Volume 12, Number 1 **ISSN 1544-0036**

JOURNAL OF LEGAL, ETHICAL AND REGULATORY ISSUES

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Academy Information
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Whitney Press, Inc.

Printed by Whitney Press, Inc.
PO Box 1064, Cullowhee, NC 28723
www.whitneypress.com

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PRESENTING THE DIMENSIONALITY OF AN ETHICS SCALE PERTAINING TO TAX EVASION

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Larry Pleshko, Kuwait University
Robert W. McGee, Florida International University

ABSTRACT

The concept of tax evasion is the primary focus of the study. Data is gathered from a survey of approximately eleven hundred individuals across six countries. An eighteen-item scale is presented, analyzed, and discussed. Findings suggest that tax evasion has three overall perceptual dimensions across the items tested: (1) fairness, as related to the positive use of the money, (2) tax system, as related to the tax rates and negative use of the money, and (3) discrimination, as related to avoidance under certain conditions.

INTRODUCTION

Many articles have been written about tax evasion. Most of them have appeared in the accounting, economics and public finance literature. The usual thrust of these articles is to discuss technical aspects of tax evasion. Practitioner journals address legal aspects and evasion techniques (Oliva, 1998). Scholarly journals focus on lost tax revenues or reasons why collections are not more efficient. Ethics is seldom discussed, or when it is discussed, it is usually done superficially. Oftentimes the discussion begins with the premise that what is illegal is also unethical.

The present paper is different. This paper begins with an overview of the ethical literature that has been published on tax evasion and proceeds to present the results of an empirical study that solicited views on the ethics of tax evasion from participants in six countries. This study had several goals. One goal was to rank the main arguments that have been used to justify tax evasion on ethical grounds over the last 500 years. Another goal was to determine which categories of arguments drew the most support from a wide range of cultures.

BACKGROUND ON TAX EVASION

People have been evading taxes ever since governments started collecting them (Adams, 1993). Sometimes they evaded because it was possible to do so with little thought to the ethics of the situation. Other times people evaded and attempted to justify their evasion on moral grounds.

In a 1944 doctoral dissertation Martin Crowe summarized 500 years of theological and philosophical literature on ethical reasons for evading taxes and found that several arguments kept appearing in the literature. Some of the most frequently given reasons for justifying tax evasion on moral grounds were inability to pay, government corruption, high tax rates or not getting much in return for tax payments. The Crowe (1944) study more or less limited itself to a study of the Catholic literature in the field, some of which was in the Latin language. Crowe's thesis introduced the English speaking public to some of the Latin language literature on this point.

More recently a number of authors have addressed ethical aspects of tax evasion from a number of religious and secular perspectives. Inglehart et al. (2004) surveyed 200,000 people in more than 80 countries on a variety of issues, one of which was tax evasion. Torgler (2003) did a doctoral thesis on tax compliance that included a discussion of tax evasion ethics. McGee (2006) divided the arguments regarding tax evasion into three categories based on the Crowe study. He found that over the centuries various scholars have categorized tax evasion as never ethical, sometimes ethical depending on the facts and circumstances or always ethical.

Not much literature exists on the view that tax evasion is always ethical. The anarchist literature, as typified by Spooner (1870) in particular, takes the position that thee is never any moral duty to obey any law because all governments are illegitimate. Presumably that would include paying taxes. Block (1989; 1993) took a less dogmatic position. His studies searched for adequate justifications of taxation in the public finance literature but found that whatever justifications that were given were inadequate for some reason.

At the other end of the spectrum are studies that concluded tax evasion to always or nearly always be unethical. The usual reasons given were that there is a duty to God, to the state or to other taxpayers. Some of the Christian and Jewish literature takes this position, although several different justifications are given by different scholars.

Cohn (1998) examined the Jewish literature and concluded that tax evasion was always unethical. One reason for this conclusion was because there is a strain of thought within the Jewish literature that there is a duty not to disparage another Jew. If one Jew commits tax evasion it makes all other Jews look bad. Tamari (1998) reached a similar conclusion, although he was more flexible in cases where the king was corrupt.

