implying such a right. The "penumbra," or shadow, refers to the fact that the Bill of Rights alludes to and accommodates the right to privacy even though the specific words are not mentioned. The case particularly relies on the 9th Amendment, which states "[T]he enumeration in the Constitution, of certain rights, shall not be construed to deny or disparage others retained by the people." In other words, the 9th Amendment specifically states that the list of explicitly recognized rights is not exclusive or exhaustive, i.e., there are rights "retained by the people" that are not listed, but nevertheless may exist.

The right to privacy was expanded in 1973 by the Supreme Court to include the unrestricted right to an abortion during the first three months of pregnancy. (*Roe v. Wade*). The Supreme Court, however, shifted direction in 1986, narrowly holding that the fundamental right to privacy did not protect same-sex sexual activity from criminal prosecution. (*Bowers v. Hardwick*). In 2003, the Supreme Court heard a challenge to a Texas law making it illegal for homosexuals, but not heterosexuals, to engage in sodomy. (*Lawrence v. Texas*). The Court overturned *Bowers*, holding in part that the Texas sodomy statute seeks "to control a personal relationship that, whether or not entitled to formal recognition in the law, is within the liberty of persons to choose without being punished as criminals." (*Lawrence*). The *Lawrence* decision is based on the protection of liberty under the Due Process Clause of the U.S. Constitution. Justice O'Connor seems to attempt to obviate the use of the *Lawrence* decision as providing a rationale and precedent for same-sex marriages: "Texas cannot assert any legitimate state interest here, such as national security or preserving the traditional institution of marriage. Unlike the moral disapproval of same-sex relations – the asserted state interest in this case – *other reasons exist to promote the institution of marriage* beyond mere moral disapproval of an excluded group." [Emphasis Added] (*Lawrence*). Extension of the right to privacy to include same-sex marriage seems entirely plausible; however, given O'Connors' disclaimer in *Lawrence*, and the Supreme Court's 2004 refusal to hear an appeal of the Massachusetts case legalizing same-sex marriage, it appears that the Supreme Court is not yet ready to tackle this issue.

A more conspicuous route to legalization of same-sex marriage may lie in the Fourteenth Amendment Equal Protection Clause. In *Goodridge v. Department of Public Health*, the Massachusetts Supreme Court held that the Massachusetts constitution requires that every individual must be free to enter into a civil marriage with another person of either sex. (*Goodridge*). The Massachusetts court made clear that it relied on its own state constitution, which provides greater

equal protection guarantees than the federal Constitution. (*Id.*). Nevertheless, a federal equal protection analysis is both likely and appropriate.

EQUAL PROTECTION ANALYSIS AND THE FUNDAMENTAL RIGHT TO MARRY

The Fourteenth Amendment provides that "No State shall . . . deny to any person within its jurisdiction the equal protection of the law." When evaluating whether a particular law violates the Fourteenth Amendment Equal Protection Clause, the court must first determine what type of right is at issue. The right to marry has been determined by the U.S. Supreme Court to be a fundamental right. (*The Right to Marry*). In 1967 in *Loving v. Virginia*, the Supreme Court overturned Virginia's miscegenation law banning interracial marriage. (*Id.*) The Court held that in additional to violating the Equal Protection Clause on grounds of race classifications, the law would also violate the Due Process Clause as an undue interference with the "fundamental freedom" of marriage. (*Id.*) Several years later, in 1978, the Supreme Court struck down a Wisconsin law that required persons under obligations to pay child support for the children of prior relationships to obtain permission of the court to marry. (*Id.*) The Supreme Court reasoned that marriage was a "fundamental right" that triggered "rigorous scrutiny" under the Equal Protection Clause. In 1987, the Supreme Court struck down a Missouri prison regulation that prohibited inmates from marrying, absent a compelling reason. (*Id.*) The Court did not even bother with strict scrutiny analysis, holding that the statute could not even pass a lowered standard of "reasonableness" that Missouri applied to the constitutionality of prison regulations. (*Id.*)

Laws that infringe upon fundamental rights are presumed invalid. (*Business Law and the Legal Environment*). The Supreme Court will analyze such laws under a "strict scrutiny" standard and they will be struck down as unconstitutional absent a "compelling government interest." (*Id.)* State laws that ban same-sex marriage are denying a significant portion of the population their fundamental right to marriage. Whether these laws can withstand constitutional scrutiny has yet to be determined by the Supreme Court. The most commonly heard argument against same-sex marriage is that the "tradition" of marriage is that it be between one man and one woman. The balance of this paper will explore that and other arguments in light of current constitutional law.

THE "TRADITIONAL MARRIAGE" ARGUMENT

An argument often made by opponents of same-sex marriage is that a "traditional marriage" consists only of a man and a woman. The tradition of marriage, however, has changed over the years, both globally and in the United States. According to Steven Mintz, a University of Houston professor who specializes in family history, "[W]henever people talk about traditional marriage or traditional families, historians throw up their hands, because we say: 'When and where?'" (*Traditional Marriage? History Shows People Wed in Many Ways for Many Reasons*). Nancy Cott,

a professor of history at Harvard University, says that in the history of the world, only a tiny portion were populated by monogamous households – mostly in Western Europe and small settlements in North America. (*Id.*)

A GLOBAL PERSPECTIVE OF MARRIAGE

Marriage was used by the ancient Greeks and Romans as a way to pass down family property. (*Traditional Marriage? History Shows People Wed in Many Ways for Many Reasons).* In fact, the state did not even get involved. Marriages were a private contract arranged by the father of the bridge and the bridegroom, and could be terminated at any time by either partner. (*Id.*) After the Roman Empire collapsed, around the 5th century, the Catholic Church elevated marriage from a civil contract to a sacred union, which formed the basis of marriage laws in most Western countries. (*Id.*) Couples were considered married if they gave their consent and consummated the relationship. (*Id.*) In 1215, marriage was officially declared one of the Catholic Church's seven sacred sacraments. (*Id.*) By the mid-1500s, most churches required that marriages be performed in public by a church representative and two witnesses. (*Id.*) Around the 16th century, the primary purpose of marriage shifted to the idea of the family as a labor force. (*Id.*) In addition, the Protestant Reformation focused on the idea that marriage should focus on child-rearing. (*Id.*) It was not until the 18th century, during the Enlightenment Movement, that the idea of marrying for love took hold. (*Id.*) People began rejecting arranged marriages. Until the 19th century, some Native American cultures permitted two men to marry if one underwent a ritual that resulted in his becoming a cross-gender or mixed-gender person. (*Id.*)

MARRIAGE IN THE UNITED STATES

In early American Colonial days, people got married simply by living together and declaring themselves husband and wife. (*Id.*) Common-law marriages such as these are still legal in eleven states and the District of Columbia. (*Id.*) Western-style marriage is based on Christianity. (*Id.*) The Christian idea that marriage should only be between one man and one woman may have originally derived from a passage in the Book of Ephesians which equates the love of a husband for his wife to that of Christ's love for his church. (*Id.*) Others draw the traditional idea of marriage from the Book of Genesis: "Therefore shall a man leave his father and his mother, and shall cleave unto his wife; and they shall be one flesh." (*A Brief History of Marriage*).

Prior to the civil war, slaves were prohibited from marrying. (*Traditional Marriage?*). After the Civil War, many states banned interracial marriages. (*Id.*) It was not until 1967 that the U.S. Supreme Court held such bans to be unconstitutional. (*Loving*). The idea of marrying for romantic love did begin to take root in the United States until around 1920. (*A Brief History of Marriage*). In

fact, a 1967 poll of U.S. college students showed that 75% of the women said they would marry a man they did not love if he was a good provider, decent, and sober. (*A Brief History of Marriage*).

FIDDLER ON THE ROOF AND THE MYTH OF "TRADITIONAL" MARRIAGE

Nowhere, however, is the myth of marriage as an unchanging cultural monolith more exposed than in the popular musical Fiddler on The Roof (adapted from the book written by Joseph Stein). How stunningly poignant this work of art is in portraying the misperception of so-called "traditional" marriage. Poor papa Tevye – each of his three daughters separately, distinctly, and with increasing magnitudes of deviation, defied the "tradition" of marriage – not only in one generation, but also in just one family! Although the work is fiction, the point is very real – and a brief examination at the plot is enjoyably enlightening.

In Fiddler on The Roof, the "traditional" marriage in the village of Anatevka was one arranged by the matchmaker Yente. When the matchmaker selected the wealthy but old butcher Lazar to be the husband for papa Tevye's oldest daughter Tzeitel, it seems Tzeitel herself had different plans. Even though papa Tevye had already willingly agreed to this arranged marriage, Tzeital was not in love with the butcher Lazar. No, Tzeitel was in love with the not so well to do and much closer to her age Motel. In fact, Tzeitel explained to her father that she and Motel had given each other a pledge, which was forbidden. Even though tradition provided for arranged marriages and thus did not allow women to pick their husbands, and even though Tzeitel and Motel had given each other a forbidden pledge, papa Tevye relented and gave his permission for Tzeitel and Motel to marry. So much for traditional marriage.

Next up for papa Tevye was his second oldest daughter Hodel who was in love with Perchick. Perchick quickly broke with tradition upon his arrival to Anatevka when he agreed to educate Tevye's daughters in exchange for food, as heretofore women were not supposed to be literate, but instead were to learn only how be a good wife and mother. Perchick also breached tradition when he danced with Hodel at in the park and at Tzeital's wedding, which violated the prohibition of boys and girls touching. Ultimately, Hodel and Perchick broke with tradition when they simply informed papa Tevye that they would be getting married, i.e., they ignored the tradition of asking permission to get married. Even so, papa Tevye gave his blessing to the marriage because he could see the love in his daughter Hodel's eyes for Perchick. So much for traditional marriage.

Finally, papa Tevye's youngest daughter Chava did the unthinkable – she married outside of her faith and, obviously, without her father's permission. This it seems was more than papa Tevye could take. Despite his deep love for his youngest daughter and even a seeming inward acceptance of her marriage, he would not budge publicly, he considered her dead, and he never talked to her again.

Three daughters – three breaks with traditional marriage. By today's standards nearly all of perceived prohibitions would be regarded as archaic, if not absurd. Please consider, for example:

1) Should it be illegal for a woman to marry outside of an arranged marriage?
2) Should it be illegal for a woman to select the man she wants to marry?
3) Should it be illegal for a woman to marry outside of her faith?

The point, of course, is not to debate the relative pros and cons of the many marriage traditions that have evolved and changed over time – the point IS that many marriage traditions have evolved and changed over time.

CIVIL MATRIMONY V. HOLY MATRIMONY IN THE CONTEXT OF THE FIRST AMENDMENT

Given how marrying outside of one's faith was in fact one of the marriage traditions breached in Fiddler on the Roof, it is useful to note that many objections to same sex marriages do indeed find their genesis in religious doctrines. Interestingly, the Founding Fathers's crafting of the First Amendment on matters religious is remarkably instructive with respect to the same sex marriage debate.

> *Congress [Government] shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof...*(U.S. Constitution, Amendment I).

While casual allusions to "Freedom of Religion" in the First Amendment are uttered often, such a colloquial reference often masks and, in so doing, does a grave disservice to the critical dichotomy of the two sub-parts: 1) The Establishment Clause; and 2)The Free Exercise Clause. In essence, the Establishment Clause is a prohibition directed at government on matters of religion and in effect tells government, "You may NOT choose." Conversely, the Free Exercise clause is a liberty accorded to the people on matters of religion and in effect tells each citizen, "You MAY choose."

Given that marriage is both a constitutionally recognized fundamental right and (in many cases) a religiously imbued ceremony, the value of applying the First Amendment's Freedom of Religion dichotomous paradigm to same sex marriage analysis becomes evident and the result is illuminating. *Civil* matrimony, with all of its attendant *legal* rights and obligations, cannot be denied by government to citizens on religious grounds because doing so would run afoul of the Establishment Clause. In fact, the more religious-based are the arguments of same sex marriage opponents, the more the Establishment Clause mandates they are not be taken into consideration. So when it comes to whether government may take into account religious doctrines in an attempt to deny some of its citizens the fundamental right of *civil* matrimony, the Constitution – and specifically the Establishment Clause – is clear: Government may NOT so choose.

Conversely, the Free Exercise Clause is a thoroughly recognized and cherished liberty of the population, and it mandates that government not interfere with (for the most part) the way in which

people practice – or not – their chosen religious beliefs. *Holy* matrimony, with all of its attendant *religious* rights and obligations, is the province of a given church. Accordingly, no religion can be forced by the government to perform, recognize, or give credence to a same sex wedding ceremony. So when it comes to whether various religions may take into account religious doctrines when denying some of its members the blessing of *holy* matrimony, the Constitution – and specifically the Free Exercise Clause – is clear: Religions MAY so choose.

That religiously infused arguments encircle and permeate the same sex marriage debate is undeniable. Constitutionally speaking, the two sub-parts of "Freedom of Religion" prescribe the critical distinction our secular and pluralistic society must make with respect to role of religion in the same sex marriage debate: The Establishment Clause prohibits government from choosing to deny its citizens the fundamental right of *civil* matrimony, while the Free Exercise Clause grants religions the option of choosing to confer – or not – the blessing of *holy* matrimony.

CONCLUSION

Gays and lesbians have not changed marriage – heterosexuals have. These changes have occurred through equal rights for women, the advent of birth control, and the increasing economic independence of women. (*A Brief History of Marriage).* People marry now for many different reasons, including love, companionship, and personal satisfaction. Ironically, less people are marrying now. In fact, the marriage rate in the U.S. is half what it was during its peak right after World War II. (*Traditional Marriage*). Nevertheless, same-sex couples are demanding that they be permitted to marry. As the U.S. Supreme Court said in *Loving v. Virginia*:

> *There can be no doubt that restricting the freedom to marry solely because of racial classifications violates the central meaning of the Equal Protection Clause.*

We offer the following restructured quote: "There can be no doubt that restricting the freedom to marry solely because of [sexual orientation] violates the central meaning of the Equal Protection Clause."

The push of the political conservatives and religious fundamentalists to try to pass a constitutional amendment banning same sex marriage is most telling. It is not so-called activist judges that necessarily concern them, but rather honest and credible constitutional analysis. In other words, those who have studied case law and Equal Protection analysis realize that the "fundamental right" status of marriage makes it extremely difficult, in constitutional terms, to prohibit same sex marriage. Given this reality, constitutionally informed political conservatives and religious fundamentalists recognize that they must try to change the constitution if they are to succeed in denying a segment of the population the fundamental right of marriage – either that, or hope that

conservative justices on the U.S. Supreme Court will ignore precedent and disregard the "fundamental right" status of marriage as it pertains to same sex couples.

Most of the arguments against same sex marriage are rooted either in religious grounds or cultural grounds. The religious objections state that same sex marriage runs counter to church teachings – and just as the Free Exercise cannot make any religion recognize a same sex marriage, the Establishment clause arguably prohibits government from banning same sex marriages on religious grounds, especially given that marriage is constitutionally recognized as a fundamental right. The cultural objections routinely point to the tradition of marriage, but as has been demonstrated, the so-called tradition of marriage is not nearly as uniform and consistent as some would suggest. Finally and sadly, there are no doubt some who oppose same sex marriage out of sheer bigotry, but should we really amend the constitution and deny a fundamental right to a segment of our population to satisfy bigotry?

In closing, it is interesting to note that the purported "moral mandate" of the voters in the 2004 election turned out to be quite misleading. According to The Economist, the percentage of Americans citing moral and ethical values as their prime concern was actually *down* from 2000 (35%) and 1996 (40%). (T*he Great Indecency Hoax*). So where do we go from here? Obviously, the business community has had no difficulty in humanely extending equal treatment to employees who are involved in same sex relationships. Many believe that just as IBM followed its employees' lead, the government will ultimately follow business' lead. Only time will tell.

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AN ANALYSIS OF RESTATEMENTS DUE TO ERRORS AND AUDITOR CHANGES BY FORTUNE 500 COMPANIES

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ABSTRACT

Events leading to the breakup of Arthur Anderson and Co. included the failure of Enron and other evidence of financial reporting irregularities. Many of these irregularities involved restatement of financial statements due to error. During the last several years, numerous articles in the accounting literature and accounting press have chronicled such restatements and the often-associated change in auditor. This paper analyzes restatements due to error and auditor changes made by Fortune 500 companies during 2001 and 2002 in order to assess whether restatements due to error lowered or raised income and whether companies with income-decreasing errors showed a greater propensity for changing auditors.

The data in this study were taken from 8-K reports filed by Fortune 500 Companies in 2001 and 2002 and from a search of the Securities and Exchange Commission's EDGAR database using the word "restate" and its derivatives. We searched for and analyzed restatements that were due to error. The income statement effects of these restatements were classified as income-decreasing or as non income-decreasing. We identified and confirmed two hypotheses related to restatements. First, restatements generally lowered rather than raised income. Second, companies reporting restatements that materially reduced income were more likely to change auditors than companies with non income-decreasing errors. More importantly, this study extended prior research by showing that the magnitude, not simply the direction, of a restatement was important in explaining when a change in auditor was likely to occur.

INTRODUCTION

Events leading to the breakup of Arthur Anderson and Co. included the failure of Enron and other evidence of financial reporting irregularities. Many of these irregularities involved restatement of financial statements due to error. During the last several years, numerous articles in the accounting literature and accounting press have chronicled such restatements. Accompanying these restatements, some companies have also changed auditors (GAO, 2002; Huron Consulting Group, 2003; Thompson and Larson, 2004; Wallace, 2005).

Some speculate that the need for restatement of financial statements creates friction between a client and its auditor (Wallace, 2005). In fact, some companies reportedly have decided to change their auditor because of disagreements related to restatements. Although companies are usually reluctant to change auditors because of the likelihood of increased audit fees during the transition period, such disagreements make a change in auditor a more plausible option. The number of auditor changes is usually very low. The breakup of Arthur Anderson has, however, exacerbated the number of auditor changes in 2002 (Plitch and Wei, 2004).

How often do auditor changes occur when restatements due to error take place? What is the effect of these restatements on financial statements? Does the effect of such restatements play a role in whether or not an auditor change occurs? This paper analyzes restatements due to error and auditor changes made by Fortune 500 companies during 2001 and 2002 in order to assess whether restatements due to error lowered or raised income and whether companies with income-decreasing errors were more likely to change auditors.

BACKGROUND

A large number of articles in the accounting literature have addressed auditor change issues, and more recently a number of articles have addressed the occurrence and impact of restatements on financial statements. However, the relationship between auditor changes and the impact of restatements on financial statements is largely unexplored.

Auditor Changes

Since companies must disclose when they change auditors, investors are able to keep abreast of the changes. The literature regarding auditor changes has focused on several issues ranging from frequency of change to reasons for change. Regarding frequency of change, Auditor-Trak, a database that follows corporate-auditor changes, reported that in 2003 each of the Big Four accounting firms lost more public-companies audit clients than it gained. PriceWaterhouseCoopers took the biggest hit, losing 91 audit clients. On the other hand, Grant Thornton, the world's fifth largest accounting firm picked up more than 1,000 new clients, including many defectors from the Big Four. The belief was that CFOs wanted more personalized attention from their audit partners, and firms like Grant Thornton gave midsize companies more attention at a better price than the Big Four, which specialize in service to large caps. In addition, Auditor-Trak publisher Richard Ossoff stated that the intense regulatory environment caused many companies to reevaluate their relationship with their auditors. For example, the Sarbanes-Oxley Act of 2002 prohibits companies from using the same firm for auditing and consulting services (Yoon, 2004). Moreover, some have suggested that mandatory rotation of registered public accounting firms should be implemented. In

fact, the European Council of Finance Ministers voted for mandatory auditor rotation (Bolton, 2005).

Even though companies and auditors parted at record rates in 2004 (Plitch and Wei, 2004), the exact reason was often unclear. In their Wall Street Journal article, Plitch and Wei reported that 75 percent of companies who changed auditors in a study by a research analyst at Glass Lewis & Co. gave no reason for the auditor's departure. Because a decision to change auditors is a sensitive decision, there are incentives for making the public disclosure as innocuous as possible. An auditor change has provided a signal to investors to dig deeper into matters leading to the change.

Hartwell et. al. (2001) studied the informational content of auditor changes. Some auditor changes signaled that potential problems exist, and others did not. For example, auditor changes designed to reduce audit fees, motivated by the need for additional services which the current auditor is unable to provide, motivated by changes in the audit firm personnel, and necessitated by a change in management do not indicate problems. On the other hand, an auditor change due to disagreement between the client and the auditor may indicate concerns regarding management's integrity, the presence of high inherent or control risk, or the clients desire to shop for an auditor who is willing to go along with questionable practices. The Hartwell study found that multiple-switch companies had a significant level of financial problems as more than 22 percent received going concern opinions. Their findings suggested that a careful examination of the Form 8-K disclosure for reasons given for the auditor change should be a part of every CPA firm's client acceptance policy.

Woo and Koh (2001) employed a research methodology that classified auditor changes based on audit and auditor characteristics and on firm characteristics. Their findings were consistent with those of prior studies and indicated that audit opinion, audit quality, management changes, income manipulation opportunities, leverage, complexity and firm growth were significant auditor-change factors.

Stafford Publications, in its data base Auditor-Trak, compiled reasons given by public companies for auditor changes. The publisher extracted the reasons from Form 8-K disclosures and then used more than 20 available coded reasons to describe the reasons for an auditor change (Stafford Publications, Ver. E-3). Hackenbrack and Hogan (2002) further classified the publisher's reasons into four categories: "service-related," "disagreement-related," "fee-related," and "uninformative." Their study was designed to assess the relative information content of earnings announcements reported before and after Form 8-K disclosures of the reason for an auditor change. They found that the average price response per unit of earnings surprise was lower following an auditor change for companies that switched for disagreement-related or fee-related reasons and higher for those that switched for service-related reasons.

Restatements

The occurrence and impact of restatements has received considerable attention in the financial press and in the accounting literature recently as a result of a shower of scandals and earnings restatements. The Huron Consulting Group (2003) and the General Accounting Office (2002) reported a significant increase in the number and trend of announcements of financial statement restatements in the late 1990's and through 2002. The GAO reported that the number of restatements increased by more than 170 percent over this period.

With the demise of Enron and the near-fall of other companies, such as HealthSouth and WorldCom, Thompson and Larson (2004) reported that public confidence in financial statements may be at an all-time low. Although loss of public confidence stemmed from financial reporting techniques that lacked transparency and involved numerous restatements of financial statements, they reported that many restatements did not indicate failure of the financial reporting system. In fact, many of the restatements should be viewed as normal rather than unexpected. For example, restatements that were due to mergers and acquisitions, changes in segments, and changes in accounting method reflected expanding business activity and were not negative in nature. Accounting errors, on the other hand, accounted for less than 8 percent of the restatements by Fortune 500 companies in 2001. The occurrence and magnitude of restatements in several high profile companies have created an image that the accounting process has failed more often than it really has.

The Role of Restatements in Auditor Changes

Like restatements, auditor changes were viewed negatively in the eyes of the public. Yet, some auditor changes did not reflect negative conditions.