A survey of the Mormon (Smith & Kimball, 1998) literature found no exceptions to the general rule that tax evasion is unethical. The Baha'i literature more or less agrees with the Mormon literature on this point, with one possible exception. Tax evasion might be acceptable in cases where the government oppresses members of the Baha'i faith. Which raises the question of whether tax evasion might be justified where the government engages in human rights abuses. Crowe (1944) did not address this issue in his dissertation, so the authors added three human rights arguments in the survey they used as part of the current study.

One of those questions was whether it would be ethical for a Jew living in Nazi Germany to evade taxes. It was thought that this argument would constitute strong justification for evading taxes, but such was not always the case, as shall be seen later. A prior study involving Orthodox Jews (McGee & Cohn, 2007) found that even Jews feel there is some duty to pay taxes to Hitler, not because there is a duty to the state or to God but because there is a duty not to disparage another Jew.

The majority of literature that examines tax evasion from an ethical perspective concludes that tax evasion may be justified in certain situations, although the reasons differ. The Catholic literature (Crowe, 1944; Gronbacher, 1998; McGee, 1994, 1998a & c; 1999a; Schansberg, 1998) gives several reasons, including ability to pay and government corruption. Tax evasion has also been viewed as justifiable when taxpayers are forced to pay for a war that is perceived to be unjust (Pennock, 1998). The Islamic literature seems to indicate that tax evasion might be ethical if the effect of the tax is to raise prices or if the tax is on income (McGee, 1997, 1998b). Thus, income taxes, sales taxes, value added taxes and tariffs could be seen as taxes that need not be paid on moral grounds. However, private conversations with an Islamic scholar dispute this conclusion. At least some Muslim scholars take the position that tax evasion is always unethical. Muslims from both perspectives cite the Quran to justify their positions.

Leiker (1998) examined the philosophy of Rousseau and concluded that tax evasion can be justified. Several studies of tax evasion in various countries also concluded that tax evasion can be ethically justifiable. The usual reason given is government corruption. That was the case for studies of Greece (Ballas & Tsoukas, 1998), Bulgaria (Smatrakalev, 1998) and Russia (Vaguine, 1998). In a study of Mexican migrant farm workers, Morales (1998) concluded that their duty to feed their families took precedence over the duty to pay taxes. A study of Armenia (McGee, 1999b) found that Armenians have no qualms about evading taxes because of the perception that the government is corrupt and because they do not get anything in return for their taxes.

Surveys of groups in Argentina (McGee & Rossi, 2006), Guatemala (McGee & Lingle, 2005), Poland (McGee & Bernal, 2006), Romania (McGee, 2005) and the United Kingdom (McGee & Sevic, 2008) found that there is widespread support for the position that tax evasion can be justified on ethical grounds in certain circumstances. In some cases the results varied by gender and in other cases they did not. Those studies will be discussed in more detail below.

DATA COLLECTION AND MEASUREMENT

The target respondents of the data collection are graduate and undergraduate students in six countries – Argentina, Guatemala, Poland, Romania, the United Kingdom and the USA. Respondents were asked to complete a survey comprised of eighteen items described in the following text. The respondents were asked to indicate their agreement or disagreement with each of the items by inserting a number from (1) strong agreement to (7) strong disagreement in the space provided. Thus, low scores show an acceptance of tax evasion, while high scores show a disagreement with tax evasion. This procedure resulted in eleven hundred usable surveys.

From the literature review presented above, eighteen items are developed which reflect the various aspects under discussion in the area of tax evasion. These items are the following:

(v1) tax evasion is ethical if tax rates are too high,
(v2) tax evasion is ethical even if tax rates are not too high,
(v3) tax evasion is ethical if the tax system is unfair,
(v4) tax evasion is ethical if a large proportion of the money collected is wasted,
(v5) tax evasion is ethical even if most of the money collected is spent wisely,
(v6) tax evasion is ethical if a large proportion of the money collected is spent on projects, of which I morally approve,
(v7) tax evasion is ethical even if a large proportion of the money collected is spent on worthy projects,
(v8) tax evasion is ethical if a large proportion of the money collected is spent on projects which do not benefit me,
(v9) tax evasion is ethical if a large proportion of the money collected is spent on projects which do benefit me,
(v10) tax evasion is ethical if everyone is doing it,
(v11) tax evasion is ethical if a significant proportion of the money collected winds up in the pockets of corrupt politicians or their friends and family,
(v12) tax evasion is ethical if the probability of getting caught is low,
(v13) tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust,
(v14) tax evasion is ethical if I cannot afford to pay,
(v15) tax evasion is ethical even if it means that if I pay less, then others will have to pay more,
(v16) tax evasion would be ethical if I were a Jew living in Nazi Germany in 1940,
(v17) tax evasion is ethical if the government discriminates against me because of my religion, race, or ethnic background, and
(v18) tax evasion is ethical if the government imprisons people for their political opinions.