Srinivasan (2004) suggested that restatements may play a role in auditor changes, particularly restatements that decrease earnings. In his study of data from the General Accounting Office that tracked companies that announced restatements between 1997 and 2000 restatements were classified into three categories: income-increasing, income-decreasing, and technical. Income-decreasing restatements are often viewed as negative or as evidence of aggressive accounting practices. Income-increasing restatements were not viewed in such a negative light despite the fact that these restatements are still accounting failures. Technical restatements do not imply improper accounting; such restatements result from routine actions, such as new accounting rules. Srinivasan focused his research on the first type of restatement, in which the company's profitability was better in the original earnings statement than what it turned out to be after the restatement. He found that these companies' restatements represented highly significant events. In fact, the average cumulative amount of net income restated was $39.5 million, a loss of nearly 10 percent of original earnings. He noted that restatements were followed by a number of reactions, including legal challenges and

corporate governance changes. In more than half of the companies, the CEOs resigned; in nearly half, the auditors changed. By comparison, income-increasing companies in his study experienced fewer lawsuits, less SEC enforcement action, less CEO turnover, and fewer auditor changes. Firms announcing technical restatement suffered no litigation or SEC action, lower rates of CEO turnover, and fewer auditor changes than either of the other two groups.

Wallace (2005) studied restatement announcements and auditor changes from 1996 to 2002. She found a rising number of restatements during those years for CompustatPC companies, but that growth rate was not reflected in the number of auditor changes. Her data indicated, however, that auditor changes were more likely to occur in conjunction with restatements. This result was driven by the fact that companies with multiple restatements during this period had a higher rate of auditor changes than companies with single restatements during this period.

The upward trend in auditor changes continued in 2003 and 2004. The number of SEC firms both changing auditors and restating their financial statements more than doubled from 14 in 2003 to 30 in 2004 (Turner et. al, 2005). Sixteen of these firms also reported internal control deficiencies in 2004. Auditor resignations in eleven of those cases may have resulted due to greater perceived client risk from the deficiency. In the remaining cases where auditors were dismissed, the uncovered weaknesses may have strained the auditor-client relationship.

METHODOLOGY

The data in this study were taken from 8-K reports filed by Fortune 500 Companies in 2001 and 2002 using the 2001 Fortune 500 list of companies. We searched the Securities and Exchange Commission's (SEC) EDGAR database using the word "restate" and its derivatives to identify restatements. The years 2001 and 2002 were selected for study because these years precede and follow the enactment of the Sarbanes-Oxley Act.

We analyzed each restatement to determine which restatements were due to error. The income statement effects of restatements due to error were determined and were classified as income-decreasing or as non income-decreasing. Except as noted, the income effects are before tax. For this purpose, an income-decreasing error is one that reduces income by at least 5 percent; a non income-decreasing error is one that is either income-increasing or whose income-decreasing effect is less than 5 percent (immaterial). In prior studies, income effects that are more than 10 percent are usually considered material; income effects of less than 5 percent are usually considered immaterial; the materiality of income effects between 5 and 10 percent are sometimes considered material, and other times are considered immaterial (Srinivasan, 2004 and Hackenbrack and Hogan, 2002). Consistent with those findings, income effects in this study of 5 percent or less are considered immaterial, and income effects of more than 5 percent are considered material.

Hypothesis I of this study was:

H1: A majority of restatements due to error have the effect of reducing rather than raising income.

This hypothesis was motivated by anecdotal evidence, such as reports by companies like Enron, Xerox, and WorldCom, that companies had significantly overstated their income. These reports seldom identified instances of income-increasing errors. The reasons for this pattern are obvious—companies with income-increasing errors were not apt to make the headlines; also companies that were involved in reporting irregularities were not motivated to understate income.

In addition, the authors reviewed each filing for evidence of a change in auditor. Such changes were reported by companies on form 8-K, disclosure item 4. For each company, the auditing firm dismissed and the auditing firm engaged were documented.

Hypothesis II of this study was:

H2: Companies with material income-decreasing errors are more likely to experience a change in auditor than companies with non income-decreasing errors.

Several reasons for this hypothesis existed. First, companies that report a significant reduction in income through restatement were often blistered in the financial press. In an effort to defend itself, the company attempted to transfer the blame to someone else—the auditor was the logical scapegoat. Second, any disagreement between a company and its auditor was likely to strain their relationship. When a restatement occurred, the company and its auditor often had different ideas about the nature and effect of the error and how it should be reported. Finally, the company at times questioned the effectiveness of the audit firm because it failed to identify the error before it occurred in audited financial statements.

RESULTS

Fortune 500 companies filed a total of 3,120 and 4,214 8-Ks with the SEC during 2001 and 2002, respectively. These 8-Ks reported 89 restatements in 2001 and 80 restatements in 2002. Table 1 shows that these restatements were due to (in decreasing frequency) merger/acquisition, change in segments, change in accounting method, discontinued operations/divestiture, error, change in presentation, and change in accounting estimate. Notably, restatements due to error accounted for only 7 and 13 of the total number of restatements for 2001 and 2002, respectively. Only one company, Xerox, reported restatements in both 2001 and 2002. The period affected by these restatements ranged from one to five years.

Table 1: Reasons for Restatements				
Reason	**2001**		**2002**	
	Frequency	**Percentage**	**Frequency**	**Percentage**
Merger/Acquisition	22	24.7%	10	12.5%
Change in Segments	21	23.6%	27	33.8%
Change in Accounting Method	18	20.2%	9	11.3%
Discontinued Operations/Divestiture	16	18.0%	9	11.3%
Error	7	7.9%	13	16.3%
Change in Presentation	3	3.4%	12	15.0%
Change in Accounting Estimate	2	2.2%	0	0.0%
Total	**89**	**100.0%**	**80**	**100.0%**

Table 2 presents information regarding the 19 Fortune 500 companies that reported restatements due to error. The impact of the restatements on income ranged from a 146.1 percentage decrease to a 0.3 percentage increase. As hypothesized, most of the restatements lowered rather than raised income. This finding is consistent with prior research by Srinivasan (2004) and Hackenbrack and Hogan (2002) on income-decreasing and non income-decreasing errors. Indeed, 13 of the 19 restatements found in this study lowered income; only one of the restatements raised income and only by 0.3 percent. Five of the restatements either did not affect income or their effects were offsetting. Companies in the shaded region of Table 2 reported income-decreasing restatements, and companies in the non-shaded region reported non income-decreasing restatements. In addition, the "percentage change in pre-tax income" column of Table 2 identifies (from most negative to most positive) the percentage of decrease or increase in income before tax for the related company.

The restatements were almost equally divided between income-decreasing and non income-decreasing. As hypothesized, companies with material income-decreasing restatements were more likely to change auditors. In fact, 6 of the 9 companies that reported income-decreasing restatements also experienced a change in auditor. On the other hand, none of the 10 companies that reported non-income-decreasing restatements experienced a change in auditor. Although the number of restatements due to error is relatively small, these findings strongly support the hypothesis that there was a significant association between companies with income-decreasing restatements and change in auditor. These findings extend prior research by Wallace (2005) and Srinivasan (2004) by showing that the magnitude, not simply the direction of a restatement was important in explaining when a change in auditor was likely to occur.

Table 2: Fortune 500 Companies with Restatements Due to Error and Change in Auditor During 2001 and 2002 By Impact of Restatements

	Company	Year(s) of Restatement	Years Affected	Change in Auditor Occurred	% Change in Pre-tax Income
Income-decreasing by more than 5.0%	Quest Communications	2002	2000-2001	Yes	(146.1%)
	Xerox	2002	1997-2001	Yes	(35.5%)
	PNC Financial Services	2002	2001	**No**	(33.5%)
	Dollar General	2001	1998-2000	Yes	(32.3%)
	Cendant	2001	1995-1997	**No**	(24.5%)
	Enron	2001	1997-2000	Yes	(22.1%)[2]
	Dynegy	2002	1999-2001	Yes	(16.2%)
	Interpublic Group	2002	1997-2001	**No**	(11.3%)
	CMS Energy	2002	2000-2001	Yes	(7.4%)
Income-decreasing by 5.0% or less or income-increasing	ConAgra	2001	1998-2000	No	(4.6%)
	AOL Time Warner	2002	2000-2001	No	(1.1%)
	Kroger	2001	1998-1999	No	(0.5%)
	Avon Products	2002	1999-2001	No	(0.1%)
	Enterprise Products	2002	2000-2001	No	0.0%[3]
	Exelon	2002	2001	No	0.0%[4]
	Kmart	2002	2002	No	0.0%[5]
	Reliant Resources	2002	2001	No	0.0%[6]
	Tyson Foods	2001	1998-1999	No	0.0%[2]
	Allegheny Energy	2002	2001-2002	No	0.3%[1]

[1] Though there were a total of 20 restatements due to error during 2001 and 2002, Xerox reported two restatements. Thus, 19 companies reported restatements due to error

[2] Pre-tax income was not available. Thus, the percentage change is based on net income.

[3] Restatement affected segment income but not consolidated income.

[4] Restatement affected deferred taxes and other comprehensive income but not income.

[5] Error and restatement occurred within the same fiscal year; no restatement of prior years' income occurred.

[6] Revenue and expense restatements were offsetting—no effect on income.

CONCLUSION

Much has been written about the presence of restatements in the financial accounting and reporting process. This paper identified and confirmed two hypotheses related to restatements. First, we found that material restatements due to error generally lowered rather than raised income. Second, we documented that companies reporting restatements that materially reduced income were more likely to change auditors. The former finding provided further empirical support for results of studies by Srinivasan (2004) and Hackenbrack and Hogan (2002) that showed companies more often make errors that overstate rather than understate income. The latter finding confirmed prior research by Wallace (2005) and Srinivasan (2004) that suggests that a change in auditor occurs when income-decreasing restatements become necessary. More importantly, this study extended the results of the Wallace (2005) and Srinivasan (2004) studies by showing that the magnitude, not simply the direction, of a restatement was important in explaining when a change in auditor was likely to occur. While this research provided strong support for the stated hypotheses, additional research is needed. This study only considered Fortune 500 companies with restatements due to error for the years 2001 and 2002. Future research should consider a larger number of restatements that spans a longer period of time.

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APPENDIX A

Selected Financial Statement Data for Companies Experiencing Both Restatement and Change in Auditor During 2001 and 2002

Dollar General - 2001 Restatements

Year	Pretax Income - $ Millions			# of Shares Millions	Pretax Income - Per Share			% Change
	Reported	Restated	Change		Reported	Restated	Change	
1998	$ 281	$ 239	$ (42)	335.8	$ 0.84	$ 0.71	$ (0.12)	-15%
1999	344	295	(49)	337.9	1.02	0.87	(0.15)	-14%
2000	323	109	(214)	333.9	0.97	0.33	(0.84)	-66%
Totals/Avg	**$ 948**	**$ 642**	**$ (306)**	**335.8**	**$ 2.82**	**$ 1.91**	**$ (0.91)**	**-32%**

Xerox- 2002 Restatements

Year	Pretax Income - $ Millions			# of Shares Millions	Pretax Income - Per Share			% Change
	Reported	Restated	Change		Reported	Restated	Change	
1997	$2,005	$1,287	$ (718)	653.4	$ 3.07	$ 1.97	$ (1.10)	-36%
1998	579	(13)	(592)	659.0	0.88	(0.02)	(0.90)	-102%
1999	1,908	1,288	(620)	663.2	2.88	1.94	(0.93)	-32%
2000	(384)	(367)	17	667.6	(0.58)	(0.55)	0.03	4%
2001	(137)	365	502	704.2	(0.19)	0.52	0.71	366%
Totals/Avg	**$3,971**	**$2,560**	**$ (1,411)**	**669.5**	**$ 5.93**	**$ 3.82**	**$ (2.11)**	**-36%**

CMS Energy - 2002 Restatements

Year	Pretax Income - $ Millions			# of Shares Millions	Pretax Income - Per Share			% Change
	Reported	Restated	Change		Reported	Restated	Change	
2000	$ 90	$ (3)	$ (93)	113.1	$ 0.80	$ (0.03)	$ (0.82)	-103%
2001	(401)	((331)	70	130.8	(3.07)	(2.53)	0.54	-17%
Totals/Avg	**$ (311)**	**$ (334)**	**$ (23)**	**121.9**	**$ (2.55)**	**$ (2.74)**	**$ (0.19)**	**-7%**

Dynegy - 2002 Restatements

Year	Pretax Income - $ Millions			# of Shares Millions	Pretax Income - Per Share			% Change
	Reported	Restated	Change		Reported	Restated	Change	
1999	227	197	(30)	230.0	0.99	$ 0.56	$ (0.13)	-13%
2000	762	682	(80)	315.0	2.42	2.17	(0.25)	-10%
2001	915	716	(199)	340.0	2.69	2.11	(0.59)	-22%
Totals/Avg	**$1,904**	**$1,595**	**$ (309)**	**295.0**	**$ 6.45**	**$ 5.41**	**$ (1.05)**	**-16%**

APPENDIX A

Selected Financial Statement Data for Companies Experiencing Both Restatement and Change in Auditor During 2001 and 2002

Qwest Communications - 2002 Restatements

Year	Pretax Income - $ Millions			# of Shares Millions	Pretax Income - Per Share			% Change
	Reported	Restated	Change		Reported	Restated	Change	
2000	126	(2,034)	(2,160)	1,272.1	0.10	(1.60)	(1.70)	-1714%
2001	(3,958)	(7,395)	(3,437)	1,661.1	(2.38)	(4.45)	(2.07)	-87%
Totals/Avg	**$(3,832)**	**$(9,429)**	**$ (5,597)**	**1,466.6**	**$ (2.61)**	**$ (6.43)**	**$ (3.82)**	**-146%**

Enron - 2001 Restatements

Year	Pretax Income - $ Millions			# of Shares Millions	Pretax Income - Per Share			% Change
	Reported	Restated	Change		Reported	Restated	Change	
1997	$ 105	$ 9	$ (96)	650.0	$ 0.16	$ 0.01	$ (0.15)	-91%
1998	703	590	(113)	695.0	1.01	0.85	(0.16)	-16%
1999	893	643	(250)	810.0	1.10	0.79	(0.31)	-28%
2000	979	847	(132)	875.0	1.12	0.97	(0.15)	13%
Totals/Avg	**$2,680**	**$2,089**	**$ (591)**	**757.5**	**$ 3.54**	**$ 2.76**	**$ (0.78)**	**-22%**

APPENDIX B

Case Studies – Fortune 500 Companies with Errors & Auditor Changes (2001/2002)

Dollar General

On April 30, 2001, Dollar General announced that it would restate its audited financial statements for fiscal years 1998 and 1999, as well as the unaudited financial information for the fiscal year 2000 that had been previously released. The company subsequently completed a review of its financial statements that identified several accounting issues in addition to those that were announced on April 30, 2001. Some of the accounting issues that caused the company to restate its financial statements were: litigation settlement expenses, COGS – Incorrect recording & inaccurate estimates, SG&A – Incorrect recording & expenses not accrued, capital leases & financing, obligations incorrectly recorded as operating leases, tax provision changes for correction of errors.

On September 21, 2001, Dollar General issued an 8-K that reported a change in auditor. Deloitte & Touche was dismissed, and Ernst & Young was engaged.

Xerox

On April 1, 2002, Xerox announced a second restatement of its financial statements for fiscal years 1997 through 2000, as well as an adjustment to fiscal year 2001 that had been previously released. This was the result of a settlement with the SEC. As in the first restatement, Xerox determined that it had misapplied GAAP in some of its accounting practices. The restatements were caused mostly by timing and allocation of revenue and expense recognition from bundled leases. Those leases were reallocated among equipment, service, supplies, and finance revenues using a more appropriate methodology.

On October 5, 2001, Xerox issued an 8-K that reported a change in auditor. KPMG was dismissed, and PricewaterhouseCoopers was engaged. KPMG was investigated by the SEC and faced lawsuits over their role in the errors.

CMS Energy

On March 31, 2003, CMS Energy released its annual report for 2002. As part of that annual report, the company restated its financial statements for fiscal years 2000 and 2001. In connection with the re-audit concerning the practice of recording "round-trip" trades on a gross basis, CMS Energy determined to make other adjustments to its consolidated financial statements for those years. From May 2000 to January 2002, CMS Energy engaged in transactions in which energy commodities were sold and repurchased at the same price. These transactions inflated revenues, operating expenses, accounts receivable, accounts payable, and reported trading volumes. The company subsequently decided that the round-trip trades should have been recorded on a net basis.

On April 29, 2002, CMS Energy issued an 8-K to report the dismissal of Arthur Anderson as the company's certifying accountant. On May 29, 2002, the company issued another 8K to report the engagement of Ernst & Young.

Dynegy

On April 11, 2003, Dynegy released its second amended annual report for 2001. As part of that amended annual report, the company restated its financial statements for fiscal years 1999 through 2001. The company completed a review of its financial statements that identified several accounting issues. Some of the accounting issues that caused the company to restate its financial statements were: cash flow classification, balance sheet presentation, and tax benefit reversal, natural gas accruals versus actual results, hedge accounting, valuation of common stock issued as consideration, valuation of long-term power contracts, incorrectly recorded operating leases, value of conversion option for ChevronTexaco, and errors in book-tax basis differences.

On March 19, 2002, Dynegy issued an 8-K that reported a change in auditor. Arthur Anderson was dismissed, and PricewaterhouseCoopers was engaged.

Qwest Communications

On October 16, 2003, Qwest Communications released its annual report for 2002. As part of that annual report, the company restated its financial statements for fiscal years 2000 and 2001. The company determined that, in certain cases, they misinterpreted or misapplied GAAP. The restatements were mainly caused by revenue recognition issues involving optical capacity asset transactions, equipment sales, and directory publishing and purchase accounting.

On May 31, 2002, Qwest Communications issued an 8-K that reported a change in the company's certifying accountant. Arthur Anderson was dismissed, and KPMG was engaged.

PRE-INJURY AGREEMENTS TO ARBITRATE HEALTH CARE DISPUTES: LEGALLY "SHOCKING" OR LEGALLY SENSIBLE?

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ABSTRACT

As healthcare providers continue to face unprecedented litigation and rising costs, many are seeking ways to reduce the costs of litigation and the unpredictability of emotional jury trials and large verdicts. One response is to provide an arbitration agreement in the treatment or admission contract prior to providing services. The business objectives of such arbitration provisions include the increased likelihood of a more knowledgeable decision-maker, lower awards, less time to resolve the dispute, and lower legal costs. This nationwide practice is hotly debated, especially when the patient is offered a binding arbitration agreement on a "take it or leave it" (adhesive) basis before treatment begins. The arbitration issue is further complicated by the widespread use of surrogate decision makers and agents who make contracts on behalf of the patient. In some cases, the surrogate or agent, either knowingly or unwittingly, signs a waiver of jury trial and a binding arbitration contract as part of the admissions process for the patient. This paper presents recent cases involving major nursing home chains and then considers whether arbitration is legally sensible from the perspective of a health care business. It discusses advantages to arbitration, including the potential positive effects on the delivery of quality care. It also discusses the disadvantages in terms of repeat arbitrator bias and costs that could be considered unconscionable or "shocking," especially when an agent has signed for the patient. Finally, this article proposes that the common law "unconscionability" analysis should be modified to a strict scrutiny approach, balancing the interests with a stricter concern for bias, costs and fair procedures. Alternatively, federal legislation should provide sufficient protections for consumers, including a voluntary agreement that is not a prerequisite to care and the right to revoke the agreement within a defined time period.

INTRODUCTION

Strong public policy, both at the federal and state level, favors private contracting and the ability to agree to arbitration as a means to resolve legal disputes. Under the Federal Arbitration Act (FAA), contracts involving interstate commerce must be treated as favorably and enforced to the same extent as any other contract by declaring that written provisions for arbitration are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation

of any contract."[1] For the first fifty years, courts were generally reluctant to enforce the FAA and found avenues to deny enforcement. Beginning in the 1980s, with crowded documents and public frustration of the trial process, the U.S. Supreme Court began to favor arbitration and broadly interpret the requirements of the FAA in a variety of commercial and consumer settings.[2] Arbitration clauses now routinely appear in pre-printed agreements ranging from credit card agreements, cell phone bills, home mortgages, to employee handbooks.

In the healthcare context, arbitration agreements are hotly contested.[3] Theoretically, the provider and patient can negotiate the terms, such as the identity of the arbitrator, the extent and amount compensable damages, the forum and rules of procedure for arbitration, and the scope of discovery.[4] In practice, the patient or his or her agent often signs the agreement prior to medical treatment without review or negotiation. Later, after a dispute arises, the plaintiff prefers to litigate with a jury trial, instead of in the arbitral forum. The plaintiff seeks a way to challenge the arbitration clause, but finds the challenge is limited to the traditional defenses of any contract. One of the few successful challenges has been the defense of unconscionability. However, unconscionable provisions are particularly hard to define and enforce. Therefore, while courts across the nation are generally upholding pre-injury dispute agreements in the healthcare context, they are struggling to define when an arbitration clause is so "shocking" that it is legally unenforceable.

Another issue which permeates healthcare is who has authority or when that authority is effective to agree to arbitration on behalf of the patient. In a recent example, the Tennessee Supreme Court upheld the validity of pre-dispute arbitration agreements in nursing home contracts when signed by an agent acting under the authority of a durable power of attorney in its *Owens v. National Health Corp*.[5] decision. The Tennessee decision is consistent with most states that have ruled on this issue of upholding a contract to arbitrate as a valid "health care" decision under a power of attorney.[6] In the wake of the Tennessee high court decision, six intermediate appellate court decisions were issued in quick succession. Each of these seven Tennessee cases involved a defendant who is a large multi-state operator of long-term healthcare facilities – Kindred Healthcare Operating, Inc., Life Care Centers of America, Inc. (LCC) or National Health Corporation (NHC) and related entities. In four of the seven cases, the courts remanded the cases back to the trial court level to determine whether the contracts or terms of executing the contracts were unconscionable or whether the agent who signed the agreement was authorized under a valid advance directive.

SHOCKING AND NOT SO SHOCKING RECENT CASES

Owens Upholds Validity of Arbitration Contracts in Nursing Homes Contracts

The *Owens* case involved an agent who signed a nursing home admission contract containing an arbitration agreement and waiver of a jury trial while acting under a Durable Power of Attorney

for Healthcare.[7] The facts unfolded as follows: Mary Francis King signed a Durable Power of Attorney for Health Care ("Power of Attorney") on August 5, 2003. The Power of Attorney authorized Gwyn Daniel and William Daniel to make health care decisions for Ms. King if she was incapacitated or unable to make such decisions for herself. It also granted the attorney-in-fact the power and authority to execute on King's behalf any waiver, release or other document necessary to implement the health care decisions. Three weeks later, Ms. King was admitted to a nursing home operated by National Health Corporation in Murfreesboro, Tennessee. The admission contract contained an arbitration provision which required binding arbitration in the event of any and all disputes and the waiver of the right to a trial by jury. Section H of the contract was one and one-half pages long and was entitled "DISPUTE RESOLUTION PROCEDURE (WHICH INCLUDES JURY TRIAL WAIVER)." This section contained the following provision, in pertinent part:

> **BINDING ARBITRATION:** Any claim, controversy, dispute or disagreement initiated by either party prior to written notice of mediation shall be resolved by binding arbitration administered by either the American Arbitration Association (AAA) or the American Health Lawyers Association (AHLA), as selected by the party requesting arbitration. In the event that the selected arbitration service is unwilling or unable to serve as arbitrator, the other named service shall be utilized. The judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction thereof.
>
> **…**
>
> **BY AGREEING TO ARBITRATION OF ALL DISPUTES, BOTH PARTIES ARE WAIVING A JURY TRIAL FOR ALL CONTRACT, TORT, STATUTORY, AND OTHER CLAIMS."**

The following provision was included with a separate signature line:

> **I hereby agree to the arbitration provisions described above in Section H, including the use where applicable of the AAA Defined "Consumer-Related Disputes." The provisions of Section H have been explained to me prior to my signature below and I also understand that I waive my right to trial by jury."**[8]

Gwyn Daniel signed both the separate signature line for the text above and the signature at the end of the admission contract.

In 2005, Ms. King's conservator, Dorothy Owens, filed suit against National Health Corporation (NHC) and its various related entities, alleging negligence; gross negligence; willful, wanton, reckless, malicious and/or intentional conduct; medical malpractice; and violations of the Tennessee Adult Protection Act[9] resulting in injury to Ms. King. The defendants then filed a motion

to compel arbitration based upon the contract terms. In response, the plaintiff claimed, among other things, that signing the waiver of a jury trial was not authorized by the Power of Attorney and that the arbitration agreement was unconscionable. The trial court denied the defendants' motion to compel arbitration and stayed the proceedings, finding that the Power of Attorney did not authorize "legal decisions" for Ms. King. The Court of Appeals reversed, holding that the decision to admit Ms. King to a nursing home is a health care decision, and not a legal decision, that was authorized under the Power of Attorney.[10]

On appeal to the Tennessee Supreme Court, the primary issue before the court was whether a durable power of attorney for health care authorized the attorney-in-fact to waive the principal's right to trial by jury through an arbitration provision in the nursing home admission contract.[11] First, the Court held that the agreement was governed by state law and not federal law since the agreement specifically provided that the arbitration agreement was to be governed and interpreted in accordance with the laws of the state where the nursing home was licensed.[12] This was important since this meant that contract formation questions were to be decided by the court, and not by the arbitrator.

The next consideration was whether the Power of Attorney authorized Daniel to sign an arbitration agreement on behalf of King and to waive King's right to a trial by jury. The plaintiff contended that the decision to waive the trial by jury and agree to arbitration was a "legal" decision that was not authorized under the Power of Attorney. The Court did not agree with this contention. The Court reviewed the definitions of "health care" and "health care decision" under the statutory provision for durable powers of attorneys for healthcare under Tennessee Code Annotated section 34-6-201(2001). The Court concluded that the decision to admit King to the nursing home was clearly a "health care decision" as provided under the Code. The Court then looked to T.C.A. Section 34-6-204(b)(2001) which provides:

> Subject to any limitations in the durable power of attorney for health care, the attorney in fact designated in such durable power of attorney may make health care decisions for the principal, before or after the death of the principal, *to the same extent as the principal* could make health care decisions for such principal if the principal had the capacity to do so…
>
> (emphasis added).

The Court concluded that Daniel was authorized to sign the arbitration provision in the nursing home contract because King herself could have decided to sign the nursing home contract containing an arbitration provision had she been capable. Moreover, the plaintiff's distinction between a "legal decision" and a "health care decision" failed to appreciate that signing of a nursing home admission contract in itself, even one without an arbitration provision, is a legal decision. The court reasoned that the uncertain result of holding that an attorney-in-fact could make some "legal

decisions" but not others would be untenable and would make if more difficult for agents to obtain health care services for their principal. The untenable result would leave patients in "legal limbo" as the patient would be incapable of entering into a contract and the attorney-in-fact would be unauthorized to do so.[13]

The Court also held that the arbitration agreement in a nursing home contract was not per se invalid as a matter of public policy. In its prior *Buraczynski v. Eyring*[14] decision, the Court held that arbitration agreements between physicians and patients were not per se invalid. The Court opined that making a public policy exception to the Tennessee Uniform Arbitration Act would be a decision more proper for the General Assembly to make.[15] The Court also found the plaintiff's appeal to the disfavor cast on pre-dispute agreements by the "Healthcare Due Process Protocol" adopted by the American Arbitration Association/ American Bar Association / American Medical Association Commission on Healthcare Dispute Resolution[16] (the "Commission") to be unpersuasive because this protocol only applied to disputes concerning managed health care decisions.[17] In response to the plaintiff's claim that neither the AAA nor the AHLA would administer a pre-dispute arbitration agreement with a health care consumer, the Court determined that the AHLA would administer this claim if so ordered by a court.[18]

Finally, the Court considered the issue of unconscionability. The plaintiff claimed that she should be allowed to conduct discovery concerning whether the contract was unconscionable if the Supreme Court found that the power of attorney authorized Daniel to sign the arbitration agreement. The Court agreed and stated that the evidence in the record was too scant to determine unconscionability. In remanding the case, the Court stated that a contract may be unconscionable if "the provisions are so one-sided that the contracting party is denied an opportunity for a meaningful choice.[19]

Rapid Fire Succession of Intermediate Appellate Cases

The *Owens* decision was issued on November 8, 2007. By December 21, 2007, the Tennessee Court of Appeals had released six opinions, all involving arbitration agreements in nursing home admissions contracts. In summary, the opinions held as follows:

1. *Cabany v. Mayfield Rehabilitation and Special Care Center:*[20] **Remand to Determine the Principal's Mental Capacity**.
2. *Necessary v. Life Care Centers of America, Inc.:*[21] **Oral Authority to Sign Admission Papers is Valid to Bind Principal to Arbitration**
3. *Raines v. National Health Corporation:*[22] **Remand on Two Issues: Principal's Mental Capacity and Whether the Agreement was Unconscionable**.
4. *Philpot v. Tennessee Health Management, Inc.:*[23] **Decision of Trial Court Reversed. Agreement Not Unconscionable and Arbitration is Compelled**.

5. *Reagan v. Kindred Healthcare Operating, Inc.:*[24] **Reverse Trial Court and Compel Arbitration Because Son Failed to Prove His Mother Lacked Capacity to Sign Her Own ADR Agreement.**
6. *Hendrix v. Life Care Centers of America, Inc.:*[25] **Affirm Trial Court's Finding that DPAHC Not in Effect Because Mother Still Able to Make Her Own Decisions**.

The holdings from these six decisions, plus the *Owens* decision, reflect that the unsettled and unpredictable issues are based on (1) whether the agreement or its manner of execution were unconscionable; (2) whether the principal had the capacity to sign his or her own arbitration agreement; or (3) whether the agent had the authority to sign the patient's arbitration agreement.

THE COMMON LAW "SHOCK" TEST

The outcome of the enforceability of an arbitration clause is not a bright line. With the favorable policy by courts to enforce arbitration agreements, an unconscionable defense is one of the few means for a plaintiff to overcome the enforceability of the provision. Courts across the country struggle to define when a contract is so "shocking" that it is unconscionable.[26]

Defining "Shocking"

The Restatement does not define the word *unconscionable*. In one of the earliest and most-cited cases concerning unconscionability, *Williams v. Walker-Thomas Furniture Co.*,[27] the court explained that unconscionability was the absence of meaningful choice on the part of one of the parties combined with contract terms which are unreasonably favorable to the other party. Several courts have followed suit in adopting this description.[28] While there is not clear definition of unconscionable, courts have variously determined that a given clause was unconscionable when it "shocks the conscience," is "monstrously harsh," or one that "no decent, fairminded person would view the ensuing result without being possessed of a profound sense of injustice."[29] Webster's Dictionary[30] defines it as "contrary to the dictates of conscience; unscrupulous or unprincipled; exceeding that which is reasonable or customary; inordinate, unjustifiable."

As stated by a Florida Court of Appeals in *Gainesville Health Care Center, Inc. v. Weston*,[31] the concept of unconscionability has been described as "chameleon-like,"[32] and as "'so vague…that neither the courts, practicing attorneys, nor contract draftsmen can determine with any degree of certainty…' when it will apply in any given situation."[33]

Because this standard is vague and what shocks one judge or jury may be the community standard according to another judge or jury, an arbitration clause is challenging to draft and implement.

Unconscionability can be segregated into procedural and substantive. In general, procedural unconscionability considers the circumstances surrounding the transaction and whether the party had a meaningful choice at the time the contract was entered. In Florida, a contract of adhesion is a strong indicator that the contract is procedurally unconscionable.[34]

The requirements for holding a contract unenforceable due to unconscionability vary by state. In Florida, for example, the court must find *both* procedural and substantive unconscionability before holding that the contract is unconscionable.[35]

Courts have applied this same vague standard of unconscionability in the context of healthcare as in commercial settings.

In the *Philpot v. Tennessee Health Management, Inc.*[36] case, the Tennessee Court of Appeals undertook the monstrous task of trying to make sense of the vague guidance from earlier Tennessee decisions. First, quoting from the *Buraczynski v. Eyring*[37] case, the court stated that enforceability "depends on whether the terms of the contract are beyond the reasonable expectations of an ordinary person, or oppressive or unconscionable."[38] The Court then added that "[a]dhesion contracts that are oppressive to the weaker party or limit the obligations and liability of the stronger party will not be enforced by the courts."[39] Next quoted was the *Owens* description that "[a] contract may be unconscionable if the provisions are so one-sided that the contracting party is denied an opportunity for a meaningful choice."[40] The Court also noted the Supreme Court's guidance form *Taylor v. Butler*[41] which stated that a contract will be found to be unconscionable only when the "inequality of the bargain is so manifest as to shock the judgment of a person of common sense, and where the terms are so oppressive that no reasonable person would make them on one hand, and no honest and fair person would accept them on the other."[42] Finally, an earlier Court of Appeals decision had explained that the unconsionability analysis has two component parts: (1) procedural, which is the absence of meaning choice on the part of one of the parties; and (2) substantive, in which the contract terms are unreasonably favorable to the other party.[43]

Because the term "unconscionable" defies definition, this fuzzy analysis is virtually impossible to apply with any consistency. Thus, the outcome of an unconscionable defense is hard to predict because what shocks one person does not necessarily shock another. This great variability is demonstrated by a series of seven cases issued within approximately a six-week time frame in Tennessee discussed above. Oddly, the litigation of this issue may defeat one of the primary aims of arbitration, which is to have fast settlement of disputes.

Burden of Proof

Who has the burden of proving that the contract is unconscionable? Once the evidence is presented, does a judge, jury or arbitrator decide who prevails? According to the decisions from the Tennessee Court of Appeals, the contract formation issues are to be determined by the judge if the Tennessee Uniform Arbitration Act governs (or by the arbitrator if the FAA governs) and the burden

is on the person making the claim.[44] In the *Raines* case, the granddaughter possessed a durable power of attorney for her grandmother who was transferred to an NHC nursing facility. The administrator of Ms. Raines' estate filed suit against NHC and NHC responded with a motion to compel arbitration. The plaintiff contended that Ms. Raines was mentally incapable of executing the power of attorney; the arbitration agreement was beyond the powers granted under the power; and that the agreement was unconscionable.[45] The trial court followed a summary judgment standard and denied the motion to compel, without obtaining evidence or making findings on these issues. The Tennessee Supreme Court has not explicitly addressed the issue of whether an evidentiary hearing by the trial court is required when facts related to an arbitration agreement are disputed. However, the appellate court held that the summary judgment standard was erroneous and that the trial court must act as the trier of fact to resolve these issues. To quote the United States Supreme Court, "certain gateway matters, such as whether the parties have a valid arbitration agreement at all or whether a concededly binding arbitration clause applies to a certain type of controversy."[46] Prior Tennessee decisions have also illustrated the necessity of such a hearing.[47] The Court of Appeals referenced a California case[48] in which that court had explained that the petitioner bears the burden of proving the existence of a valid agreement, and the party opposing the petition bears the burden of proving any fact necessary to its defense. The trial court sits as the trier of fact and no jury is available. If the matter requires resolution of factual issues, such as issues of unconscionability, fraud, or lack of authority, the trial court must act as the trier of fact to resolve such issues and make a clear ruling as to whether or not the agreement is enforceable. In concluding, the *Raines* court held that "the trial court must proceed expeditiously to an evidentiary hearing when it faces disputed issues of fact that are material to a party's motion to compel arbitration; it may not decline to resolve the question until trial of the underlying case."[49]

WAIVING ANOTHER PERSON'S RIGHTS

Advance Directives and Oral Authorization

Can an agent acting under a written power of appointment as a health care agent make the "legal" decision to bind the principal to arbitration? The answer requires construing the written instrument and state law principles governing the law of agency and any statute applying to advance directives.[50] The *Owens* case involved a power governed by the Durable Power of Attorney for Health Care Act[51] (DPAHCA), and the Court held the decision to arbitrate was a "health care" decision under the power of attorney and its governing act.[52] The Court explained that an admissions contract, even one without an arbitration provision, is technically a "legal" decision. Therefore, trying to distinguish permissible legal decisions from impermissible legal decisions would be untenable and could leave the patients in legal limbo.

The *Necessary* [53]case involved a husband's oral express authority to his wife to sign admission documents, without expressly stating the wife could waive his constitutional rights to a trial by jury and bind his disputes to arbitration. The wife admitted that her husband was mentally competent and gave her the authority to sign admission papers since she had to quickly find a home for him. She claimed this was the only nursing home in that part of the state with the resources and beds available. Plaintiff claimed that she was about to leave town on business, and therefore, everything had to be signed and completed that day. Plaintiff signed a two-page stand-alone arbitration agreement as the "legal representative."[54] The plaintiff admitted that she did not read the entire agreement because she was in a hurry and did not understand much of it. The intermediate appellate court recited the *Owens* rationale that the distinction between legal and health care decisions fails to appreciate that signing a contract for health care services is itself a "legal decision," and could leave an incapacitated principal in "legal limbo,"[55] and therefore, the plaintiff's claim that she could make all decisions, except the authority to sign an arbitration agreement, was untenable.[56]

Timing of the Agent's Power

Another question is when is the agent's power effective? Some advance directives require the principal to be incapacitated or unable to make decisions before the agent's authority "springs" into effect. The interpretation of whether the agent's authority is a "springing" power is again a question of the language of the authorizing power and any state governing act.[57] In Tennessee, the statutes for advance directives default to a springing power, and thus, the principal must be mentally incapacitated before the agent has the authority to sign, unless the written authorization specifically authorizes the agent to act concurrently while the principal is capable.

"SHOCKING" LEGISLATION

There is a much controversy regarding the use of arbitration in the pre-injury patient context.[58] In the managed care-consumer context, a Joint Commission comprised of the American Arbitration Association, American Bar Association, and the American Medical Association produced a report in 1998 that recommended that binding forms of dispute resolution should be used only where the parties agree to do so after a dispute arises.[59] In patient-provider disputes, the AHLA and AAA service will no longer perform arbitration unless agreed to by both parties after the dispute arises or so ordered by a court.[60] There is at least one state that does not allow pre-treatment arbitration clauses at all by legislation.[61]

On the other hand, seven states have enacted voluntary arbitration clauses which specifically authorize agreements to arbitrate prior to the initiation or during the course of treatment.[62] These laws generally establish some protections for the consumer, such as the right to revoke within a set time period or inability to mandate the agreement as a prerequisite to treatment. Alaska law provides

that the parties may execute the agreement to submit to arbitration any dispute arising out of the care by the provider during the period the agreement is in force or that has already arise, but it may not be made a prerequisite to receipt of care and this must be so stated; the form must contain certain provision in bold print and be approved in advance by the attorney general; the patient must be able to revoke it within 30 days after execution; for hospitals, the agreement must be re-executed upon each admission; three arbitrators selected from a list provided by the attorney general and compensation is to be paid by the court; the court shall also pay the costs of the experts, up to three per side up to a max of $150 per day for each expert witness. The California Code provides for a voluntary agreement with specific details for any dispute as to professional negligence of a health care provider for medical malpractice, including 10-point bold red type with uniform language, and a 30 day right to rescind. Case law has interpreted this to include pretreatment authorization and retroactive agreements. Colorado law provides for voluntary arbitration agreements with health care providers for professional negligence if the agreement conforms to the statutory provisions, which include specific language, warnings and type; the health care provider may not refuse medical services if the patient refuses to sign or exercises a 90 day right of rescission (and if so, this constitutes unprofessional conduct with potential disciplinary action); no medical malpractice insurance carrier may require an arbitration clause; and no agreement may be submitted to a patient for approval when the patient's condition prevents the patient from making a rational decision whether or not to execute. The Florida statute provides for voluntary agreements to determine the damages for medical negligence claims after completion of presuit investigation, with limitations of $250,000 for noneconomic damages and no punitive damages; the defendant shall pay the claimant's attorney's fees and costs up to no more than 15 % of the award, plus the costs of the arbitration proceeding and arbitrator's fees. Louisiana law provides for an arbitration agreement with a medical or dental practitioner or medical institution and must inform the patient in writing that the patient has a right to void the agreement within 30 days of execution. South Dakota provides for voluntary agreements between hospitals or physicians and patients relating to services provided to the patient for past and future services; provided the party may terminate it as to future services by giving written notice. Finally, Utah provides that the patient and health care provider may agree to arbitration if the patient is given certain details in writing (such as the manner in which arbitrators will be selected and responsibility for costs) and the patient has the right to rescind the agreement within 10 days of signing.

Beyond private party contracting, several states implemented court-annexed arbitration for medical malpractice claims. These latter statutes were passed in the wake of the "medical malpractice insurance crisis" to address the cost of litigation and large jury verdicts.[63] These statutes have generally survived constitutional challenges in all but a few state cases on grounds of the right to a jury trial, due process or equal protection.[64]

Currently, Tennessee does not have an arbitration statute for voluntary agreements or for court-annexed arbitration. Courts in Tennessee have upheld arbitration clauses which give the

patient a right to revoke the arbitration provision within ten business days of admission.[65] NHC, a large national operator of nursing homes, is headquartered in Tennessee. In response to the *Owens* and intermediate appellate court decisions, NHC has supported state legislation that would mandate patients to sign arbitration agreements as a condition of admission to a nursing home.[66] This legislation, if passed, would allow nursing homes to force patients to agree to arbitration clauses in as a condition of admission, without any right to object to arbitration or revoke the right.[67] The proposed legislation would also allow any person *who is authorized* to be named as a surrogate decision maker to sign the arbitration agreement for the patient.[68] This means virtually any adult could bind the principal to arbitration, waiving the patient's right to a trial by jury. Proponents of the legislation claim that Tennessee is the second highest in terms of liability insurance cost per bed.[69] However, medical arbitration statutes were passed based on a similar cry from medical practitioners and recent studies now show that the magnitude of the medical insurance crises may have been overstated.[70] This proposal shows the extent to which some health care providers are interested in mandating resolution of claims in the arbitral forum.

THE LEGAL AND BUSINESS SENSE (AND NONSENSE) OF ARBITRATION IN HEALTHCARE

Why are some healthcare corporations so anxious to have their tort actions settled by arbitration? There are several business advantages to arbitration. There may even be quality advantages to arbitration, although further empirical studies would be needed to support this proposition.

The Business Perspective

Arbitration has been used as a means to settle disputes for hundreds of years. Pre-injury dispute agreements to arbitrate are simply contracts between parties as to the method of resolving a future dispute. While the right to contract is an important public policy concept in American jurisprudence, courts were slow to recognize the validity of pre-dispute arbitration agreements until after the passage of the Federal Arbitration Act in 1925. The Federal Arbitration Act made arbitration agreements involving interstate commerce enforceable by specific performance.[71] In the last three decades, the healthcare industry has increasingly become interested in using arbitration, following the trends in general commercial contexts to include arbitration provisions in consumer contracts. New Jersey was the first state to enact legislation requiring most claim payment disputes to be resolved by mandatory binding arbitration administered by the National Arbitration Association.[72] In the nursing home context, large chains such as Kindred Healthcare Operating, Inc., Life Care Centers of America, Inc. and National Health Corporation (NHC), have included

arbitration agreements in nursing home admission contracts. In response to the medical malpractice crisis, physician groups in many states clamored for court-annexed arbitration.[73]

What is the drive for businesses to include pre-dispute provisions to arbitrate disputes as a solution to litigation woes? There are several business advantages to arbitration. There may even be quality advantages to arbitration, although empirical studies would be needed to support this proposition.

Advantages

There are several advantages that arbitration offers in the healthcare setting. First, arbitration agreements are a contracting matter, and thus, parties can define the process to whatever they want, including the selection of the arbitrator and time limits and extent of discovery.[74] The ability to limit discovery is especially helpful in lowering the overall direct costs of the conflict. According to one study, sixty percent of the typical costs are spent on discovery.[75]

Another justification offered by proponents of arbitration is that the high jury awards have caused insurance premiums to rise to exorbitant levels in some instances, resulting in a malpractice insurance crisis in some states. Ultimately, the high costs of insurance are passed on to consumers which makes healthcare more expensive to society as a whole. Arbitrators are presumably more rational, educated and experienced decision-makers who will judge the case on its merits. Thus, proponents seek arbitration for lower awards which will ultimately result in lower insurance costs.[76]

Arbitration is also favorable for limiting the length of time the conflict remains open. This occurs for at least three reasons. One, the arbitration agreement can set the process with time limits in which the arbitrator(s) selection has to be finalized and a decision by the arbitrator rendered. Two, discovery is typically limited in arbitration, either in the contract, rules of the service or by the discretion of the arbitrator.[77] Three, in binding arbitration, there is no appeals process except in extraordinary circumstances. In contrast, the trial and appeals process may take several years, depending on the backlog in the particular court system and the number of appeals. This is advantageous in that the finality of the initial award shortens the conflict resolution process.

Special Quality Issues in Healthcare

The indirect effect of this shortening of the time has another major advantage that is infrequently mentioned in the literature: it frees up time and energy involved in resolving conflict, thus enabling management to focus on more productive activities. Management time involved in litigation is as a hidden cost to conflict. In some cases, this indirect cost can exceed actual legal fees.[78] In a case reported by the CPR Institute for Dispute Resolution, the dispute involved defective medical equipment. The dispute required three days of management time with the lawyers, four days of depositions; 100 hours of investigation; and 180 hours of other in-house staff time. The case

remained open for five years and eventually settled for $250,000.[79] A quicker resolution of the dispute may have enabled management to shift this time to more productive undertakings.

One of those more productive undertakings could be a focus on improved quality of care. Improving quality of care is an on-going concern in the U.S. healthcare industry, affecting healthcare organizations small and large, urban and rural. As stated by professors Sarah Pitts and Rob Kamery, "The focus on quality performance, a trend bordering on impatience on the health plan front, is sure to determine who leads and who survives among hospitals."[80] Two important studies have made us aware of quality issues in health care: The landmark IOM report issued in 2000, *To Err is Human: Building a Safer Health System*[81] and a 2003 study published in the New England Journal of Medicine which showed that patients received recommended care across a broad array of clinical conditions only about half the time.[82]

The conflict-laden health care industry is ripe for techniques to settle disputes efficiently and effectively to minimize these effects on quality. As conflict diverts management time, it also has a negative effect on the healthcare providers whose acts or omissions are the subject of the lawsuit. The effects of a malpractice suit on a physician may include emotional and physical reactions, such as devastation, intense anger, major depression, and even increased incidence of malpractice.[83] Physicians may practice defensive medicine as a response.

Various alternative dispute resolution techniques have been attempted in healthcare settings. For example, at Rush-Presbyterian-St. Luke's Medical Center, located in Cook County, Illinois, initiated one of the first hospital-based mediation programs in the country. This involved training attorneys as mediators and then teaming up an experienced plaintiff's attorney with an experienced defense attorney to conduct co-mediations. Each side in the dispute got to select from the listing of trained attorney-mediators. During the period studied between 1995 and 2000, 80% of the cases submitted to co-mediation were successfully resolved, with the majority within three to four hours. In addition, cases taken to mediation resulted in a 50-70% cost reduction. Surprisingly, instead of attracting more lawsuits, the co-mediation program resulted in a slight reduction in the number of medical malpractice suits.[84]

Unfortunately, the implementation of ADR has had mixed results in healthcare and has not gained major sway.[85] Despite the setbacks, the Joint Commission on Accreditation of Healthcare Organizations recognizes the need for organization leaders to work together to manage conflict so that conflict does not compromise the delivery of safe, high-quality care.[86] The Commission has mandated a new leadership standard for organizations, to go into effect on January 1, 2009. This standard requires leadership groups to have a process in place to help them manage conflicts so that health care safety and quality is protected. Skilled individuals must be identified to help their organization more easily manage, or even avoid, future conflicts. These people many be either internal to the organization or external. The standard suggests that these skills can be acquired in various ways, such as training and experience. The goal of the standard is not necessarily to resolve the conflict (which can be productive in some instances) but to create the expectation that

organizations will implement a process so that the conflict does not harm patient safety or quality of care.[87]

Disadvantages

There are several disadvantages to arbitration in the patient-provider context. There are no precedents or due process safeguards that must be followed.[88] If the result is unfavorable to the defendant, there are very limited grounds for appeal.