ANALYSES AND RESULTS

Table 1 shows the mean scores for each country for each statement and also the average mean score for all six countries.

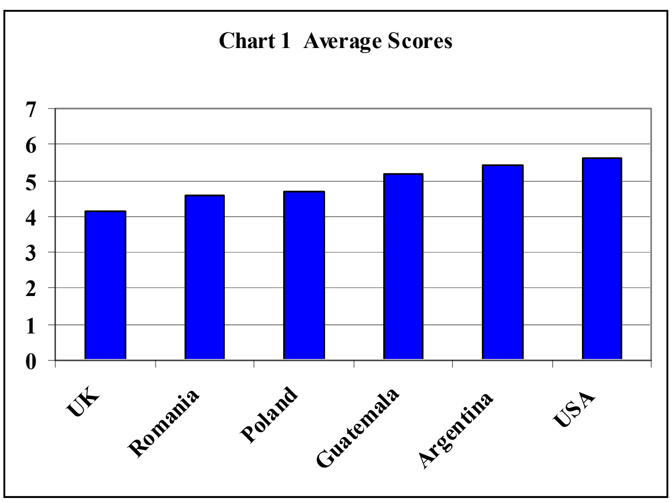
Table 1: Average Scores
(1 = strong agreement; 7 = strong disagreement)

Stmt.	USA	Arg.	Guat.	Pol.	Rom.	UK	Avg.
1	5.69	4.8	5.2	4.7	4.17	3.81	4.73
2	5.92	6.5	6.3	5.5	5.00	4.59	5.64
3	5.19	4.4	4.5	4.2	3.87	3.27	4.24
4	5.15	4.7	4.4	3.7	4.38	3.65	4.33
5	6.00	6.6	6.3	5.8	4.80	4.74	5.71
6	5.68	5.5	4.8	3.7	4.69	3.99	4.73

Table 1: Average Scores
(1 = strong agreement; 7 = strong disagreement)

Stmt.	USA	Arg.	Guat.	Pol.	Rom.	UK	Avg.
7	5.97	6.1	5.8	5.7	4.72	4.58	5.48
8	5.98	6.4	6.0	5.2	4.95	4.88	5.57
9	5.97	6.5	6.3	5.7	4.86	4.68	5.67
10	6.17	6.2	6.2	5.4	5.24	4.72	5.66
11	5.51	4.2	3.7	3.4	4.18	3.39	4.06
12	6.08	6.5	6.2	5.6	5.16	4.81	5.73
13	5.59	4.8	4.9	4.6	4.45	3.81	4.69
14	5.43	4.1	4.5	4.1	4.16	3.42	4.29
15	5.96	6.3	6.1	5.6	5.03	4.84	5.64
16	4.99	4.1	4.0	3.9	4.50	4.10	4.27
17	4.91	4.6	4.3	3.4	4.07	3.62	4.15
18	4.95	4.9	4.7	4.4	4.32	3.80	4.51
Avg.	5.62	5.4	5.2	4.7	4.59	4.15	4.94

Chart 1 compares the average scores by country graphically. The UK sample had the lowest mean average, indicating the least resistance to tax evasion. The USA sample had the highest mean score, indicating the strongest aversion to tax evasion. The mean scores ranged from 4.15 to 5.62, which, on a scale from 1 to 7 indicates that tax evasion was viewed as something that could be considered ethical sometimes



The next step was to rank the 18 statements from strongest argument to weakest argument. Table 2 shows the results of the ranking for each country and for each statement. For example, statement 1 ranked 10th for the USA, Guatemala and Poland samples, 7th for Argentina and the UK and 4th for the Romanian sample.