If the parties are going to have a continuing relationship, arbitration may not be advantageous. Arbitration is similar in litigation in that each side presents its best case to a third party who renders a decision. Thus, the antagonism of a winner/loser environment surfaces in arbitration. This is in contrast to the potential healing effects in mediation where the parties can craft their own mutually beneficial solutions.[89]

Arbitration with full discovery can be as expensive and even as time-consuming as litigation. Thus, the primary benefits expected from arbitration (cost savings and quicker resolution) will not necessarily occur if full or expanded discovery is allowed.

Not all claims are ideally suited for arbitration – at least from the business entity's perspective. If the dispute involves a collection matter, or an issue that is not subject to an emotional jury trial, the organization may prefer to litigate. NHC has cleverly drafted its admission agreements to direct its collection claims against patients to small claims court. In the *Philpot* case, the admission agreement provided that claims below the jurisdictional limit of the general sessions' court would be heard in court, but that claims over that amount were subject to arbitration. The plaintiff argued that the practical effect of this provision was to prohibit the plaintiff, but not the defendant, to seek judicial remedies because the defendant's claims would generally be under the limit, while the plaintiff's claims would not. The Tennessee court rejected this argument, finding that the parties mutually agreed to this provision.[90]

The Patient's Perspective

Advantages

A shorter period to resolving conflict can bring emotional benefits to the plaintiff. The finality of the award, except in unusual circumstances, ends the conflict process and allows the parties to move beyond this issue.[91] Thus, there is an intangible benefit in alleviating the emotional distress of litigation. There can also be cost advantages to limited discovery and faster resolution of conflict. Additionally, the patient may receive his or her reward faster from an arbitration proceeding.[92]

Disadvantages

The disadvantages for businesses are also disadvantages for patients. The lack of written decisions, lack of appeal, and lack of accountability are especially troublesome for patients. The arbitrator's decision is generally not reviewable on appeal for mistakes of law. Opponents of arbitration in the healthcare context claim that it deters the ability to obtain sufficient reimbursement for severe injuries.[93] Many times the proceedings are confidential. The process is shrouded in secrecy since the forum is not open to public scrutiny by means of public trial and written opinions.

The patient consumer may also be at a disadvantage when the healthcare provider is a repeat player in obtaining arbitrators.[94] For example, a large or multi-state organization has the advantage of repeatedly selecting arbitrators. There is also an inherent conflict of interest because the arbitrator may ultimately earn his or her living from the large repeat players. This may create bias on the part of the arbitrators to render favorable awards to player who may be able to select and pay for their services in the future. Thirty percent of Kaiser's cases in 1999 were decided by just eight repeat arbitrators according to a report by the California Research Bureau, with six of those eight arbitrators ruling in favor of Kaiser in 80% of the cases.[95] In one particular case against Kaiser Permanente H.M.O., the arbitrator selected by the State Superior Court in San Mateo County had dealt with thirteen other Kaiser disputes. [96] In another instance, the California Supreme Court overturned the arbitrator's ruling because the arbitrator has not disclosed that he had served as Kaiser's own arbitrator in five prior cases.[97] If the arbitrator renders an unfavorable decision to the organization, a prudent business organization would be unlikely to select that arbitrator in the future. A report compiled by the state-financed California Research Bureau in 2000 found that none of the arbitrators who awarded patients more than one million dollars from April 1999 to March 2000 were selected again by health care providers during that time.[98]

The costs savings that are touted may also not be realized by the consumer, as the forum costs and arbitrator fees can be high.[99] For example, in one case against Kaiser Permanente in 2001, the plaintiff estimated that she spent more than $200,000, including the hiring of medical experts.[100] In order to dispute the arbitration clause, the plaintiff may take action to strike down the contract as unenforceable as unconscionable or due to other defenses to a valid contract.[101] This adds costs to the plaintiff and additional time to litigate these issues. In addition, the upfront costs may deter some consumers from bringing their claims. Also, the smaller awards in arbitration may deter some attorneys from representing plaintiffs, making it more difficult to find good counsel.[102]

Finally, the contract may also provide that the consumer gives up their right to statutory claims that were passed to protect the consumer and give legal remedies. It is questionable if consumers really understand what they are giving up when they sign an adhesive health care contract. Thus, there is a public policy argument that consumers should not be bound to health care contracts when there is a statutory remedy.

A THEORETICAL MODEL TO ESTABLISH LEGALLY SENSIBLE ARBITRATION

A Modified Common Law Approach to the "Shocking" Analysis

One of the few ways for a plaintiff to overcome the enforceability of a pre-dispute agreement is to successfully argue that the contract was procedurally or substantively unconscionable. This is a difficult case to make in light of the FAA and expansive court interpretations. Yet there are special issues in healthcare that merit additional scrutiny with respect to pre-dispute arbitration agreements. One is that patients are often incapacitated and it is the agent who actually waives the patients' rights to a jury trial. Two, patients are frequently signing admission agreements in exigent circumstances or when pressing medical issues take precedence over potential legal issues. Three, patients are in a special relationship with their healthcare provider and may assume (more so than in the commercial context) that their provider agreements are in the patient's best interests.

A new common law approach is proposed to add a balancing prong to the unconscionable analysis. This third prong would balance the public's interest in favoring an efficient arbitral forum with the public need to ensure patients (especially incapacitated patients) have voluntarily waived their rights to a jury trial and have retained access to a fair, unbiased process. In theory, a model based on a balancing approach could ensure that the reasonableness of the provision, including the forum and procedures, are carefully weighed against the potential injury to the plaintiff and the public. This balancing approach would be similar to the balancing approach engaged in for three centuries by courts across the nation in the non-compete arena. In the healthcare setting in particular, a few state courts have recognized special issues in healthcare and have heightened the balancing approach by strictly scrutinizing the enforcement of a non-compete imposed on a physician against the potential harm to the public. For example, the Idaho Supreme Court held that the doctor-patient relationship is different than the relationships between most other service providers. While the public has an interest in freedom to contract, this must be balanced against the public interest in upholding the personal relationship between the doctor and the patient. The public's interest includes the patients' interests in continuity of care and access to the provider of their choice. The restrictive covenant must, therefore, be no more restrictive than necessary to protect legitimate business interests of the practice. The court recognized that the employer has a legitimate interest in it patient base, referral sources, training, and confidential business information.[103]

Under the proposed arbitration analysis, the court would subject the agreement to a higher level of scrutiny, balancing the approach to efficiency in the arbitral forum against the rights of contracting parties to voluntarily waive their rights and still have access to an unbiased forum. This model could theoretically be adopted in cases where the Federal Arbitration Act does not apply. Under the FAA, a court cannot invalidate an agreement to arbitrate except on a ground that is applicable to any contract.[104] Thus, federal legislation is required to ensure sufficient protections

for consumers, including a voluntary agreement that is not a prerequisite to care and a right to revoke the agreement.

CONCLUSION

Unfortunately, the status of state legislation or additional court scrutiny that places conditions on the enforceability of healthcare contracts is legally questionable. The FAA requires agreements to arbitrate to be enforced to the same extent as any other contract. If challenged, any limitations or stricter scrutiny would likely be in conflict and displaced by the FAA.[105] Federal legislation is the only definitive way to ensure enforceable consumer protections.

Sensible legislation should maximize on the advantages, while overcoming the disadvantages of arbitration in healthcare to the greatest extent possible. It must consider the needs of the providers to have claims heard quickly by impartial decision-makers, as well as the need to protect the right of injured claimants to a fair hearing. The terms of the agreement should not unduly dissuade patients from bringing claims based on excessive fees or limited selection of arbitrators or rules that unduly favor the provider. The agreement should not be a prerequisite to care and the patient should have a right to revoke the agreement. Legislators can decide whether there is a rational reason to place caps on non-economic or punitive damages in light of the availability of providers, the ability to obtain insurance at reasonable rates, and other state-specific factors.

An example of legally sensible legislation is the Alaskan law. This law strikes a balance with its statute on voluntary agreements by providing that the parties may execute the agreement to submit to arbitration any dispute arising out of the care by the provider during the period the agreement is in force or that has already arise, but it may not be made a prerequisite to receipt of care and this must be so stated. The form must contain certain provision in bold print and be approved in advance by the attorney general; the patient must be able to revoke it within 30 days after execution; for hospitals, the agreement must be re-executed upon each admission; three arbitrators selected from a list provided by the attorney general and compensation is to be paid by the court; the court shall also pay the costs of the experts, up to three per side up to a max of $150 per day for each expert witness.[106]

Another sensible scheme appears in the Florida law. This allows for voluntary agreements on the issue of damages after it appears that there is medical malpractice. Florida law provides for voluntary agreements to determine the damages for medical negligence claims after completion of presuit investigation. The Florida law also places caps on the awards to those who agree to the arbitration of the damage award: limitations of $250,000 for noneconomic damages and no punitive damages. The defendant must pay the claimant's attorney's fees and costs up to no more than 15 % of the award, plus the costs of the arbitration proceeding and arbitrator's fees.[107]

Finally, the traditional common law unconscionability analysis is much preferred to ill-considered legislation which authorizes or forces arbitration without a defined set of guidelines.

Adhesive contracts can easily lead to overreaching and sham agreements that fail to provide fair procedures for injured health care consumers. There are too many serious disadvantages to arbitration in healthcare to allow unfettered arbitration in adhesive healthcare contracts to reign.

ENDNOTES

[1] 9 U.S.C. § 2.

[2] The U.S. Supreme Court has continuously expanded the scope of the Federal Arbitration Act since the 1980s. *See generally,* Arbitration and Unconsionability after Doctor's Associates, Inc. v. Casarotto, 31 Wake Forest L. Rev. 1001 Winter 1996; Stephan Landsman, *ADR and the Cost of Compulsion*, 57 Stan. L. Rev. 1593, 1603-1604 (2005).

[3] See *generally,* Id.; Ann E. Krasuski, *Mandatory Arbitration Agreements Do Not Belong in Nursing Home Contracts with Residents,* 8 DePaul J. Health Care L. 263, 273 (2004) (Juries increased compensatory awards against nursing homes fourfold from 1995 to 1998 to an average of $1.3 million); Amy B. Crane, *Taking the Offensive Against Claims Denials*, H&HN: Hospitals & Health Networks. Vol. 81, Issue 4, p 46-50; Laura M. Owings and Mark N. Geller, *The Inherent Unfairness of Arbitration Agreements in Nursing Home Admission Contracts*, Tennessee Bar Journal March 2007; Rebecca Adelman and Chase Pittman, *Letter to Editor*, Tennessee Bar Journal April 2007.

[4] Kenneth A. DeVille, *The Jury is Out: Pre-Dispute Binding Arbitration Agreements for Medical Malpractice Claims*, Journal of Legal Medicine 28:333-394, July-September 2007.

[5] __ S.W.3d __, 2007 WL 3284669 (Tenn.2007).

[6] Briarcliff Nursing Home, Inc. v. Turcotte, 894 So.2d 661 (Ala.2004); Hogan v. Country Villa Health Servs., 148 Cal.App.4th 259, 55 Cal.Rptr.3d 450, 453-55 (Cal.Ct.App.2007) (citing Garrison v. Superior Court of Los Angeles County, 132 Cal.App.4th 253, 33 Cal.Rptr.3d 350 (Cal.Ct.App.2005)); Sanford v. Castleton Health Care Ctr., L.L.C., 813 N.E.2d 411 (Ind.Ct.App.2004). But see Texas Cityview Care Ctr., L.P. v. Fryer, Nos. 2-06-373-CV, 2-06-426-CV, 2007 WL 1502088, *5 (Tex.Ct.App. May 24, 2007) (stating "nothing in the medical power of attorney indicates that it was intended to confer authority on [the attorney-in-fact] to make legal, as opposed to health care, decisions for [the principal], such as whether to waive [the principal's] right to a jury trial by agreeing to arbitration of any disputes").

[7] *Owens,* supra note 5, at *4 - *11.

[8] Id.

[9] T.C.A. § 71-6-101 to -122.

[10] *Owens*, supra note 5, at *3.

[11] Id. at *1.

[12] Id. at *5.

[13] Id. at *6.

[14] 919 S.W.3d 314 (Tenn.1996).

[15] *Owens,* supra note 5, at *10.

[16] Final Report, July 27, 1998 *available at* http://www.adr.org/sp.asp?id=28633 (last visited 1/30/2008).

[17] The Commission recommended that in disputes involving managed health care decisions for patients, binding forms of dispute resolution should be used only where the parties agreed to do so after a dispute arose.

[18] *Owens,* supra note 5, at *8.

[19] Id. at *11 (quoting *Haun v. King,* 690 S.W.2d 869 (Tenn.Ct.App.1984).

[20] 2007 WL 3445550 (Tenn.Ct.App.).

[21] 2007 WL 3446636 (Tenn.Ct.App.).

[22] 2007 WL 4322063 (Tenn. Ct.App.)

[23] 2007 WL 4340874 (Tenn.Ct.App.).

[24] 2007 WL 4523092 (Tenn.Ct.App.).

[25] 2007 WL 4523876 (Tenn.Ct.App.).

[26] Compliance with a state statute is required in some jurisdictions.

[27] 350 F.2d 445, 449 (D.C.Cir. 1965).

[28] *See, e.g., Gainesville Health Care Center, Inc. v. Weston*, 857 So.2d. 278, 284 (Fla.App. 1 Dist. 2003).

[29] Id. at 283-284.

[30] Deluxe Encyclopedic Edition.

[31] *Gainesville Health Care Cneter, Inc.,* supra note 28 at 284.

[32] Id. (quoting *Steinhardt v. Rudolph*, 422 So.2d 884, 890 (Fla. 3d DCA 1982).

[33] Id. (quoting *Fotomat Corp. of Fla. v. Chanda*, 464 So.2d 626 n. 1 (Fla. 5th DCA 1985).

[34] Id. at 285.

[35] Id. at 284.

[36] *Philpot,* supra note 23. In this case, the Court of Appeals held that the arbitration agreement was not oppressive or unconscionable: The contents of the arbitration provision and waiver were not hidden, but were separate and prominently displayed with bold capital letters on its face and on the cover page. The acknowledgment was set apart and stated that the provisions had been explained and he had been provided the opportunity to ask questions. The plaintiff argued that it was urgent for him to find a facility for his mother on the day she was to be released from the hospital and he was told he had to take the open spot or it would be filled by someone else. However, this urgency, in part, was due to plaintiff's desire to complete this matter during his lunch break. There were also other facilities in the area known to the plaintiff. The plaintiff contended that the NHC employee quickly flipped through the pages of the lengthy admissions packet without explaining that the plaintiff was giving up his right to a jury trial. NHC disputed this contention. The Court found nothing in the record to suggest that the plaintiff's education or abilities prevented him from understanding the agreement, and he did not ask questions or request additional time to read it. Therefore, he was presumed to know the contents of the contract he signed. The Court also rejected the plaintiff's argument that the agreement was cost-prohibitive because the evidence was insufficient for the trial court to make that finding. The burden was on the plaintiff to prove this point.

[37] *Buraczynski* , supra note 14 at 320. Here, the Tennessee Supreme Court upheld an arbitration contract between a physician and patient. The contract was a separate one page document with 10-point capital letter red type directly above the signature line that clearly stated the patient was giving up a right to a jury trial on any malpractice claim. The terms were laid out clearly. Each party was able to pick an arbitrator and those arbitrators were to select a third arbitrator. Patients could revoke the agreement for any reason within thirty days of its execution. The agreement did not limit liability for breach of duty or change the standard of care, but merely shifted the dispute to the arbitral forum.

[38] *Philpot*, supra note 23, at *4 (quoting *Buraczynski*, supra note 37).

[39] Id.

[40] Id. (quoting *Owens,* supra note 5, at *11).

[41.] 142 S.W.3d 277, 285 (Tenn.2004).

[42] *Philpot*, supra note 23, at *4 (quoting *Taylor,* supra note 41 which was citing *Haun*, 690 S.W.2d at 872).

[43] *Elliott v. Elliott,* No. 87-276-II, 1988 WL 34094 at *4 (Tenn.Ct.App. April 13, 1988).

[44] *Raines,* supra note 22.

[45] Id. at *1.

[46] *Green Tree Fin. Corp. v. Bazzle,* 539 U.S. 444, 452, 123 S.Ct. 2402, 156 L.Ed.2d 414 (2003).

[47] *Howell v. NHC Healthcare-Fort Sanders, Inc.*, 109 S.W.3d 731, 732-35 (Tenn.Ct. App.2003); *Raiteri v. NHC Healthcare/ Knoxville, Inc.*, 2003 WL 23094413, at *4 (Tenn.Ct.App. Dec. 30, 2003).

[48] *Rosenthal v. Great Western Fin. Sec. Corp.,* 926 P.2d 1061 (Calif.1996).

[49] *Raines,* supra note 22, at *6.

[50] Id. at *6 (quoting 3 AmJur.2d Agency, Section 27 (2007).

[51] T.C.A. Section 34-6-201 – 218.

[52] In Tennessee, there are two alternative statutes that can apply to health care directives. The older statute is The Durable Power of Attorney for Health Care Act (DPAHCA) passed in 1990 and the newer act is The Tennessee Health Care Decisions Act (HCDA) passed in 2004.

[53] *Necessary,* supra note 21.

[54] Id. at *1.

[55] Id. (quoting *Owens,* supra note 5, at *6).

[56] Id. at *5.

[57] Under Tennessee's DPAHCA, supra note 51, the statute provides that, subject to any limitations in the durable power of attorney, the agent may make health care decisions for the principal to the same extent as the principal "if the principal had the capacity to do so." If the form is prepared by a person other than the principal, the statute requires a rather ominous warning that includes the retention of the principal's right to make decisions as long as the principal can give informed consent. This is interpreted to mean that the power only "springs" into effect if the patient is mentally incapacitated and only for as long as the patient is incapacitated. With forms governed by the more recent HCDA, the governing statute is more direct in stating that, unless otherwise specified in the advance directive, "the authority of the agent becomes effective only upon the determination that the principal lacks capacity." Thus, it is possible to draft a power that is concurrent with the principal's capacity, but this practice is probably rare since the default (and the model forms) is a "springing" power.

[58] See Ann E. Krasuski, supra note 3 , at 273; Stephan Landsman, supra note 2.

[59] American Arbitration Association/ American Bar Association / American Medical Association Commission on Healthcare Dispute Resolution Final Report July 27, 1998, "Healthcare Due Process Protocol" *available at* http://www.adr.org/sp.asp?id=28633 (last visited 1/30/2008).

[60] However, the AHLA will provide the service for a pre-injury health care arbitration in a consumer dispute agreement if so ordered by a court. See Important Rules Amendments last retrieved on 2/2/08 at http://www.healthlawyers.org/Template.cfm?Section=About_Arbitration_and_Mediation_Services&Template=/ContentManagement/ContentDisplay.cfm&ContentID=3049.

[61] Alabama law provides that the parties can agree to arbitration only *after* the health care provider has rendered or failed to render services, and the procedural rules shall be those established by the American Arbitration Association with 3 arbitrators. Ala.Code 1975 § 6-5-485.

[62] Alaska, California, Colorado, Florida, Lousiana, South Dakota and Utah. *See* AK ST § 9.55.535; Cal.C.C.P. § 1295; C.R.SA. § 13-64-403F.S.A. § 766.207, L.S.A.-R.S. 9:4235, SDCL § 21-26B-1, U.C.A. 1953 § 78-14-17.

[63] See generally, Carol Crocca, 24 A.L.R.5th 1, (originally published in 1994), updated weekly ; A. Thomas Pedroni & Ruth F. Vadi, *Mandatory Arbitration or Mediation of Health Care Liability Claims?* 39 APR Md. B.J. 54 (2006); Thomas B. Metzloff, *Alternative Dispute Resolution Strategies in Medical Malpractice* 9 Alask L. Rev. 429 (1992).

[64] See Matthew Parrott, *Is Compulsory Court-Annexed Medical Malpractice Arbitration Constitutional? How the Debate Reflects a Trend Towards Compulsion in Alternative Dispute Resolution*, 75 Fordham L. Rev. 2655, 2719-2740.

[65] *Philpot,* supra note 23.

[66] Senate Bill, SB 4075, introduced by Senator Jim Tracy, last retrieved on 3/2/08 available at http://www.legislature.state.tn.us/bills/currentga/BILL/SB4075.pdf.

[67] Id.

[68] Id.

[69] Business Wire 2008, *Proposed Legislation Takes Aim at Soaring Nursing Home Liability Costs in Tennessee,* 2/1/2008, available at http://www.pr-inside.com/proposed-legislation-takes-aim-at-soaring-r416156.htm.

[70] See Matthew Parrott, supra note 64 at 2742. Opponents of the proposed legislation also point out that only four medical negligence verdicts were awarded against Tennessee nursing homes from 2005-2007. During the same period, nursing home admission suspension tripled, with 22 nursing homes in 2007 having their admissions suspended for putting their resident in jeopardy. Business Wire 2008, *Proposed Legislation Strips Nursing Home Residents of their Legal Protections,* 2/4/2008, available at http://finance.abc7news.com/kgo?ChannelID=3191&GUID=4517465&Page=MediaViewer.

[71] 9 U.S.C. § 2.

[72] Amy B. Crane, *Taking the Offensive Against Claims Denials*, H&HN: Hospitals & Health Networks. Vol. 81, Issue 4, p 46-50.

[73] Kenneth A. DeVille, supra note 4 (quoting Keith Mauer, Director of health care and insurance ADR solutions for the National Arbitration Forum as saying "[re]solving these disputes through arbitration is becoming a trend because the traditional way of resolving them is through lawsuits, which are expensive, time-consuming and cumbersome**.")**

[74] See Myra W. Isenhart & Michael Spangle, *Collaborative Approaches to Resolving Conflict,* 129-136, Sage Publications (2000).

[75] American Hospital Association and CPR Institute for Dispute Resolution, *Managing Conflict in Health Care Organizations* 3 (1995).

[76] See Albert Yoon, *Mandatory Arbitration and Civil Litigation: An Empirical Study of Medical Malpractice in the* West, 5 Am. L & Econ. Rev. 95, 97 (2004); Christopher R. Drahozal, *A Behavioral Analysis of Private Judging*, 67 Law & Contemp. Probs. 105, 105 (2004) (discussing medical profession's and public's view of medical malpractice system with irrational anti-physician jurors who are predisposed to grant huge and non-meritorious damage awards).

[77] See, e.g., Rule 4.02 of the American Health Lawyers Association, *Rules of Procedure for Arbitration*, last retrieved on 2/21/08 at hpp://www.ahla.org/Template.cfm?Section =About_Arbitration_and_Mediation_Services.

[78] Donald A. Glenn, *Easing the Strain of Litigation Costs*, Outlook, Fall 93, Vol. 61 Issue 3, p 34.

[79] See American Hospital Association, supra note 75.

[80] Pitts, Sarah T. and Kamrey, Rob H. *Legal and Financial Issues in Small Hospital Failure: A Theoretical Framework for Avoiding Closure,* Journal of Legal, Ethical and Regulatory Issues, 7.1-2 (Jan-July 2004); p 103.

[81] Kohn, LT.;Corrigan, J.; Donaldson, MS. *To Err is Human: Building a Safer Health System.* Washington, D.C: National Academy Press; 2000. According to the 2005 National Healthcare Quality Report, developed by the Agency for Healthcare Research and Quality, health care quality is improving, but several measures still present significant challenges, including: the rate of late stage breast cancer has not changed over the past 10 years; the rate of new AIDS cases has not changed over the past 5 and remains 17 times higher than the Healthy People 2010 target; and the percentage of elderly that had 1 of 11 drugs that should always be avoided by the elderly remained unchanged over the past 6 years. *National Healthcare Quality Report*. December 2005. AHRQ Publication No. 006-0018. Agency for Healthcare Research and Quality, Rockville, MD. Retrieved on 2/29/08 at http://www.ahrq.gov/qual/nhqr05/nhqr05.pdf.

[82] McGlynn EA, Asch SM, Adams J, et al. *The Quality of Health Care Delivered to Adults in the United States*. *N Engl J Med.* 2003;348(26):2635–45.

[83] See, e.g., Fillmore, Buckner, *A Physician's Perspective on Mediation Arbitration Clauses in Physician-Patient Contracts,* 28 Cap. U. L. Rev. 307, 307-308 (2000).

[84] John W.Cooley, A Dose of ADR for the Health Care Industry, 57 APR Dip. Resol. J. 16, 19-20 (2002).

[85] See generally, Edward A. Dauer, Postscript on Health Care Dispute Resolution: Conflict Management and the Role of Culture, 21 Ga. St. U. L. Rev. 1029 (2005); Charity Scott, Forward to the Symposium: Therapeutic Approaches to Conflict Resolution in Health Care Settings, 21 Ga. St. U.L. Rev. 797 (2005); Carol A. Crocca, Arbitration of Medical Malpractice Claims, 24 A.L.R. 5th (originally published in 1994, updated weekly); Bryan A. Liang, Understanding and Applying Alternative Dispute Resolution Methods in Modern Medical Conflicts, 19 J. Legal Med. 397 (1998); Marc R. Lebed & John J. McCauley, Mediation within the Health Care Industry: Hurdles and Opportunities, 21 Ga. St. U.L. Rev 911 (2005); Kathrine K. Galle, Comment: The Appearance of Impropriety: Making Agreements to Arbitrate in Health Care Contracts More Palatable, 30 Wm. Mitchell L. Rev. 969 (2004)/

[86] The Joint Commisssion *Pre-Publication Standards*, *Hospitals*. Effective 1/1/2009. Last Retrieved on 6/18/2008 at http://www.joingcommission.org/Standrads/Pre-PublicationStandards/.

[87] The Joint Commisssion *Pre-Publication Standards*, supra note 85, Standard LD 2.40.

[88] See Myra W. Isenhart & Michael Spangle, supra note 74, at 134.

[89] For an insightful look at when various ADR techniques are best applied, confer Bryan A. Liang, *ADR in HealthCare: An Overview of the ADR Landscape,* in E.A. Dauer, et al, eds., Health Care Dispute Resolution Manual at 3:3 through 3:38 (New York: Aspen Press, 2000) (describing various ADR techniques and then applying these techniques to various case scenarios).

[90] *Philpot,* supra note 23.

[91] See David Zucker, Note, *The Role of Arbitration in Resolving Medical Malpractice Disputes: Will a Well-Drafted Arbitration Agreement with the Medicine Go Down?,* 49 Syracuse L. Rev. 135 (1998)

[92] Kenneth A. DeVille, supra note 4.

[93] Id.

[94] See Elizabeth Rolph et al., *Arbitration Agreements in Health Care: Myths and Reality,* 60 L. & Contemp. Probs. 153, 155 (1997).

[95] Laura B. Benko, *Arbitration is Optional*, Modern Healthcare 3/18/2002, Vol. 32 Issue 11, p 28. However, according to Kathleen McKenna, director of California's largest HMO, Kaiser Permanent, one-third of Kaiser's arbitration cases in 2001 favored the patient and the awards averaged $200,000.

[96] Michelle Andrews, *For Patients, Unpleasant Surprises in Arbitration*, The New York Times, Mar 16, 2003.

[97] Edward Felsenthal, *Legal Beat: What Happens When Patients Arbitrate Rather than Litigate,* Wall Street Journal, Feb. 4, 1994.

[98] Michelle Andrews, supra note 96.

[99] See Ann E. Krasuski, supra note 3, at *293-294.

[100] Michelle Andrews, supra note 96.

[101] Kenneth A. DeVille, supra note 4 (self-executing clauses may place an additional cost burden on the plaintiff who must obtain an order to stay arbitration until the court determines whether the dispute is within the scope of the agreement. If the plaintiff fails to file this motion, the process may continue and render a judgment that the plaintiff would later have to attack.)

[102] Id. at *295-297.

[103] *Intermountain Eye and Laser Centers, P.L.L.C. v. Miller 2005*, 142 Idaho 218, 127 P.3d 121 at 128, 131-133 (2005). *See also, Iredell Digestive Disease Clinic, P.A. v. Petrozza*, 92 N.C.App. 21, 373 S.E.2d 449 (1988);

aff'd 324, N.C. 327, 377 S.E.2d 750 (N.C. 1989). *Valley Med. Specialists v. Farber*, 194 Ariz. 363, 982 P.2d 1277 (Ariz. 1999)

[104] See *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 116 S.Ct. 1652 (1996).

[105] Id. at 683 (U.S. Supreme Court held that the special notice provision in Montana's statute for franchise agreements conflicts with the FAA and was therefore preempted).

[106] AK ST § 9.55.535.

[107] F.S.A. § 766.207.

CREATING POSITIVE FIRST WORK EXPERIENCES FOR YOUNG ADULTS: THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION'S (EEOC) YOUTH @ WORK INITIATIVE

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ABSTRACT

The percentage of sexual harassment allegations filed by workers under the age of eighteen has increased dramatically since 2001. It is generally accepted that attitudes toward work and many basic work related behaviors are learned early in life. Because of that, the initial job experiences that young workers encounter are important in shaping their future behavior in the workplace. The purpose of this paper is to examine the Equal Employment Opportunity Commission's (EEOC) Youth@Work initiative and to present policy and practice suggestions that employers can utilize to reduce their exposure to litigation and create positive first work experiences for young adults.

INTRODUCTION

> *The first job is a rite of passage for any teenager, giving young workers their first taste of real responsibility and teaching them some important financial lessons. But as some unfortunate teenagers in Arizona will tell you, their first taste of the working world can also include some very "grown-up" problems (Reynolds, 2007).*

"Give today's kids a taste of work—and you'll get better employees tomorrow" (Personnel Journal, 1995). It is generally accepted that attitudes toward work and many basic work related behaviors are learned early in life. Because of that, the initial job experiences that young workers encounter are important in shaping their future behavior in the workplace. In recent years, sexual harassment and discrimination, aspects of workplace behavior that have plagued many organizations, have been identified as a serious problem for organizations that employ teenage workers (Flahardy, 2005). The percentage of sexual harassment allegations filed by workers under eighteen has increased dramatically since 2001 from 2 percent to 8 percent in 2004 (Flahardy, 2005). The number of lawsuits filed by the EEOC involving teen workers increased from eight cases in

2001 to 15 in fiscal year 2005 (Armour, 2006). One published source estimated that the EEOC "has filed at least 131 lawsuits across the country involving the harassment of teenage employees" (Phillips Jr., 2007). In response to the increased complaints and litigation involving young workers, the Equal Employment Opportunity Commission initiated the Youth @ Work Initiative in September of 2004. This comprehensive outreach and education campaign is designed to inform teenagers about their employment rights and responsibilities and to help employers create positive first work experiences for young adults (EEOC, 2007). The primary objective of the program is to inform young workers as to their "real world rights and responsibilities as an employee"(EEOC, 2007). To that end, the EEOC web site (www.youth.eeoc.gov) and more than 2,100 Youth@Work events held nationwide since the program was initiated have spear headed the EEOC's efforts to inform young people as to their rights and how the EEOC process works. Additionally, the EEOC's outreach efforts have also been directed at employers, with the objective of helping employers "create positive first work experiences for young adults"(EEOC, 2007). The purpose of this paper is to examine the increase in sexual harassment allegations associated with workers under the age of eighteen, the Equal Employment Opportunity Commission's (EEOC) Youth@Work initiative, and to present policy and practice suggestions that employers can utilize to reduce their exposure to litigation and create positive first work experiences for young adults.

NATURE OF THE PROBLEM

Employers have recognized for a number of years the importance of creating positive first work experiences for young people. Numerous programs like Kids and the Power of Work (KAPOW) and Developmental Partners, a project between Duke Power Co. and the Charlotte-Mecklenburg school system of North Carolina have been developed to give young people as early as their elementary school years a "taste of work" with the objective of getting "better employees tomorrow" (Personnel Journal, 1995). KAPOW, founded in 1991 by Grand Metropolitan PLC and the National Child Labor Committee was designed to "fill a gap in the nation's school-to-work initiatives" and connect younger kids to jobs they may hold in the future (Personnel Journal, 1995). Companies participating early on included Green Giant, Burger King and Alpo Pet Foods. The Developmental Partners project began in 1986 and was aimed at improving opportunities for minority and underprivileged students. In this program, high school juniors attended classes on study skills, test taking, time management and college-major planning. In their senior year, they discussed interviewing techniques, dressing for success, resume writing and etiquette (Personnel Journal, 1995). The current curriculum of the KAPOW program focuses on job and career awareness, self-awareness, positive work habits, teamwork, overcoming bias and stereotype, communication, and decision making (National Child Labor Committee, 2007).

Jennifer Ann Drobac in her article focusing on adolescent consent presents an eye-opening example of the problem of the sexual harassment of teenagers (Drobac, 2006). Drobac details the

case of a fifteen year old girl and the behavior of her forty-year old registered sex offender manager that eventually led to the manager being prosecuted for statutory rape. Drobac goes on to cite statistical evidence developed by Susan Fineran to support the seriousness of the problem (Drobac, 2006). Fineran found in her study that thirty-five percent of high school students who worked part time had experienced sexual harassment (Fineran, 2002). Drobac also cites more recent unpublished survey work of Fineran and Gruber that found that 46.3% of working students had been sexually harassed in the last year (Drobac, 2006). Drobac, again citing the survey work of Fineran and Gruber, reported that youth restaurant workers experienced more harassment than care workers who engaged in tasks such as babysitting and housekeeping (Drobac, 2007).

In launching the Youth@Work initiative, EEOC Chairwoman Naomi Earp and many others associated with the issue, agree that teenagers are "more vulnerable" to sexual harassment and discrimination in the workplace. Many "experts" assert that the vulnerability is due primarily to their inexperience and that "they often don't understand what is and isn't appropriate workplace behavior"(Flahardy, 2005). Flahardy goes on to point out that many teens work in food service and retail, establishments that are often "casual environments that foster a social environment". Naomi Earp states that "drawing a line of distinction between appropriate behavior at work, in the mall and in internet chat rooms, and what is appropriate at work, is not always clear to younger workers"(Flahardy, 2005). In addition to this vulnerability, if teen workers are also reluctant to report inappropriate behavior because they are ignorant as to their rights under the law, the potential for a very negative first work experience is very real.

RECENT LITIGATION AND SETTLEMENTS

In March of 2007, the EEOC announced a $550,000 settlement of a sexual harassment lawsuit against GLC Restaurants, Inc. (GLC) doing business as McDonald's Restaurants in Arizona and California (EEOC, 2007). The lawsuit alleged that a group of teenage workers in Cordes Junction, Arizona, "some who were only 14 years old at the time", were sexually harassed by a middle-aged male supervisor, including unwanted touching and lewd comments. The EEOC alleged in its lawsuit that the male supervisor in question was a repeat offender who had previously harassed teen female employees at GLC's Camp Verde, Arizona location. The EEOC alleged that GLC knew of the manager's previous conduct but failed to take appropriate action to prevent him from repeating the unlawful behavior at the Cordes Junction location. According to published reports, GLC had notice of the supervisor's sexually harassing conduct within weeks of his hiring and, that after more than a year of "continuous complaints" simply transferred the supervisor to another location. There, he continued to sexually harass the teen female employees for two more years. Included among the allegations were that he reached down the pants pockets of an employee, told the same teenager that he wanted to have oral sex with her, cornered another employee in the freezer and pushed himself on her, and even pinned down an employee and kissed her. After four years of reports of this type

of behavior, GLC finally terminated the supervisor (Reynolds, 2007). In addition to the $550,000 in monetary relief, GLC is required to provide training and other relief aimed at educating its employees about sexual harassment and their rights under the law. According to EEOC trial Attorney Michelle Marshall, " no one should have to endure sexual harassment to earn a paycheck" - and - Employers must be extra vigilant in protecting teen workers, who are one of the most vulnerable segments of the labor force" (EEOC, 2007).

In October of 2006, federal district court jury awarded $585,000 to 13 young women, "mostly teenagers still in high school" in an EEOC lawsuit against Everdry Marketing and Management Inc. (Everdry) and Everdry Management Services Inc. (Cappuccio, 2007). The suit alleged that over a four year period, the firms managers and salesmen engaged in numerous "egregious acts of verbal and physical conduct" and that despite complaints to local and national management, failed to take "necessary steps to stop the behavior" (Cappuccio, 2007).

In April of 2005, a San Diego California jury awarded four teenage girls $6.85 million in a sexual harassment case against UltraStar Cinema (Kay, 2007). The teens "alleged in their lawsuit that the harassment included theater managers putting a retractable knife blade to the throats of two of the women, placing them in police-style restraint holds and inappropriately touching and leering at them" (Marshall 2005). The trial court granted UltraStar Cinema's motion for a new trial over the amount of damages (Figueroa, 2005). The case is currently under appeal by both sides with UltraStar Cinema's parent company filing for bankruptcy one day after the jury's decision (Kay, 2007).

In September of 2005, Carmike Cinemas, Inc. (Carmike), a large movie theater chain operating theaters in 36 states, agreed to pay $765,000 to settle an EEOC lawsuit. The suite alleged that between February and October 2003, 14 young men working in various positions at Carmike were subjected to unwelcome sexual touching, egregious sexual comments, sexual advances and requests for sexual favors from their male supervisor, a convicted sex offender, (EEOC, 2005).

In December of 2004, the St. Louis District of the EEOC settled a lawsuit against Midamerica Hotels Corp. for $400,000 (EEOC, 2004). In that lawsuit, the EEOC alleged that in one of the company's Burger King locations, the restaurant manager subjected female employees, most of them teenagers, to repeated groping, sexual comments, and demands for sex over a 6-month period. The women complained to their first line supervisors and to a district manager, but no action was taken until the women learned how to contact the corporate office (EEOC, 2004).

SUMMARY AND RECOMMENDATIONS FOR EMPLOYERS

In many of the cases reviewed in researching this paper, alleged victims voiced complaints to various levels of management. In both the GLC and the Everdry cases cited above, it took four years for management to take action to effectively stop the harassing behavior. In the GLC case, management was clearly aware of the alleged harasser's behavior during his first year of

employment but, did little more than transfer him to another location where he continued to allegedly harass teen employees for an additional two years before terminating him (EEOC, 2007). In the Midamerica Hotels Corp. situation, lower level managers failed to take action after six months of complaints from many of the female employees at the Peerless Park, Missouri location (EEOC, 2004). Another disturbing element in two of the cases cited in this paper, a convicted sex offender was also the harasser (Drobac, 2006 and EEOC, 2005).

In settling these lawsuits with the EEOC, the agreements that employers enter into with the EEOC generally include an agreement to implement training of all of its employees about sexual harassment. The suggestion that firms step up training in regard to discrimination and harassment is not new. Courts have been scrutinizing employer training efforts for a number of years. In regards to the "who, what, when, where and how" case law to date has provided the following:

- *Formal training is essential and it should be thoroughly documented.*
- *The scope of harassment training should go beyond sexual harassment to include harassment on all basis.*
- *Frequency and currency: basic training to all new employees; supervisors should receive regular refresher updates.*
- *Effectiveness: trainers must be qualified and materials must be accurate and up-to-date (Willman, 2004).*

In addition to more extensive training, to avoid the potential problems of putting sexual predators in a position of supervising teenagers, employers should conduct more thorough background checks for supervisory positions involving teen employees. When hiring in any service related occupation, it is becoming more apparent that a criminal background check must be part of the applicant screening process (Socolof and Jordan, 2006).

The EEOC in June of 2006 issued the following suggestions to promote "voluntary compliance and prevent discrimination cases involving young workers":

- *Encourage open, positive and respectful interactions with young workers.*
- *Remember that awareness, through early education and communication, is the key to preventing discrimination or harassment.*
- *Establish a strong corporate policy for handling complaints of discrimination or harassment.*
- *Provide alternate avenues, other than directly to the employee's manager, to report complaints and identify appropriate staff to contact.*
- *Encourage young workers to come forward with concerns and protect employees who report problems or otherwise participate in EEO investigations from retaliation.*

- *Post company policies on discrimination and complaint processing in visible locations such as near the time clock or break area, or include the information in the young worker's first paycheck.*
- *Clearly communicate, update, and reinforce discrimination policies and procedures in a language and a manner that young people can understand.*
- *Provide early training to managers and employees, especially front-line supervisors. Remind them the EEO laws apply to young people as well.*
- *Consider hosting an information seminar for the parents or guardians of teens working for your organization (EEOC, 2006).*

A number of firms have been addressing the harassment issue in recent years. Wal-Mart's mandatory orientation program, required of all new employees, includes training on how to identify and prevent harassment and that there are multiple options available to "associates" to make management aware of their concerns (Armour, 2006). At sports and apparel retailer Finish Line, where one-third of its 12,000 employees are teenagers, the company utilizes "custom tailored" training that has produced effective results. The company utilizes training videos that focus on the "specifics of its business, complete with young actors wearing Finish Line uniforms dealing with difficult situations in stores" (Flahardy, 2005). The Finish Line training process also includes group discussions with employees being encouraged to ask questions and discuss how "they would handle various situations"(Flahardy, 2005). To complete the program employees must complete a 20 question quiz on Finish Line's harassment policy (Flahardy, 2005).

Effective orientation and training of all new employees and the maintenance of effective complaint procedures are critical to an organization's efforts to reduce it's exposure to harassment allegations. Additionally, effective selection, training and development of supervisory personnel are also especially critical if organizations are to create working environments that will provide young workers with positive first work experiences.

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LINKING ETHICS DECISIONS TO PHILOSOPHICAL RATIONALES: AN EMPIRICAL STUDY

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ABSTRACT

This paper investigates the attitudes of college students towards ethics in their own lives. Students were asked which of three common approaches to ethics was most relevant to their own situations. Then they were asked to evaluate several scenarios with regard to the ethics involved in some decisions that were described.

Statistical analyses were performed to determine if differing views towards ethics resulted in different responses to the ethical scenarios. We also investigated the differences in responses to the scenarios based on demographic information such as gender, academic classification, and major. Students who considered the moral absolutes approach to ethics as most important tended to view more actions as unethical than did those who rated the moral absolutes less important. A few other relationships were also statistically significant.

INTRODUCTION

In *Ethics Education in Business Schools* (2004), the AACSB's Ethics Education Task Force emphasized the importance of business schools' efforts to heighten the ethical sensitivity and ethical reasoning skills of business students. Ideally business students will be equipped with the traditional (deontological and teleological) ethical frameworks necessary to address ethical questions in the business world. These they will use to identify and work through ethical issues for the benefit of stakeholders. Wrestling with significant ethical questions is essentially a personal quest as well as an organizational exercise. One's individual preferences and values become apparent in ethics discussions. An interesting research question in this regard is the importance of individual factors in the ethical decision making process. In this study we look at the differences in ethical decision making based on gender, major of the students and academic classification.

LITERATURE REVIEW

Gender is the most comprehensively researched individual variable in the ethical decision-making literature. It is considered to be an independent variable that is potentially related to practically every component of individual ethical decision making: from ethical awareness or sensitivity to intent or motives to ethical behavior. In an exhaustive review of the empirical ethical decision making literature, O'Fallon and Butterfield (2005), reported that sixteen of forty-nine studies showed significant differences between males and females' ethical behavior—females behaving more ethically. Twenty-three of forty-nine studies showed few or no significant differences. O'Fallon and Butterfield conclude that the results of the studies, while mixed, are fairly consistent. When significant differences are found, females are more ethical than males.

Could it be the case that females view ethical issues through glasses colored with compassion and understanding while men make decisions based on fairness and justice? This is perhaps the explanation for females consistently being more ethical than men where significant differences are observed. Luthar et. al. (1997), for example found that while males and females had similar assessments of the *how it is* of ethics, there was a wide gap regarding their assessment of the how it *should be* of ethics. But, as stated above, in spite of the large volume of gender- related ethics research, absolutely definitive conclusions and ironclad prescriptions are not forthcoming.

The ethical guidelines or frameworks used by decision makers are another significant avenue of research in business ethics. In a 1984 study, Fritzsche and Becker asked managers to determine the acceptability of ethically questionable actions and to explain why the action was judged to be acceptable/unacceptable. In this research effort to link philosophy to behavior, the authors concluded that managers rely heavily on utilitarian frameworks for ethical decision making. Managers analyze the ethical component of business issues by calculating benefits and costs accruing to themselves and others as a consequence of the decision. Fritzsche and Becker stated that such utilitarian decision making may not be in the long run best interest of society.

Since Fritzsche and Becker, considerable research efforts have been made to clarify the link between ethical philosophy and behavior. O'Fallon and Butterfield's literature review cited ethical philosophy or values orientation as the second most researched variable in the ethical decision-making literature. The research has shown generally that deontologists are more "sensitive" to ethical issues and more likely to judge ethically questionable actions as unfavorable or unacceptable. Deontologists (Lying is just wrong) rank higher than relativists (It depends on the circumstances) or teleologists (Consider the costs and benefits) on ethical behavior scales (Ford & Richardson, 1994). "Situationists" (Keyton & Rhodes, 1997), are more accepting of ethically questionable actions.

Premeaux, like Fritzcshe and Becker, sought to link ethical rationales to behavior. His two studies, (1993 and 2004), indicated that managers rely heavily on utilitarian or teleological (cost/benefit) rationales. With increasing emphasis on business ethics issues and relentless media

attention to corporate scandals over the time period of the two studies, managers' ethics, in his studies at least, appeared to change little—neither in behavior nor in reliance on utilitarian ethics. How significant are personal or individual factors such as educational level and/or job experience as variables having an impact on ethics? Are freshmen college students more ethical than graduating seniors? Are college students more ethical than their counterparts in industry? Does ethical awareness or behavior differ across college majors? Are student accountants more ethical than student journalists? These types of questions have prompted a fairly large volume of research in business ethics. Overall, research along these lines has produced mixed results. Cohen (2001), for example, reports no major difference in the ethical sensitivity of freshmen and seniors or between students and professional accountants. Other studies indicate that students entering the ethics class may see ethical issues as mostly black-and-white, but toward the end of the ethics class they see ethical issues as being more complex. Their ethical judgment has become more "flexible" (Carlson & Burke, 1998).

The business ethics research generally reports that education and work experience are positively related to higher ethics, but the relationship of these variables to ethics does not appear to be as strong as the relationship of either gender or ethical/values framework to ethics.

Another area of business ethics research receiving considerable attention is moral intensity (Jones, 1991)—that is, the degree to which the moral issue is perceived to be more or less intense based on six factors. Intensity increases with *proximity* (psychological or physical closeness of the moral agent to the beneficiary/victim). Intensity increases with the amount of *social consensus* that has developed around the issue. Intensity increases with the *magnitude* of the issue's impact and the likelihood that the action and its consequence will actually take place (*probability*). Intensity increases with *immediacy* (Result immediately follows action). Intensity increases with greater *concentration of effect*—much harm to a few compared to a little harm to many.