What Table 2 shows is that the statements that made the strongest arguments to justify tax evasion in one country tended to also be highly ranked in the other countries. Likewise, the statements that were weakest in one country tended to be weakest in all countries.

However, there were some variations. Statement 3 – Tax evasion is ethical if the system is unfair – was the strongest argument for Romania and the UK and was ranked in the top half for all countries. But statement 11 -- Tax evasion is ethical if a significant proportion of the money collected winds up in the pockets of corrupt politicians or their friends and family – was the strongest argument for the Guatemala and Poland samples. It also ranked in the top half for all countries.

Statement 16 -- Tax evasion would be ethical if I were a Jew living in Nazi Germany in 1940 – was the strongest argument in Argentina and was in the top three for the USA and Guatemala but ranked in the lower half in the UK. Statement 17 -- tax evasion is ethical if the government discriminates against me because of my religion, race, or ethnic background – ranked first in the USA and Poland.

Table 2: Average Rank
(1 = strong agreement; 7 = strong disagreement)

Stmt.	USA	Arg.	Guat.	Pol.	Rom.	UK
1	10	7	10	10	4	7
2	11	15	16	13	15	12
3	5	4	5	7	1	1
4	4	6	4	2	7	5
5	16	18	16	18	12	15
6	9	10	8	2	10	9
7	13	11	11	16	11	11
8	15	14	12	11	14	18
9	13	15	16	16	13	13
10	18	12	14	12	18	14
11	7	3	1	1	5	2
12	17	15	14	14	17	16
13	8	7	9	9	8	7
14	6	1	5	6	3	3

Table 2: Average Rank (1 = strong agreement; 7 = strong disagreement)						
Stmt.	USA	Arg.	Guat.	Pol.	Rom.	UK
15	12	13	13	14	16	17
16	3	1	2	5	9	10
17	1	5	3	1	2	4
18	2	9	7	8	6	6

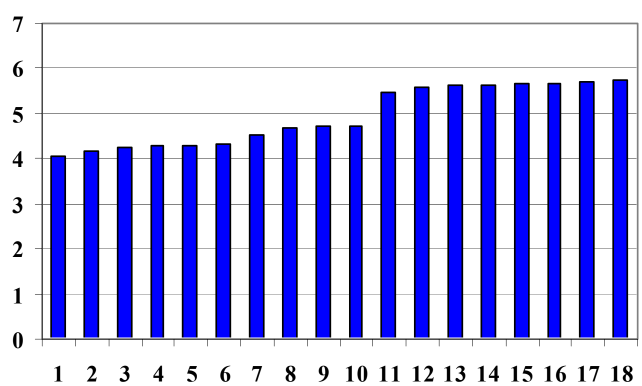
The next step was to combine the scores for all six countries and rank the statements from strongest to weakest. Table 3 shows the results. The strongest argument to justify tax evasion was if a significant proportion of the money collected winds up in the pockets of corrupt politicians or their friends and family. In second place was the discrimination argument. The fairness argument was in third place. The Jews in Germany argument came in fourth.

Table 3: Ranking of Arguments Strongest to Weakest			
Rank	Stmt. #	Statement	Avg. Score
1	11	Tax evasion is ethical if a significant proportion of the money collected winds up in the pockets of corrupt politicians or their friends and family.	4.06
2	17	Tax evasion is ethical if the government discriminates against me because of my religion, race, or ethnic background.	4.15
3	3	Tax evasion is ethical if the tax system is unfair.	4.24
4	16	Tax evasion would be ethical if I were a Jew living in Nazi Germany in 1940.	4.27
5	14	Tax evasion is ethical if I cannot afford to pay.	4.29
6	4	Tax evasion is ethical if a large proportion of the money collected is wasted.	4.33
7	18	Tax evasion is ethical if the government imprisons people for their political opinions.	4.51
8	13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust.	4.69
9	1	Tax evasion is ethical if tax rates are too high.	4.73
9	6	Tax evasion is ethical if a large proportion of the money collected is spent on projects, of which I morally approve.	4.73
11	7	Tax evasion is ethical even if a large proportion of the money collected is spent on worthy projects.	5.48
12	8	Tax evasion is ethical if a large proportion of the money collected is spent on projects which do not benefit me.	5.57
13	2	Tax evasion is ethical even if tax rates are not too high.	5.64