Magnitude of consequences and social consensus seem to trump the other components of moral intensity with regard to their influence on ethical decision making (McMahon & Harvey, 2006). Magnitude of consequences may have a strong influence on moral decision making. If the moral agent recognizes that a decision's (negative) impact is significant, moral awareness should be acute, and the ethics of the decision should be heightened (Barnett & Valentine, 2004). Also, social consensus may have a strong influence on moral decision making. That is, if the decision maker perceives that there exists strong social consensus regarding an ethical issue, this may influence ethical decision making in a positive way (O'Fallon & Butterfield, 2005). The other components of moral intensity have shown mixed results on moral decision making.

In light of the observation of O'Fallon and Butterfield that deontological frameworks for ethical decision making seem to produce more ethical decisions on a fairly consistent basis, it may be worth noting that all the components of moral intensity except social consensus are based on utilitarian guidelines for ethical decision making. Magnitude, proximity, concentration, probability, and immediacy are all consequences-related. Social consequences could be based on society's

acceptance of deontological rules for ethical conduct (avoiding fraud and deceit, making charitable contributions).

APPROACHES TO ETHICS

Students taking ethics course are exposed to several frameworks or rationales that can be used in evaluating the ethics of situations. Generally these frameworks are of the deontological variety or the teleological variety—based on duty (obligation, moral absolute, categorical imperative, golden rule) or based on consequences (benefits and costs).

Deontology (Moral Absolute Approach)

Deontologists argue that certain actions are moral in and of themselves and are not dependent on the consequences (Hoffman & Moore, 2000). An action is right because it meets the demands of moral absolutes, justice, or duty to our fellow man. For example, murder and lying are always wrong, regardless of the situation. We have a duty to behave in certain ways regardless of the consequences. Religious guidelines such as the "Golden Rule" constitute deontological rationales for ethical decision making. Immanuel Kant holds that one should perform right actions because it is one's duty to do so. Moral imperatives are absolute and unconditional. They are binding no matter what the results. Kant's basic formulation of the moral imperative was that humans should behave in such a way that they would will their behavior to become a universal rule, and that we should treat humans as ends in themselves, never solely as a means to an end.

Ethical Relativism (Situational Approach)

Ethical relativism claims that any two individuals or cultures can hold different moral views and both can be right (DeGeorge, 1995). Thus an action may be "right" for one person and "wrong" for the other. There is moral diversity just as there is cultural diversity, and moral judgments are merely statements of opinion or feeling. There is no universal or absolute standard by which to judge an action's morality. What a person or society believes is right, is right.

Ethical relativism does not stand up well with close scrutiny. It contradicts the way we think and behave regarding ethical questions. We cannot at one moment consider our own behavior to be ethically acceptable but believe the same behavior performed by another to be ethically unacceptable. Our practice in every day life teaches us that stealing is wrong and one's opinion to the contrary makes no difference. If morality is merely a statement about one's feelings or opinions, then no definitive moral judgment can be made about anything. The moral experience of humans is that we do make judgments about the morality of actions.

Teleology (Cost/Benefit Approach)

Teleological, or consequentialist, ethical systems define the rightness of a decision in terms of the good it produces (Baron, 2000). The consequences of an action are the only factors to be taken into account in determining the morality of an action. The act itself is not the focus, rather the benefits and/or costs the action brings. An action is good if it produces the greatest amount of good for the greatest number of people affected by the action. Teleologists could explain that lying is not morally acceptable because of the effects it produces on society. The costs would be high in terms of society's inability to form trusting, dependable relationships. Truth-telling would produce trusting, cooperative relationships and generally higher welfare than lying. Teleologists would not claim that all lying is immoral. Cost/benefit analyses are also useful in deciding how clean the environment should be or how safe automobiles should be. A perfectly clean environment and completely safe automobiles would be very costly—so costly that consumers would not likely be willing to pay for them. The "right" decision is one that balances benefits and costs among all parties affected.

In this paper we attempt to link the ethical judgments of business students to their use of the rationales named above: deontology, relativism, or teleology. We also attempt to determine if their responses to these rationales impacts their actual attitudes towards ethical decision making. The students read seven ethics scenarios or vignettes and indicated whether they judged the action described in the scenario to be definitely ethical or definitely unethical, or somewhere in between using a 1 to 5 scale. The students also provided demographic information. Generally we hypothesized that students who chose the moral absolute rationale as being most descriptive of themselves would tend to judge the ethically questionable behaviors in the scenarios as being less acceptable—more toward the definitely unethical end of the scale.

THE DATA

Questionnaires (see Appendix) were administered to students at a public university in Louisiana. Freshman, sophomores, juniors, and seniors responded to this. Demographic information was collected about age, sex, major, and academic classification. Table 1 provides summary information describing these students.

The students were asked to consider the three approaches towards evaluating ethical decision-making that were discussed above. Students were asked to rank these three approaches according to how they themselves determined right from wrong, with a rank of 1 being the most descriptive of their own attitude and a rank of 3 being the least descriptive. This is shown in Figure 1. A paragraph describing the meaning of each of these terms was also provided to the students, although this is not shown in Figure 1.

Table 1: Demographic Information of Sample		
Sex	Classification	Major
73 Male	45 Freshman	118 Business
69 Female	26 Sophomore	24 Non-business
	23 Junior	
	48 Senior	

Students were then asked to rate their attitudes on these same three approaches on a scale of 1-10 with 1 being Extremely Unimportant and 10 being Extremely Important as shown in Figure 2. This was done because some individuals may consider one approach (e.g. Benefits and Cost) less important than the other two, but they still consider it to be extremely important. In other words, a person may have given all three approaches a rating of 9 or 10 (extremely important).

There were some inconsistencies in the data that had to be addressed. Some students ranked "Moral Absolutes" as the most descriptive (number 1 out of 3) of their own attitudes when compared to "Situational" and "Benefits and Costs", and yet they rated this lower (on the 1-10 scale from Least Important to Most Important) on the next set of questions. A total of 17 observations with severe inconsistencies were omitted from analysis. This resulted in 142 observations to use in the study.

Each student was then asked to evaluate seven scenarios (see Appendix 1) dealing with responses to ethical situations. The scenario was presented, an action was described, and students were to rate the action on a scale of 1 (Definitely Ethical) to 5 (Definitely Unethical).

SURVEY RESULTS

The following questions related to demographics and the attitudes towards ethics were investigated. Do males views ethics differently than do females? Are business majors different from non-business majors? Are upper class students (juniors and seniors) different from lower class students (freshmen and sophomores)? If a student considers him/herself a moral absolutist, would that student view ethical scenarios different than a student who favored the cost/benefit approach to ethics?

Demographics and Attitudes Towards Ethics

Cross tabs were used to determine if different types of students had different attitudes about their own view of ethics. The results are presented in Table 2. The first issue is whether men and women differ in how they rank (on the 1-3 scale) the approaches to ethical decision making in their own lives. There was a significant difference in the cost/benefit ranking. Males tended to rank this

approach number 1 more often than females. There was no difference between the sexes for the situational or the moral absolute rankings.

Table 2: Demographics and Attitudes Towards Ethics

	Sex	Major	Academic Classification	Academic Classification: Business only
Moral Absolute Rank	*	*	*	0.087
Situational Rank	*	*	0.076	0.071
Benefits/Cost Rank	0.082	0.092	*	0
Moral Absolute –importance rating	0.085		*	0
Situational – importance rating	*	*	*	0
Benefits/Cost –importance rating	*	0.002	*	0

* Indicates no significant difference at the 0.10 level.

The next gender-related analysis involved the ratings (1-10) of the approaches. As previously mentioned, students were asked to rate their attitudes on the three views of ethics on a scale of 1-10 with 1 being Extremely Unimportant and 10 being Extremely Important. Due to a limited number of responses and the problem with the chi-square analysis when the expected cell value is too low, we combined some of these scores. Responses of 9 or 10 were considered strong, while responses of 8 or less were considered moderate or less. There was a statistically significant difference between the sexes on the rating of the moral absolute approach, but there was no difference for the other two approaches. Females tended to rate this higher than did males.

It is conceivable that business majors differ from non-business majors in how they view ethics. Therefore, we examined this issue. From the chi-square analysis, we found a significant difference in the two groups for the benefits/cost approach to evaluating the ethics in a decision. A higher percentage of non-business majors ranked cost/benefit number 1 than did business majors.

When comparing the importance ratings for business and non-business majors, there was a significant difference only for the cost/benefit approach. As with the rankings, the non-business majors tended to rate this higher than would be expected. Upon further investigation, we found there were a higher percentage of males in the non-business group than in the business group. Since there was a statistically significant difference between the sexes for the rating of the cost/benefit approach, it is possible that gender rather than major may explain this difference between business and non-business majors in this study.

As students experience college life and mature through this experience, it is possible that views towards ethics may change also. To analyze this, we grouped the students into two groups – upper class (juniors and seniors) and lower class (freshmen and sophomores). The analysis on

academic classification showed a difference only in the ranking of the situational approach to dealing with ethics in a decision-making scenario. The upper classmen tended to be more extreme in ranking the situational approach (rank of 1 or 3), while lower classmen tended to rank this in the middle (rank of 2). There were no other significant differences between the two groups on either the rankings or the importance ratings of the three approaches to ethics.

Business students at AACSB accredited schools are exposed to ethics somewhere in their curriculum, while this is not necessarily true of non-business majors. Does this exposure cause a change in their attitudes towards ethics? To investigate this, we eliminated all non-business majors and performed a cross tab analysis for both the ranking and the importance rating of the three approaches to ethical decision-making. There was a statistically significant relationship between the academic classification of business majors and the rank of moral absolutes ($p = 0.087$). The freshmen and sophomores in business rated this higher than expected, while the juniors and seniors in business rated this lower than expected. There was also a significant relationship with the classification of students and the rank of situational ethics ($p = 0.071$). Again, the upperclassmen were more extreme, ranking this as 1 or 3, while the underclassmen tended to rank it 2. All other relationships were statistically insignificant.

Seven Scenarios and the Analysis of Rankings

After considering how different groups of students viewed the approaches to ethics, we tested to see if their responses to these approaches actually impacted how they viewed the ethics involved in decisions presented in seven scenarios. The action in each scenario was rated on a 1-5 scale with 1 being definitely ethical and 5 being definitely unethical. We used chi-square (cross-tab) analysis to test for statistical significance. Due to the sample size, it was necessary to modify the scale. The original scale was 1-5, but this was converted to a 3 point scale with 1-2 (definitely ethical and ethical) in one category, 3 (neutral) by itself, and 4-5 (unethical and definitely unethical) in the third category. The statistics were run using these categories. We first considered the students' rankings (1-3) of the three attitudes towards ethics. The results are summarized in Table 3.

Table 3: Ranking of Ethics Approaches and Scenarios

Scenario	1	2	3	4	5	6	7
Moral Absolute Rank	*	*	*	*	*	*	0
Situational Rank	*	*	*	0.014	*	*	0
Benefits/Cost Rank	*	*	*	0.057	*	*	0

* Indicates no significant difference at the 0.10 level.

In evaluating different rankings (on the 1-3 scale) of moral absolutes with the seven scenarios, nothing was found to be statistically significant at the 10% level. In other words, if a person ranked moral absolutes 1 (most descriptive of the individual) the evaluation of the scenarios was not significantly different than the evaluation of a person who ranked moral absolutes 3 (least descriptive of the individual).

The same type of analysis was performed to determine if the rankings of the attitudes on situational and benefits/cost approaches had any impact on the responses to the seven scenarios. Only two relationships were statistically significant, and both of these involved scenario 4, which related to environmental issues in the construction of a plant. The company met the federal guidelines, which were binding by law, in the construction of the plant. However, it failed to meet the more stringent industry-imposed guidelines, which were non-binding. The situational variable and the benefits/cost variable were both significant. This indicates that there is some relationship between the ranking individuals give situational ethics and their view of the ethical implications of the decision in this scenario. Similarly, there is a statistically significant relationship between the ranking on benefits/cost and the responses to this same scenario.

Seven Scenarios and the Analysis of Ratings

After analyzing the scenarios and the rankings, we repeated the analysis using the scenarios and the importance ratings (1-10) on the attitudes towards ethics. Table 4 provides a summary of these results and helps show how student views on their own attitudes towards ethical decision-making impact their evaluations of specific scenarios. The results are interesting in that the ratings on the moral absolutes approach showed a significant relationship to both question 2 (salesman claiming personal expenses) and question 7 (competitor's marketing report). In both situations, an unusually large number of students who rated moral absolutes extremely high tended to consider the behavior unethical. There was no statistically significant result for either the situational approach to ethics or the cost/benefit approach to ethics and the ratings for these seven scenarios.

Table 4: Ratings of Ethics Approaches and Scenarios

Scenario	1	2	3	4	5	6	7
Moral Absolute –importance ranking	*	0.007	*	*	*	*	0.079
Situational – importance ranking	*	*	*	*	*	*	0
Benefits/Cost –importance ranking	*	*	*	*	*	*	0

* Indicates no significant difference at the 0.10 level.

Seven Scenarios And Demographics

To further investigate student responses to the scenarios, we considered sex (male or female), major (business or non-business), and academic classification (upper or lower class). Once again, cross tabs were performed on each of these and the responses to the scenarios. The results are summarized in Table 5. The sex of the individual appeared to have an impact on the responses to scenarios 1 (bank loan to a friend), 5 (grocery price changes on certain days), and 6 (reduced package size for bag of chips). In each case, males tended to view the activity as more ethical than did the females.

Table 5: Demographics and Scenarios

Scenario	1	2	3	4	5	6	7
Sex	0.018	*	*	*	0.062	0.023	0
Major	*	0.024	*	0.055	0.084	*	0
Academic Classification	*	*	*	*	*	*	0

* Indicates no significant difference at the 0.10 level.

Whether a student was a business major or non-business major appeared to have an impact on question 2 (salesman claiming personal expenses), 4 (environmental issues), and 5 (grocery price change). The business students tended to rate the actions in question 2 as more unethical than did the non-business students. This same pattern occurred on question 4 also, as the business students viewed this decision as more unethical than did non-business students. On question 5, the vast majority of the students, both business and non-business, viewed the activity as unethical. This caused the expected number in one of the cells to be extremely small. Consequently, while the p-value indicated a significant difference, this result is questionable.

The academic classification did not appear to have an impact on any of the responses to the scenarios. There was no difference between the lower class and the upper class students in their reactions to these scenarios.

RESULTS AND IMPLICATIONS

There were a few differences in responses based upon the gender of the individual. Males tended to rank cost/benefit approach number 1 more often than females, while females tended to rate the moral absolute approach higher than did males. The sex of the individual also appeared to have an impact on the responses to three scenarios, with males tending to rate the activities as more ethical than did the females. The means that females tend to see issues as black and white (right or wrong) more often than males. People advocating a position that might be viewed by some as

unethical should be particularly careful in how their ideas are presented to females if they wish to have their ideas accepted. In the classroom, instructors should point out these differences and make students aware of the differences. If students have discussions of these issues in the classroom, they will have a better understanding of differing viewpoints when they enter the work force.

A few differences were noted between business and non-business majors. A higher percentage of non-business majors ranked cost/benefit number 1 than did business majors. This was true not only for the ranking but also for the importance ratings for non-business majors and the cost/benefit approach. However, the large number of males in the non-business group may have impacted this result, and the sample size was not large enough to explore this issue further. If there is a difference in attitudes towards ethics between majors, one possible explanation might be that business majors have been exposed to discussion of ethics in a number of business classes or perhaps had an entire course on ethics. Thus, business majors may be more attuned to a variety of approaches to evaluating actions from different ethical perspectives. This would tend to indicate that different audiences will process the same information in different ways. Understanding the audience is important when trying to promote an idea. Instructors should emphasize that, upon entering the workplace, the students should pay attention to the background of the people impacted by various decisions. Providing cost/benefit information related to a decision may be particularly helpful when addressing people without business backgrounds.

Students were compared based upon academic classification. The upper classmen tended to be more extreme in ranking the situational approach (rank of 1 or 3), while lower classmen tended to rank this in the middle (rank of 2). There was a statistically significant relationship between classification and the rank of moral absolutes for business majors. A higher percentage of business lower classmen ranked moral absolutes higher than did the business upperclassmen. There was also a significant relationship between classification of business students and the rank of situational ethics. This would imply that exposure to ethics in a number of different classes has had an impact on their attitude towards ethics.

How students viewed the approaches to ethics had little or no impact on how they viewed many of the seven scenarios. When there were significant differences in how students evaluated the scenarios for the different scores on moral absolutes, those students who viewed absolutes as very important tended to view the actions in the scenario as more unethical than those who rated moral absolutes lower.

It is important that educators understand that differences exist and address these differences in the classes that they teach. This is even more important in today's diverse workplaces and universities because cultural differences are exposed as well. A number of questions can be raised that must be addressed if students are to be grounded in the study of ethics and the implications of this area of study. Does the business curriculum attract people with certain ethical attitudes or are the attitudes developed by the classes taken and the associations students have in the business school environment? The apparent differences in attitude towards ethical situations between men and

women must be addressed by the professors in business courses or real problems might when these problems are encountered in the work place after leaving college.

SUMMARY AND CONCLUSIONS

A survey was administered to a set of college students to determine how they viewed three approaches to ethics. They were then asked to evaluate the ethics of seven scenarios involving business decisions. Analyses were performed to see if there were any differences among the groups. There were a limited number of statistically significant results. This study shows that different groups of students may have different attitudes towards ethics and may react differently to ethical dilemmas. Further research is necessary to discover what the evolution process entails. Future studies on this would have to be carried out post graduation as well, perhaps several years into the future. This could lead to a better understanding of perceptions of ethics and help instructors improve their discussion of ethics in the classroom.

All of the questions in this study would benefit from further research. While this study provides some insight into how students view ethics, it is difficult to generalize at this time. The number of different statistical tests performed and the number of students involved should cause one to be cautious. However, this does provide a direction for further study of these issues.

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Figure 1. Ethics Questionnaire – Approaches to Ethics

How accurate are the following paragraphs in describing the way that you go about deciding if an action is right or wrong? Place a 1 by the paragraph that is most descriptive of how you decide right and wrong, a 2 by the paragraph that is second most descriptive of you, and a 3 by the paragraph that is least descriptive of you.

_____ Moral Absolutes paragraph
_____ Situational paragraph
_____ Benefits and Cost paragraph

_____ MORAL ABSOLUTES paragraph

I tend to think of ethics as being black or white. That is to say that most decisions about right or wrong are based on certain unchanging principles or truths. It is always right to tell the truth; it is always wrong to murder; it is always right to treat people with dignity and respect – to treat them as I would wish to be treated. It is my duty to conform to these (and other) moral absolutes.

_____ SITUATIONAL paragraph

I tend to think of ethics as being situational. That is to say that my decision about right and wrong is based on my assessment of the particular situation at hand. It is the situation that determines the rightness or wrongness of a situation. I do what is right for me in the situation. And what is right for me may not be right for someone else, just the same way that different cultures have differing views of right and wrong. You can't really say other cultures are "wrong", just different.

_____BENEFITS AND COSTS paragraph

I tend to think of ethics as being based on a who-is-hurt-and-who-is-helped sort of a calculation. That is to say that right and wrong depend on the consequences of the decision. If more good than bad comes out of the decision, it is ethical. As they say, "the greatest good for the greatest number" should be the guiding principle in deciding right and wrong. So if the decision maker sizes up the benefits and costs for those affected by the decision, and the benefits outweigh the costs, the decision is ethical.

Figure 2. Ethics Questionnaire - Ratings of Approaches

Compared to the other methods, how important to you is the moral absolutes method when you make decisions about right and wrong? (Circle number)

1	2	3	4	5	6	7	8	9	10
Extremely unimportant									Extremely important

Compared to the other methods, how important to you is the situational method when you make decisions about right and wrong? (Circle number)

1	2	3	4	5	6	7	8	9	10
Extremely unimportant									Extremely important

Compared to the other methods, how important to you is the benefits and costs method when you make decisions about right and wrong? (Circle number)

1	2	3	4	5	6	7	8	9	10
Extremely unimportant									Extremely important

APPENDIX - ETHICS SCENARIOS

(Taken from Broekemier, G.M., S. Seshadri & J.W. Nelson (March 1998). Ethical Decision Making: Are Men and Women Treated Differently? *Teaching Business Ethic*s, *2*(1), 49-69.)

Below are seven ethics scenarios. Please read each one and indicate how ethical you think the behavior to be. Circle the number 1 if you believe the behavior to be "definitely ethical." Circle the number 5 if you believe the behavior to be "definitely unethical." Or circle 2, 3, or 4 for behaviors that you believe to be neither definitely ethical nor definitely unethical—somewhere in between.

1	2	3	4	5
definitely ethical		(Circle number)		definitely unethical

Why? _____
(Explain why you answered as you did)

For each scenario, in the space provided, please write a short sentence or phrase indicating *why* you decided as you did. That is, by what reasoning did you decide that the behavior was ethical or unethical?

A promising start-up company applies for a loan at a bank. The credit manager at the bank is a friend of and frequently goes golfing with the company's owner. Because of this company's short credit history, it does not meet the bank's normal lending criteria.

Action: The credit manager recommends extending the loan.

1	2	3	4	5
definitely ethical		(Circle number)		definitely unethical

Why? _____
(Explain why you answered as you did)

A salesman, the father of two small children, has been promoted to a job which requires that he travel away from home for the firm on a regular basis. Because the trips are frequent and inconvenient for his family life, he is contemplating charging some small personal expenses while traveling for the company. He has heard that this is a common practice in the company.

Action: The salesman charges the company $50.00 for family gifts.

1	2	3	4	5
definitely ethical		(Circle number)		definitely unethical

Why? _____
(Explain why you answered as you did)

A person bought a car from a franchised automobile dealership in the local area. Eight months after the car was purchased, he began having problems with the transmission. He took the car back to the dealer, and some minor adjustments were made. During the next few months he continually had a similar problem with the transmission slipping. Each time the dealer made only minor adjustments on the car. Again, during the thirteenth month after the car had been bought the man returned to the dealer because the transmission still was not functioning properly. At this time, the transmission was completely overhauled.

Action: Since the warranty was for only one year (twelve months from the date of the purchase), the dealer charged the full price for parts and labor.

1	2	3	4	5
definitely ethical		(Circle Number)		definitely unethical

Why? _____
(Explain why you answered as you did)

A company concerned about environmental issues has been considering the construction of a new plant in an area where several other similar companies are located. The new company plant will meet federal waste treatment standards but not the standards of the industry.

Action: The company approves the plans to build the plant.

1	2	3	4	5
definitely ethical		(Circle number)		definitely unethical

Why? _____
(Explain why you answered as you did)

A retail grocery chain operates several stores throughout the local area including one in the city's ghetto area. Independent studies have shown that prices do tend to be higher and there is less of a selection of products in this particular store than in other locations.

Action: On the day welfare checks are received in this area of the city the retailer increases prices on all of his merchandise.

1	2	3	4	5
definitely ethical		(Circle number)		definitely unethical

Why? _____
(Explain why you answered as you did)

A significant increase in the price of potatoes has put a strain on the profitability of potato chips for a snack foods company. The company could decrease the size of the package that chips come in rather than increase the price of the chips. Changing the net weight of the package is less noticeable than increasing the price.
Action: The company puts plans in motion to reduce package size.

1	2	3	4	5
definitely ethical		(Circle number)		definitely unethical

Why? _____
(Explain why you answered as you did)

A salesperson for Omega Computers, while attending a trade association meeting, noticed that the marketing director of Dynamark Company (a major competitor) was carrying a stack of their marketing plans for the next year. When the director left the room, he inadvertently left a copy of the report on the table. It would be easy to pick up without being noticed and could give Omega important information about a competitor.
Action: The Omega salesperson takes the report.

1	2	3	4	5
definitely ethical		(Circle number)		definitely unethical

Why? _____
(Explain why you answered as you did)

PERSONAL INFORMATION

Please answer a few questions about yourself. Remember that all questionnaires are confidential. No names are required.

Sex: (Circle number) 1 MALE
2 FEMALE

Age: _____ Major: _____

Academic classification: (Circle number)

1 FRESHMAN
2 SOPHOMORE
3 JUNIOR
4 SENIOR
5 GRADUATE

DOES YOUR BACKGROUND CHECKER PUT YOU IN JEOPARDY? A CASE FOR BEST PRACTICES AND DUE DILIGENCE

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ABSTRACT

The process of outsourcing background checks to third parties is fertile ground for testing employer liability. Failure of employers to select and retain qualified employees affects the quality of life and reputations of both the workers and the organizations involved. Many of these selection and retention decisions must follow procedures required by the Fair Credit Reporting Act, particularly when consumer reporting agencies provide the background information. As a best practice, business needs to apply the same due diligence and good faith in contracting with these vendor-CRAs as they do in selecting and retaining qualified workers in-house.

This article begins by explaining why most businesses investigate and many recheck employee backgrounds. The authors proceed to detail the relevant managerial, legal and compliance implications of screenings. The article then discusses the challenges facing employers that attempt to obtain accurate background information in order to comply with due diligence and good faith in their selection processes. The article also identifies the key constraints challenging employers, including erroneous or misleading data provided by a largely unregulated screening industry. Finally, the authors conclude with recommendations of good faith efforts and best practices for employers checking the checkers.

INTRODUCTION

Following September 11, 2001, many companies adopted Ben Franklin's adage, "an ounce of prevention is worth a pound of cure" (Franklin, c. 1736). Seeking to reduce workplace violence by unknown workers, business increasingly verified the identities of prospective and current employees. Additionally, with the upsurge in negligent hiring and retention lawsuits, employers continued their prevention efforts by checking the qualifications and backgrounds of prospective and current employees. Despite these efforts at preventive litigation, many companies failed to receive their pound of cure. Employees and applicants have slapped organizations with lawsuits alleging that the very pre-employment checks implemented to avoid workplace violence and tort litigation as well as to verify background information are themselves flawed. Plaintiffs have filed claims of

negligence, false light invasion of privacy (making public statements that give an inaccurate impression), defamation (untruthful assertions affecting one's reputation), and violation of the Fair Credit Reporting Act (FCRA) as amended. Many of these allegations are in the beginning stages of litigation; however, some have been dismissed, others are proceeding to trial, and a few have been settled out of court.

The process of conducting background checks, whether in-house or outsourced to third-party vendors, appears to be a new fertile ground for testing employer liability (Employment Law Alert, 2005). Background reports affect the quality of life and reputations of both the workers and the organizations involved. Plaintiff-litigants argue that business, in order to satisfy due diligence requirements in selecting and retaining qualified workers, must use information about individuals that is accurate. If the information obtained is not accurate, business must demonstrate its good faith efforts to obtain accurate information, particularly through third-party vendors. Thus, business needs to continue and expand its best practices to prevent or minimize litigation risks.

The alleged experiences of The Vanguard Group and Federal Express offer glimpses into the twin risks posed by strictly name-based background checks. The consequences of using inaccurate data from a third party causes either a risk to privacy through a false positive (claiming workers have a tarnished past when they do not; usually a person's name is associated with another's criminal record) or a risk to security through a false negative (claiming workers have a clean slate when they do not; usually a criminal record is missed or the worker under review provided false information) (DOJ Report, 2006). The Vanguard Group required James R. Gorman, a $100 million account manager, to renew his Pennsylvania insurance license and, simultaneously, to undergo a routine background check. Two private investigation companies completed the license renewal and background checks. Much to Vanguard's surprise, the background report claimed James R. Gorman was a convicted felon who previously pled guilty to fraud. Vanguard allegedly fired Mr. Gorman even though he disputed the findings. Gorman sought to restore his reputation and discovered, with ease, that the felonious James R. Gorman had a different social security number (SSN), date of birth (DOB), and address (Scalet, 2004). The Vanguard Group's adverse action against Gorman was the result of a false-positive background report. Although Gorman eventually returned to work, his reputation remained in disrepute. He sued the three companies for libel and slander, arguing they failed to exercise due diligence and good faith by not verifying the easily ascertainable categories of SSN and DOB. The three companies settled with Mr. Gorman before trial.

More disturbing for organizations, however, are those erroneous background checks that present a clean slate for prospective or current employees (false negatives). The parents of an eight-year-old boy recently sued FedEx/Kinko's for hiring Paul Sykes to work in one of its Connecticut stores (*Doe*, 2005). The lawsuit alleges that the outsourced vendor reported Sykes' record as clean, failing to discover several felony convictions involving sexually-related crimes. Plaintiff-customer claims that Sykes entered their home to repair a computer and sexually assaulted their son. The $1 million plus civil suit against FedEx alleges negligence in conducting Sykes' background check

(Burr, 2006). Plaintiff's attorney argues that he easily found Sykes' 19-page criminal history, including sexual assault convictions. Accordingly, the screening company could find the information as well.

A RISK MANAGEMENT TOOL

Few employers today consider background checks a superfluous formality of selecting and retaining employees. These checks manage risk so that the organization, its employees and the public are not placed in jeopardy (DOJ Report, 2006). To avoid legal difficulties, pre- and post-employment screens need to be relevant to the particular job functions as well as the skill sets necessary to perform those essential functions successfully (*EEOC Guidelines*; Ruiz, 2007). A 2004 study by the Society for Human Resource Management (SHRM) found that 96% of employers surveyed conducted background checks of applicants, up from 66% in 1996 (Burke, 2005). SHRM also reported that 80% of employers conducted criminal background checks (Esen, 2004, January), up from 51% in 1996. According to *Small Business Focus* (SBF), citing the Small Business Administration, "For every dollar an employer invests in personnel screening, the savings range from five to 16 dollars in reduced absenteeism, improved productivity, lower turnover, safer working environments, reduced insurance premiums, and decreased employer liability" (Ceridian, 2006). Organizations find that performing background checks helps them address the following managerial, legal and compliance issues.

Managerial issues

Dishonesty, exaggeration, and misrepresentation are some of the troubling challenges that employers face from today's employees. Many employers claim that an epidemic of false credentials and exaggerated resumes pervades the workplace. Therefore, employers routinely screen all prospective employees. More companies are beginning to check regularly the backgrounds of current workers, particularly prior to promotion or license renewal. In so doing, companies can make more informed hiring and promotion decisions. A study by Automatic Data Processing, Inc. (ADP) found that 49% of applicant-provided information about previous employment, education, and/or credentials is inflated or erroneous, either by inadvertence or falsification (2006). The most common resume lie stretches dates of employment to fill in employment gaps (Business & Legal Reports, Inc., 2006, October). Approximately 18% of applicants lie about previous employers, and 15-16% of them misrepresent academic degrees, institutions, technical skills, and certifications. According to Human Resource Management (HRM), allegedly 10,000 workers, or 25% of those employed in financial services and information technology, lied or exaggerated their employment qualifications, particularly previous salary, educational qualifications and job responsibilities (2006, Safe in the knowledge). Well-seasoned executives also misrepresent their qualifications. Recently,

Radio Shack's Chief Executive Officer (CEO), David Edmondson, resigned for falsifying his educational degrees. Radio Shack failed to recheck Edmondson's background prior to his promotion to CEO (Marquez, 2006).

Fraud and theft also concern employers. According to the Association of Certified Fraud Examiners (ACFE), the typical organization loses approximately 6% of its annual gross revenues through employee occupational fraud (2006). A startling number of employees steal from their employers. One study concludes that employee theft or embezzlement contributes to 30% of business failures (Inquest, *n.d.*). Retail trade associations report that theft by dishonest employees costs approximately $848 per employee, nine times more than the costs of shoplifting. Companies that experience theft of their intellectual property lose between $200 million and $1.2 trillion annually (Wu, 2006).

Costly employee turnover results when employers fail to address the above managerial concerns with more than a simple cursory background check. For example, approximately one-half of all new hires are unsuccessful on the job and 60% of new executives fail within 18 months (Hire Authority, 2005). Turnover is both an indirect cost (lowered productivity and decreased morale) and direct cost (separation, replacement and training expenses) to business. Essentially, turnover operates as a business tax (Galbreath, 2007). According to the 2004 SHRM study of reference and background checking, the average cost per hire is over $3,900 and the average time to fill a position is 37 days (Dooney & Smith, 2004). Replacement costs range from approximately $7,000 for a salaried employee, to $10,000 for a mid-level manager, and $40,000 for a senior executive (Inquest, *n.d.*). When all expenditures are reported, turnover costs employers conservatively, two to three times the annual salary of the employee being replaced (Hilton Investigations, 2006). In order to address these managerial concerns, most organizations conduct background checks.

Legal issues

Violence in the workplace continues to be of great concern to society. In 2005, the Occupational Safety and Health Act (OSHA) reported over two million incidents of workplace violence, ranging in seriousness from verbal threats to homicides (Capwell, 2007; 1970). According to the Bureau of Labor Statistics, more than 481 deaths by homicide occurred at work (2005). In addition to these human costs, organizations lost a reported $36 billion annually because of workplace violence (Inquest, *n.d.*). The OSHA mandates that employers develop and maintain a workplace free from recognizable hazards, which includes abusive or violent employees. Many states have enacted workplace violence laws and developed employer guidelines that place the onus of prevention on employers (CA Labor Code Section 6400, 2007). To meet the due diligence requirements of providing a safe work environment and safe workers, many employers conduct reasonable pre- and post-employment screens of both prospective and current employees. Courts today find employer liability for the violent acts of employees regardless of whether they exercise

little or no control over those employees (Bradley, Moore, & Rubach, 2003). The torts of negligent hiring and negligent retention reflect this judicial interpretation.

Negligent hiring

The need to avoid negligent hiring litigation is best confirmed by viewing some startling statistics. According to Employment Screening, Inc. (ESI), employers lose 79% of negligent hiring lawsuits (2007), with cases settling out of court between $1 million and $1.6 million (Hight & Raphael, 2004). An average jury award for employment law litigation approximates $1.6 million (Armour, 2003). Compensatory and punitive damages are recoverable, including emotional distress. As a consequence, organizations must exercise good faith and due diligence in employing workers to avoid violence at work and allegations of negligent hiring.

As a relatively new independent tort, negligent hiring serves as the basis for a legal claim. The tort developed in the courts from the failure of employers to screen applicants properly for employment. As a consequence, business hired individuals who had a history of or were prone to acts of violence which subsequently spilled into the workplace (VeriRes, 2001). In other words, employers breached their duty not to employ individuals who were dangerous to others. Negligent hiring relies to a great extent on the worker's past conduct and whether the employer used sufficient due diligence to discover that misconduct. The due diligence standard increases as the employee's position requires increased contact with others (Bradley, Moore, & Rubach, 2003). For example, greater due diligence is required for workers who have access to customer homes and who have contact with the more vulnerable (*e.g.,* children, disabled, and elderly). Employers need to "know" their employees by seeking job-related information about prior employment, educational experience, knowledge and skills, criminal convictions, and financial stability (Deming, 2006).

Negligent retention

Employers face allegations of negligent retention when they knew or should have known of the violent propensities or wrongful conduct (e.g., harassment, theft) of employees and have failed to discharge or reassign the employee (Demming, 2006). Negligent retention speaks to the need for employers to check continuously the backgrounds of their employees. Since their hire, employees in financial positions may have filed for bankruptcy; employees in transportation positions may have received citations for drunk driving; other employees could have faced charges of assault and battery. Fresh Direct (FD), the hip online and home delivery grocery, now receives automated, biweekly background updates on all its workers, including the CEO, Dean Furbush. In 2004, FD experienced the unfortunate consequences of allegedly receiving a false negative on one of its delivery drivers. The driver pled guilty to stalking and harassing female customers. The third-party background vendor allegedly reported that the driver, then an applicant, had no criminal record.

Unfortunately, he did. The driver's record included previous misdemeanors and felonies (BusinessWeekOnline, 2006). Fresh Direct switched its screening company to Verified Person, co-founded by John Scully. Verified provides automated screening capabilities for companies to check continuously the backgrounds of their current employees.

Some employees may consider continuous background checks an invasion of privacy which negatively affects morale. Management may be reluctant to interfere with morale in this way; however, that reluctance needs to be balanced against jury awards, such as the following for $29 million. The case involved a delivery driver under the influence of methamphetamines who caused a fatal accident. The plaintiff successfully argued that despite being aware of the employee's erratic behavior, the employer failed to drug test the worker and negligently retained him (Allen, 2006). While employers need not foresee a particular injury, they must reasonably foresee any appreciable risks of harm to others. These ongoing checks alert employers of any job-related changes in circumstances of their employees. At that point, the employer engages in more judicious in depth reviews. The strategy of continuous checking demonstrates the employer's oversight of current workers and is another reflection of due diligence.

Compliance issues

Over the years, and particularly following September 11, 2001, the federal government has interpreted legislation as applicable to background checks or issued industry-specific regulations that require some organizations to conduct background checks of h applicants and employees.

Fair Credit Reporting Act

The federal statute, FCRA as amended by Fair and Accurate Credit Transactions Act (FACTA), and more restrictive state consumer reporting laws regulate third-party providers of background information. These laws protect consumers, particularly those seeking employment and/or credit. Employers trigger the FCRA's detailed and specific notification, information, and consent responsibilities when they outsource background reporting. Knowledge of this law is critical for human resource departments, particularly when they vet third-parties to become their outsource partner. One of the more important best practices requires employers to verify that the outsourced vendors under consideration have spot-on knowledge of and a history of compliance with this particular law.

Despite having to comply with these detailed requirements when screens are outsourced, many employers nevertheless choose to do so. As noted above, SHRM's recent outsourcing survey reported that 73% of respondent companies, both large and small, outsource background checks because they are not cost-effective to be conducted in-house (Esen, 2004, July; Davis, 2006). Further, the FCRA may impact employers that perform in-house background checks. Thus, as a

legal precaution, those employers must also follow the FCRA in developing background checking policies and procedures.

The FCRA classifies providers of background reports as "consumer reporting agencies" (CRAs). Those CRAs provide both records-only, eligibility background reports ("consumer reports") as well as reports derived through personal interviews with friends, associates, references, employers, *et al*. ("investigative consumer reports") (DOJ Report, 2006). Consumer reports are the most commonly requested reports. The information contained in consumer reports includes criminal records, education, motor vehicle records, SSN traces, and similar types of data (Rosen, 2001). The FCRA requires that employers and their CRAs comply with four very specific regulations that "impose fair-information practices" (DOJ Report, p. 3). Minimally, the FCRA requires employers to: 1) provide conspicuous disclosure information to and obtain written consent from those individuals undergoing background reviews; 2) certify to the CRA that the employer complies with the disclosure, authorization, and adverse action requirements of the FCRA and will not misuse the information contained in background reports; 3) recognize the rights of the consumer if the company plans to take adverse action based on information contained in the background report. In advance of such action, the employer provides the consumer with a copy of the report and statement of rights, allowing a reasonable time (no fewer than five days) for the consumer to dispute information, correct inaccuracies, and/or update data; and, 4) send a notice of adverse action to the consumer, indicating that the employer intends to take the adverse action (HR Reporter, 2004; FCRA, 2003, as amended; Rosen, 2001). A key responsibility of the CRA is to develop reasonable procedures that ensure the "confidentiality, accuracy, relevancy, and proper utilization" of the information contained in the report (FCRA, 2003). The FCRA also provides a "private right of action that includes punitive damages and attorneys' fees" (Barnes, Lemley & Christiansen, 2003, p.3).

The FCRA reflects the beginning efforts of Congress to regulate the background screening industry. The 2006 DOJ Report recommends specific requirements for accessing particular information, certifying training, and applying notice/fair-use of information. The recommendations also require CRAs to provide consumer rights, such as the right of consent, the right to notice about reporting disclosures, and the right to challenge the accuracy of the information, parroting many of the above FCRA requirements. As noted, the FCRA applies only to the conduct of outsourced background reporting. The CRA, however, also has to comply with state regulation which is frequently more restrictive than its federal counterpart. Further, employers conducting in-house investigations must comply with applicable state regulations as well. For example, the FCRA allows CRAs to report criminal convictions indefinitely. California allows the CRA to report criminal convictions for only the past seven years (CA Civil Code, 2006). Further, under CA Civil Code 1786.18(a)(8)(c), a CRA cannot include public record information in a background report unless the CRA verified the information during a 30-day period before the report is issued. Therefore, a best practice for employers that choose to outsource background reporting to third parties is to assure that

their CRA knows about and complies with the FCRA and the myriad of state consumer protection laws.

Other regulations

Healthcare and financial services are examples of industries for which Congress mandated background checks. Trucking must also comply with some regulations of the Federal Motor Carrier Safety Act. Furthermore, the reporting and accountability requirements of Sarbanes-Oxley and the USA Patriot Act suggest the importance of thorough background screening (Taleo, 2006). The U.S. Patriot Act requires states to determine whether individuals applying for a Hazardous Materials endorsement on their commercial drivers' licenses pose security risks. Generally, this assessment for the Transportation Security Administration includes a fingerprint-based FBI criminal history check, a security-related check, and immigration status verification (2005).

Various state laws require background checks for certain classifications of employees, especially those involved in health care, child care, elder care, financial services, and in-home contractors. For example, the CA Health and Safety Code, Section 1522, requires a background check of several individuals who have contact with clients of community care facilities. These include applicants, licensees, adult residents, volunteers and employees of those facilities (2007).

NEW CHALLENGES AND CONSTRAINTS

Given the managerial, legal, and compliance issues that accompany background checks, many employers outsource these checks to screening companies. According to SHRM's Human Resources Outsourcing Survey, 73% of the respondent organizations outsource background checks (Esen, 2004, July). Generally, conducting pre-employment checks in-house is not cost-effective (Davis, 2006). The sheer volume of checks for large organizations and the lack of personnel in small businesses merit their outsourcing this function, similar to financial institutions that outsource verification of creditworthiness. However, according to the U.S. Association of State Public Interest Research Groups (PIRG), over 75% of credit reports contain errors (2004). Given that many of the same organizations conduct background and credit checks, errors in conducting one kind of check (credit) should make the employer similarly suspect of the accuracy of the other (background).

The business landscape is replete with examples of background check failures, referred to as false positives and false negatives. The failures either reduce the employability of the screened individuals or cause workplace associates to be at risk because of the screened individual's employment. Employers should now be on notice about the difficulties of obtaining accurate information concerning workers, in-house or outsourced. In 2003, the U.S. District Court of Northern Illinois held that Edward Socorro, a former employee of Hilton Hotels, could sue both Hilton and IMI Data Search, Inc., the company that completed Socorro's background check. The

court specifically rejected the claims of Hilton and IMI that the FCRA pre-empted Socorro's claims of defamation and false light and let him proceed on these claims. The data provider erroneously reported that Socorro was a convicted felon; Hilton fired him. The court ruled that Socorro could sue both for defamation and false light. Allegedly Hilton told others that Socorro lied on his application and was a convicted criminal (Socorro, 2003).

Data difficulties

Many employers believe that using accurate background information, particularly criminal, is the only way to demonstrate due diligence (DOJ Report, 2006). Despite seeking criminal background information, employers know that the Equal Employment Opportunity Act (EEO) regulates if and when employers can deny employment and licenses to applicants with criminal records (1964). Under *EEOC Guidelines*, an employer cannot automatically eliminate an applicant or employee because of a criminal record. Rather, the employer must consider, among other issues, the nature of the crime and its relationship to the job in question (*EEOC Guidelines,* rev2000). Nevertheless, business continues to seek criminal data even though such data is infamously inaccurate. A study on recidivism, conducted by researchers at the University of Maryland, inadvertently revealed the problem of inaccurate criminal background checks. The researchers requested background checks on 120 convicted criminals currently on probation or parole in order to determine whether additional arrests had occurred. Out of the 120 criminals checked, however, the data provider reported only 56 were convicted criminals; in other words, 64 criminals were deemed "clean." Inaccuracies such as these result in either false positive or false negative background reports (Briggs, *et al,* 2004).

Unfortunately, no computerized national repository of crime data exists. No single source provides "complete and up-to-date information" (DOJ Report, 2006, p.6). Only law enforcement agencies and the Federal Bureau of Investigation (FBI) can access the National Crime Information Center (NCIC) (Zimmerman, 2004). According to the 2006 Department of Justice Report (DOJ Report) on criminal background checks, the FBI maintains the Interstate Identification Index (Triple I) which, with limited exceptions for jobs in regulated industries, is also unavailable to the private sector for non-criminal justice purposes. Although Triple I is more accurate than name-only repositories (Triple I uses fingerprint identification), that resource is missing final dispositions for approximately 50% of its records.

In view of these data problems, many employers believe their only choice is to outsource background checks to commercial database providers or screening vendors.

These commercial databases are frequently inaccurate and do not contain FBI criminal records. Data sources that do provide information to commercial databases generally do not supply either complete or regularly updated information. With over 10,000 local, state and federal courthouses in the U.S., screeners face a daunting task in seeking criminal information. Many county

courthouses require in-person requests for criminal records. Consequently, employers that do not outsource background checks generally send a courthouse record runner to the county courthouse of an applicant's or employee's residence. However, that residence may not be in the county or state of an earlier arrest or conviction. While screeners may use courthouse computerized databases, those repositories are notorious for being "outdated, inaccurate and incomplete" (Morris, 2004). The usefulness of these databases depends on how the court, repository or provider manages and updates the information. According to a report by ADP, "human errors, court delays, processing lags, and staffing shortages" impair the quality of data (2005). Misspelled words, erroneous birth dates, and transposed address numbers can cause mis-or no information for the report. Further, time limits may exist for acquiring criminal histories. While the FCRA no longer limits the time for investigating prior convictions, some states do. For example, California limits businesses checking criminal histories to seven years from the date of disposition, parole or release from prison (Johnson, 2002). As Gary Kessler, president of Backgroundchecks.com reportedly stated, "We're not in the business of authenticating the identity of individuals. All we do is report the data that's supplied to us from the courts" (Zetter, 2005). Thus, data providers cannot distinguish the records of individuals with the same or wrong name nor incorrect SSN, DOB and address.

If employers or their outsource partners rely on sub-par criminal databases, the ability of those employers to demonstrate due diligence in screening may fall on deaf jury ears. According to Les Rosen, Employment Screening Resources and National Association of Professional Background Screeners (NAPBS) founding member, if an employer relies only on a database for hiring decisions, "(t)here would be a considerable legal question as to whether having used a database would provide evidence of due diligence. In other words, databases may well not demonstrate that an employer took reasonable care" (Background Investigator, *n.d.*).

Unregulated industry

The background screening industry is largely unregulated. Although some federal laws, such as the FCRA and EEO, affect how screening companies conduct background checks, no law specifically requires consistent standards for or government oversight of the employment screening industry. Tal Moise, chief executive of Verified Person notes, "This is an industry that has delivered historically a very low quality product" (Christoffersen, 2006).

Oversight may be forthcoming. The Office of Legal Policy (OLP) sought public comment for the U.S. Attorney General (AG) about employment screening for criminal records. The AG requested input concerning 15 factors, many of which affect the "effectiveness and efficiency of utilizing commercially available databases" (Employment Screening for Criminal Records, 2005, p. 2). Specifically, the OLP request focused on federal policy for access to criminal background checks for employment. Following public comment, the Attorney General issued his report on *Criminal History Background Checks*. The report confirmed that employers are "subject to liability

if they fail to exercise due diligence" in seeking background information (DOJ Report, 2006, p.1). Recognizing the need for standards, a number of employment screening companies formed the National Association of Professional Background Screeners (NAPBS). While the NAPBS has become a voice for the screening industry, the association does not yet have certification or enforcement authority.

THE INDUSTRY RESPONDS—NAPBS

Founded in 2003, NAPBS is a non-profit trade association whose aim is to represent the interests of companies involved in employment and tenant background screening. NAPBS offers "an opportunity for qualified companies to participate in shaping the body of knowledge and regulations impacting" the industry. As of January, 2006, the NAPBS consists of approximately 600 members, a significant growth from the initial 200 founding members. A board of directors and standing committees deal with issues such as ethics and accreditation, best practices and compliance, and public awareness and communication (2006).

The mission statement of the organization focuses on ethical business practices, compliance with the FCRA, and awareness of consumer protection and privacy rights for the background screening industry. Although NAPBS does not yet have any power to censure screening companies for wrongdoing, its code of conduct makes clear the association's concern over standards. The code continues by suggesting behaviors that members should adopt, such as discharging professional responsibilities in a diligent and competent manner (2006). Through newsletters and training, NAPBS members become aware of the best practices for screeners (NAPBS, 2006). Eventually, NAPBS plans to conduct research, create business standards, and certify member employers (Rose & Misenzhnikova, 2006).

The NAPBS functions as an advocacy group that represents membership interests before Congress as well as state and local governments. In 2005, the NAPBS commented on a Department of Justice's (DOJ) proposal to investigate practices in and tighten standards for the screening industry, focusing on how to improve the effectiveness of current databases which now contain incomplete and inaccurate data (Morris & Poquette, 2005). The investigations by the DOJ may be only the beginning of concerns about and possible regulations of the screening industry. In response to ongoing investigations and other industry concerns, the NAPBS is developing ethical and accreditation standards so that the industry can monitor whether its members adopt and exercise uniform principles and practices. "Once a set of uniform practices has been developed, adherence to these principles can be monitored from within the industry" (NAPBS, 2006). The Privacy Rights Clearinghouse (PRC), an advocacy organization protecting the privacy rights of consumers, recently made supportive comments about NAPBS. At a recent NAPBS conference, Beth Givens, PRC director, commented, "I have already encountered…people…[experiencing] problems with

erroneous criminal records and the background check process….from what I have observed of the NAPBS, your association will be part of the solution to this most serious societal problem" (2006).

BEST PRACTICES AND DUE DILIGENCE IN SELECTING A CRA

In making selection and retention decisions, employers that use a CRA's background report are highly accountable for the information submitted by its vendor. This background information needs to be both valid and reliable. Valid information means the screened information is job-related and satisfies business necessity. Reliable information means the screened information is consistent over time. Employers also owe a general duty of care to provide a safe working environment for individuals. They use due diligence and good faith in selecting and retaining those workers who have not engaged in wrongful or violent acts. Hiring and retention decisions are generally reliable when employers use credible information sources and eliminate data inconsistencies. Business then should be able to avoid instances of false positives and negatives or at least demonstrate best efforts to do so.

Given these concerns, businesses that outsource screening responsibilities to CRAs must comply with the FCRA and use due diligence and good faith in selecting which company to perform their background checks. A California case serves as a cautionary note to employers nationwide that they need to conduct background checks not only on applicants and employees but perhaps on independent contractor-CRAs as well. In *Dean v. Oppenheim Davidson Enterprises, Inc.,* the defendant (formerly America's Best Carpet Care) negligently retained an independent contractor, Jarrol Woods (*dba* Jerrol's Affordable Carpet Cleaning), to shampoo carpets for customers. Best Carpet dispatched Woods to the home of Dr. Kerry Spooner-Dean who found his work to be shoddy. Woods returned later to re-clean the carpets but instead fatally stabbed the doctor. He pled guilty to first degree murder and received life without parole. The doctor's husband sued Best Carpet for failing to conduct a background check on the independent contractor, Woods. Best Carpet claimed no liability because 1) Woods was an independent contractor and 2) the company had no reason to suspect Woods posed a danger. Woods was on parole, and he had a criminal record that Best Care could have ascertained easily through a background check. Woods also had been fired by his previous employer, Sears. The jury awarded monetary damages of $11.5 million. Dean and Best Carpet settled following the verdict, barring future appeals (*Dean v. Oppenheim*; Novarro, 2001).

Recent litigation continues to suggest that plaintiff-applicants/employees who are accused erroneously of wrongful acts or illegal activity, or other plaintiff-individuals who suffer from conduct of a worker given a "clean-slate," will seek to hold both the employer and CRA responsible for any resulting harm. These plaintiffs may allege the employer violated the FCRA and/or committed other torts including negligent hiring, false light and defamation. In this litigious business world, many customer-employers, as a prudent business practice, routinely purchase Employment Practices Liability Insurance (EPLI) as a protection against employment-related

lawsuits. Defenses to these allegations focus on whether the employer exercised due diligence and good faith in establishing sound background checking policies, and in selecting, transitioning, and managing the CRA. Furthermore, the contract between the parties should demonstrate the use of due diligence and good faith throughout the customer-CRA relationship and clearly set forth the agreed-to responsibilities of both.

EPL Insurance

Employment Practices Liability Insurance will provide some safeguards in response to claims involving erroneous background checks and resultant injuries. Given the costs involved with defending employment complaints, companies should investigate whether EPLI coverage helps them reduce or prevent any ruinous expenses and consequences. With increasing employment litigation, *e.g.,* sexual harassment, discrimination, and erroneous background checks, the demand for EPLI continues to grow. Citing the Equal Employment Opportunity Commission (EEOC), the American International Group, Inc. notes "(t)he readiness to sue has become commonplace, and with that has come frequent multi-million dollar employee-related claims against corporations. In fact, settlements and judgments in these suits have increased by almost 200% within the last few years" (2005).

Small businesses may elect to obtain necessary coverage through an endorsement on their existing business policy, while larger firms may choose to purchase EPLI insurance (Oblander, Cloutier, & Zeabart, 2005, p. 6).

Once an insurer deems the organization as a sound risk, the business receives policies and endorsements that cover wrongful failure to hire and wrongful termination, issues that are aggravated by insufficient or inaccurate background checks. In fact, the first suggestion made to employers on the Insurance Information Institute's (III) website is to "create effective hiring and screening programs to avoid discrimination in hiring" (2007). Such effective hiring and screening also includes accurate background checks. While the expense of EPLI claims is high, the cost for EPLI insurance is not. In many cases, "this (cost) is less than what an organization pays for its coffee service on a per employee basis" (Welbel, 2005).

Due diligence and good faith

With recent litigation concerning outsourced background checks, employers have a duty to use due diligence and good faith in selecting vendors. By exercising due diligence and good faith in their selections, many employers establish a defense against claims of false positives and false negatives. Further, by exercising those duties, employers may be able to allege a new tort of negligent reporting against those vendors.

In its simplest description, due diligence is a process that requires organizations to do their homework well and document those efforts. In other words, research the deal, analyze the deal, and prove you followed your background checking and vendor selection processes by documenting that due diligence. With respect to selection procedures (including background checks), due diligence means, "the employer must consider if a potential new employee represents a risk to others in view of the nature of the job" (Rosen, 2007, Negligent hiring….). Essentially, by using due diligence, business may avoid costly mistakes as well as buyer's remorse (Boland, 2006). Westlaw offers legal due diligence reports on publicly-traded companies. Employers that purchase those reports are able to "uncover key corporate, financial management and litigation profile information" about possible vendors (2007). With respect to using diligence in the selection of background vendors, employers ought to develop guidelines or checklists of the process the company will use to determine the qualifications of an outsourced vendor.

"Good faith," as a legal term, refers to business conducting their due diligence with honesty, openness, and without malice. In hopes of insulating themselves from liability, many employers are careful to follow their due diligence process and negotiate with vendors in good faith. In so doing, any outsourcing selection should represent the best interests of all parties (employer, applicants and employees) by reducing the likelihood of false positives and negatives.

The following discussion on developing policies for checking backgrounds, and for selecting, transitioning, and managing vendors, serves as a basis for meeting the requirement of due diligence. A key reason for failed outsourcing relationships is the "misalignment of sourcing decisions with business strategy" (Cohen & Stone, 2006). Approximately 30 percent of companies have adopted formal sourcing strategies and established appropriate governance (Olswang, 2005). Failure to develop and/or follow guidelines may demonstrate to a jury the failure of an organization to meet due diligence and good faith. Unfortunately, business may not know whether its background checks are reasonable or whether its outsourcing policies satisfy due diligence until the jury returns a verdict.

Background checking policy

Inconsistency is the major issue for employers in checking backgrounds because the inconsistent sourcing and application of screens could lead to allegations of discrimination. Many articles describe what constitutes a sound background checking or pre-screening policy (Capwell, 2007; Auffant & Park, 2006; Allen, 2006). Generally, human resources complies with the *EEOC Guidelines on Employee Selection Procedures* by constructing job descriptions and standards that accurately depict the duties and skills required to perform a job successfully (*EEOC Guidelines*,1978). Best practice requires that employers tailor the parameters and relevancy of background checks to these job descriptions and job specifications. In *Field v. Orkin,* the court confirmed that "the general policy of Title VII requires employers to make hiring and retention

decisions on the basis of job-related factors" (*Field*, 2001, p.8). In most instances, therefore, employers pull the driving records (*e.g.,* licenses, citations) of prospective or current employees for only those jobs which require driving. Similarly, employer financial institutions check the criminal records of applicants for financially-related crimes, *e.g.*, the bank would not select an applicant for a teller position if the candidate had a previous conviction for embezzlement.

Three key aspects of a judicious background checking policy include that the employer screens the backgrounds of every applicant and continues to do so throughout employment. This policy is noticed on every piece of selection material (*e.g.* advertisements, applications). Due diligent employers require the completion of a standardized application form, either stand alone or supplemental to a resume. Application forms, unlike resumes, enable uniformity in the hiring process, eliminate receipt of information that the employer should not consider, and document gaps in employment that necessitate an explanation (Rosen, 2007, Why applications…). To assist in effective criminal record checks, the form also seeks addresses for the past seven years. Another key aspect of such a policy requires that background checks serve as a condition of employment. The third aspect calls for the policy to warn about misrepresentation, *i.e.,* if prospective or current employees misrepresent themselves on any selection document, the employee is subject to immediate discipline, up to and including dismissal. These procedures may deter at least some individuals who, without such warnings, are more prone to provide inaccurate statements. They also assist the CRA's better understanding of the organization's policies and procedures in gathering background information.

The selection

The process of selecting a CRA, though challenging, is critical to documenting due diligence in background checking. Outsourcing occurs when an otherwise in-house HR function is performed on a recurring basis by an outside party. Executives cite time and cost savings as reasons for outsourcing HR functions (Greer, Youngblood, & Gray, 1999). For example, one executive in Greer, *et al*'s study outsourced recruiting when the company had 50 openings at one time. Frequently, outsourcing vendors reduce liability and risk by providing a level of legal expertise that is not held by many customer-employers, particularly smaller companies.

Some employers protest that outsourcing background checks to a CRA is too expensive. With the exceptions of executive, highly skilled, and security-based positions, the cost of individual screenings is usually the cost of a day's pay for that individual. Customer-employers need to verify particularly the offers for instant background checks at low cost. A cursory check will not afford the necessary defense against allegations of negligent hiring, particularly if the accuracy of the data base is questionable and the resulting report appears superficial. Remembering the adage, "you get what you pay for," this cost should be compared to the cost of possible judgments against employers that fail to perform checks appropriately (Human Resource Management, 2006, Back to the

future…). Outsourcing is not a silver bullet for checking backgrounds; however, developing effective and diligent background vendor strategies and policies map out the best practice for the selection, transition, and management of a CRA.

The selection of CRAs frequently requires the development and evaluation of an RFI (Request for Interest) and RFP (Request for Proposal). Employers need to solicit information from the most qualified suppliers of background screening information. Key to finding those interested and qualified third parties is describing carefully the background functions that the customer-employer intends to outsource and the parameters for CRA screenings of individuals. An RFI may not be necessary for small companies with few background checks; however, for large companies, an RFI operates as an initial screen and brings forward those companies truly willing and interested in performing the service (Alsbridge, 2007). For RFPs, the background checks must be relevant to and descriptive of the jobs to be reviewed; however, the degree of review will vary for different jobs. According to Merry Mayer of SHRM, the RFP's format for checking backgrounds is similar to other vendor RFPs (introduction, customer-employer description, and project overview). The document also indicates what information vendors need to submit, due dates, requirements, and evaluation criteria, among other items. To assist CRA applicants, the RFP could include a proposal outline for describing the CRA company structure, resources, timeline for performance, references, and previous specific experience in providing background checking services (2002). The initial solicitation generally addresses all the data about which the customer-employer may be interested. For example, the customer-company may indicate an interest in record-only reports of criminal records, SSN traces, address history, DMV reports, credit reports, and verifications of professional licenses, certificates, education, and employment (Ceridan, 2006). With definition and detail, the CRA's response to the RFP should be specific and clear, facilitating the CRA selection decision and recording due diligence.

Key questions

In making a CRA selection, the customer-employer needs to seek some key information about the operations of the vendor-candidates. In so doing, the employer is better able to make its best business decision not only in selecting a CRA but also in demonstrating due diligence. Attorneys of the parties generally reduce to contract language any critical information about the outsourcing from CRA that is gleaned through research and interviews. The following identifies some of the questions and information the customer-employer needs to pose to and obtain from CRA candidates, either through the RFI, RFP, or during an interview:

CRA qualifications

1) Ascertain whether the CRA can provide the job-related information needed by the customer-employer. For example, criminal (seven-year limitation for some states, *e.g.,* California), employment, education, and residential histories; SSN trace; professional licenses and certificates; credit history. 2) Determine how the CRA assures the accuracy of its data. Does the CRA obtain the most accurate data through primary, not secondary, sources? 3) Ascertain the methods used by the CRA to insure the legality and reliability of the information provided. Does the CRA adhere to professional standard of the NAPBS? Note: Ask to review the vendor's quality assurance program. 4) Determine whether the CRA can provide the requisite information according to the customer-employer's specifications. For example, do searches access information from county, state, and/or national repositories? 5) Query whether the CRA offers privacy safeguards in the transmission of any personal information the CRA provides, for example, by encryption. 6) Determine if the CRA can explain the meaning behind the data points of the report. 7) Ascertain the process by which the CRA verifies negative information. For example, does the CRA return to the original reporting jurisdiction and conduct a physical search of public records to assure accurate results of the information before entering the final report (Capwell, *n.d.*)? 8) Determine whether the CRA qualifies for or has purchased Errors and Omissions insurance (E&O). By demanding insurance, the customer-employer becomes better protected against litigation concerning background information that is erroneous, overlooked, or missing (When you're ready to find a policy…., 2004). 9) Determine by what mechanism the CRA-candidate enables the organization to re-examine current employees. For example, find out whether the vendor provides online capabilities so that the customer-employer can access the information itself at designated intervals. Current employees then may be rechecked annually depending on the security-risks of their position or, perhaps, when employees seek advancement in the organization.

Knowledge of and compliance with FCRA and other relevant federal and state laws.

1) Ascertain that the CRA understands its FCRA responsibilities, both before and after obtaining a background check. For example, ask the CRA to describe their step-by-step process of accessing information, from the customer-employer's initial request to the provision of the asked-for information. 2) Determine if the CRA has knowledge about the various state laws governing background checks that generally are more restrictive than federal laws.

Databases

1) Have the CRA indicate what database it accesses to obtain background information. Note: If a CRA uses a commercial database, that information should not be the sole source for a

background check. 2) Determine if the CRA has sound relationships with court researchers in all states so that the CRA is able to check criminal records, both through state data bases and in person (Daniel, *n.d.*). 3) Determine if the CRA's data systems are off-site and professionally-managed.

References and vendor information

1) Determine if the CRA is a member of NAPBS. If not, membership in and agreement with the principles and ethics espoused by NAPBS should be a contract requirement. 2) Ask the CRA for customers currently receiving background checks. Note: Referenced companies should be of a similar size, in a similar industry, and with a similar market share to that of the customer-employer. Additionally, the CRA needs to provide verifiable information about the quality of its product, timeliness, and reliability in delivering the background report. 3) Obtain from the CRA names of companies that previously used the CRA's background check services. Note: Those companies need to be contacted as to the CRA's performance and the reason(s) for the termination of the relationship. 4) Research the stability of the CRA in the industry. Determine its reputation, perhaps by ordering a due diligence legal report (Strickland, 2006).

Timeliness

1) Have the CRA describe the timeliness of delivering specific types of background reports once a request is tendered. Customer-employers have indicated that the failure to provide reliable data in a timely manner is of utmost concern in this relationship (Strickland, 2006). 2) Establish penalties for failure to perform within the agreed-to timeline.

Vendor's employees

1) Ascertain how the CRA's employees are trained in data collection and government regulations. 2) Determine how the CRA checks the backgrounds of its employees and how they are schooled in privacy protections.

The transition.

One critical risk in an outsourcing relationship occurs when the customer-employer transitions the background checking process to the selected CRA (Maccoby, 2006). How the organization effectuates the transition is another determinant of due diligence in acquiring personal and private information. In order "to minimize cycle times and ensure business continuity," the customer-employer needs a qualified individual to guide the organization through the task of transitioning the current in-house activity of checking backgrounds to the designated CRA (The

Return on Outsourcing Company, 2007). Large organizations establish a position of Transition Manager, seeking an individual with experience in transferring business processes. The company designates that individual to manage the transition needs and to be knowledgeable about the FCRA as well as other legislation and regulations affecting background checks. Because transitioning is so critical, any contract needs to reflect the step-by-step processes, together with any pre-determined penalties for non-compliance.

The management

In managing the CRA relationship, the customer-employer periodically needs to audit the efficiency, timeliness, and accuracy of the CRA's processes, operations, and report content. Continuing organizational oversight of the CRA's operations demonstrates due diligence over background reporting. If the employer is concerned about false-positives or negatives, one approach is to review a random sample of applicants for whom the customer-employer received background reports from its current CRA. By re-investigating these applicants, either in-house or with another CRA, the customer-employer is better able to determine the accuracy of the current CRA and further demonstrate due diligence in the monitoring the CRA's performance (Dear Workforce, 2001).

Another legal precaution requires the customer-employer to review the CRA's background report prior to its distribution. This practice again demonstrates a due diligence commitment to accuracy in checking backgrounds. Particularly critical is to verify the spelling of the reported applicant's/employee's name, the social security number, addresses, and other available information. Apparently, had the Vanguard Group reviewed the SSN and DOB of the reported individual against that of its employee, James R. Gorman, the company might have avoided costly litigation.

The contract

Although suggesting contract provisions, the authors are not offering legal advice on constructing legal agreements. After the parties negotiate the issues of transition and management, and discuss the terms and penalties for ending the relationship, attorneys who are knowledgeable about outsourcing relationships, particularly those involving background checks, need to reduce the agreement to writing and draft a contract reflecting the agreed-to risks and responsibilities. As noted previously, the customer-employer is inevitably anxious when the CRA takes over checking the backgrounds of prospective and current workers (Gladis, 2006). Outsourcing contracts ought to provide a detailed yet flexible transition provision focused on the core needs of the agreement. Carefully-worded performance objectives together with a "gradually-escalating dispute resolution process" usually keep any problem-resolution at the operational level (Gladis, 2006). Areas of disagreement in customer-employer/CRA relationships are usually predictable. According to Donna K. Lewis of Kilpatrick Stockton LLP, successful outsourcing relationships have as a basis "clarity,

flexibility, and realistic goals" (2006). According to Gartner, many relationships will be renegotiated. The dynamics of the business environment therefore dictate how critical flexibility is (Out-Law.com, 2005). An agreement with a CRA should be viewed as a "strategic relationship rather than a commercial transaction" (Lewis, 2006), one that clearly addresses "a strong sourcing governance" (Gartner, 2005). Among many provisions, these agreements detail the services offered by the CRA, the price of those services, the termination of the agreement, and the presentation of change orders that may impact services, prices, and termination (Maccoby, 2006).

A key contract provision is the parties' compliance with the laws that impact the screening relationship. According the Geofrey L. Masters, a sound contract specifies a review by the customer-employer of the CRA's compliance with laws and regulations governing background checks. Ultimately, the employer may be responsible for the CRA's performance, "whether as a practical or actual legal reality" (n.d.). If the CRA fails to conform to the FCRA and other state and federal laws, the employer may be subject to fines/penalties, service interruption, and third-party litigation. As a result, customer-employers clearly identify in their contracts the CRAs' compliance commitment, generally through a warranty commitment (Masters, *n.d.*). Ultimately, the customer-employer operates better with flexible and effective mechanisms that manage the CRA's responsibility for meeting the requirements of current and future laws.

Failure to act in accordance with requisite laws governing this relationship and its subject matter poses a tremendous legal risk to the customer-employer. According to attorney Geofrey L. Masters, outsourcing transactions should consider the following "checklist of considerations:" 1) Because the *customer-employer may be liable for CRA activities*, the CRA must comply with the requisite laws, usually in the form of a supplier's warranty (emphasis added). 2) The customer-employer also agrees to comply with the applicable laws. The CRA usually seeks reciprocal legal compliance. As noted previously, employers that outsource background checks must have equally in depth knowledge of the laws governing those checks, particularly the FCRA, EEO and privacy. 3) The CRA usually agrees to a process by which the CRA will conform to changes in applicable laws and regulations. Because laws change, the CRA details how it will adapt to changes prior to the effective date of the change. If these changes have a major financial impact on the parties, a contract clause usually identifies the process by which prices are renegotiated. 4) Both parties obligate themselves to identify and notify each other of applicable laws in the way background information is accessed, reported, processed, and utilized (2007). In view of the importance of understanding the laws and regulations, a customer-employer needs to have the CRA provide indemnification in the event the CRA fails in its compliance efforts.

CONCLUSION

Employers need to exercise due diligence and good faith in selecting and retaining qualified employees. Question is now raised whether that same due diligence and good faith is necessary in

selecting a provider of background information used in making those employment decisions. With the implementation of the FCRA, many organizations rethought how they conducted background checks. Most large companies and many smaller ones chose to outsource those reporting responsibilities to third-party vendors known as CRAs. In so doing, employers place themselves and their CRAs under the auspices of the FCRA. These CRAs provide critical background information on prospective and current employees that frequently serves as the basis for employment decision-making. However, employers frequently receive erroneous background information provided by companies in an unregulated industry that lacks credible sources. Of particular concern for business is receipt of false-positive and false-negative information. In order to avoid these difficulties, must the employer screen the screener to satisfy its duties of due diligence and good faith in hiring and retaining employees? The authors suggest the answer is "yes."

Employers that want to stay ahead of the litigation curve should recognize that a cursory review of a CRA's capabilities no longer suffices. A simple look in the yellow pages or selection of a low cost, online provider may not be inexpensive in the long run nor exercise good business judgment. Given the likelihood of receiving inaccurate information through third-party vendors, employers may be held to a standard of knowing that such background information frequently lacks validity and reliability. The authors listed a number of best practices that address due diligence in determining which CRA is better qualified to provide necessary background information. The selected CRA should assist employers in avoiding managerial, legal, and compliance difficulties. Employers who choose not to exercise due diligence and good faith in selecting a CRA do so at their peril.

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