Table 3: Ranking of Arguments Strongest to Weakest			
Rank	Stmt. #	Statement	Avg. Score
13	15	Tax evasion is ethical even if it means that if I pay less, then others will have to pay more.	5.64
15	10	Tax evasion is ethical if everyone is doing it.	5.66
16	9	Tax evasion is ethical if a large proportion of the money collected is spent on projects which do benefit me.	5.67
17	5	Tax evasion is ethical even if most of the money collected is spent wisely.	5.71
18	12	Tax evasion is ethical if the probability of getting caught is low.	5.73

Chart 2 shows the range of mean scores. The range was slightly above 4 to slightly below 6, indicating that there is a widespread feeling that tax evasion is not always unethical.

Chart 2 Range of Mean Scores



In order to determine the underlying dimensionality of the items measured, the data is subjected to principal axis factoring. The output of the initial factor analysis is then rotated using a varimax rotation with Kaiser Normalization. Only those dimensions with eigenvalues greater than one are included in the rotation. An inspection of these initial rotated loadings leads us to eliminate V13 and V14 due to low or indiscriminate loadings across the rotated dimensions. The procedure is then repeated, including only the remaining sixteen items. This results again in three dimensions which explain more than 55 percent of the common variance. See Table 4 for the output of the principal axis factor procedure. The final sum of squared loadings for the rotation is presented in Table 5.

Table 4: Output of Final Round of Principal axis Factoring			
Factor	Initial	% of Initial	% of Rotated
	Variance	Variance	Variance
1	6.489	40.558	27.611
2	2.550	15.937	15.247
3	1.102	6.886	12.877
4	0.767	4.796	
5	0.667	4.168	
6	0.638	3.986	
7	0.541	3.383	
8	0.466	2.914	
9	0.443	2.769	
10	0.424	2.651	
11	0.400	2.498	
12	0.350	2.188	
13	0.342	2.139	
14	0.300	1.873	
15	0.273	1.706	
16	0.248	1.547	

As is shown in Table 5, generally load highly on one dimension and not on others. If we look at the highest few loadings for each dimension, then it is possible to name the three dimensions. Factor one is correlated highly with V9, V8, V7, V5, and V2. Those highly loading questions indicate that factor one is most likely a *fairness* dimension. Specifically, fairness appears to include the worthiness of how the money is spent and how that relates to the beneficiaries. Factor two is correlated highly with V1, V3, V4, and V11. Those highly loading questions indicate that factor two is most likely a *tax system* dimension. Specifically, the tax system seems to indicate the rate of tax levies and possibly any corruption in the system. Factor three is correlated highly with V16, V17, and V18. Those highly loading questions indicate that factor three is most likely a *discrimination* dimension. Specifically, the discrimination seems to indicate the ethics of taxing people who are not treated as equal under the system.

Table 5: Rotated factor Loadings

Variable	Factor 1	Factor 2	Factor 3
V1	.423	.562	.204
V2	.705	.255	.044
V3	.255	.725	.203
V4	.203	.752	.221
V5	.785	.062	.008
V6	.322	.436	.290
V7	.738	.096	.035
V8	.728	.268	.106
V9	.822	.091	.035
V10	.583	.189	.078
V11	.083	.610	.340
V12	.625	.263	.123
V15	.621	.203	.184
V16	-.028	.221	.636
V17	.087	.281	.837
V18	.181	.197	.743

DISCUSSION AND LIMITATIONS

The purpose of this study is to derive a measure and its underlying dimensionality for the investigation into the ethics of tax evasion. Eighteen items are presented which cover the domain of tax evasion. Two of the original items are eliminated, resulting in sixteen variables that are useful for this and future studies. In the final factor analysis, three dimensions are evident that focus on different aspects of this important topical area. The three dimensions are (1) fairness, (2) the tax system, and (3) discrimination. Future studies might focus on how these three dimensions of tax evasion are perceived by different ethnic and demographic groups.

The study is limited in that only samples from six countries are examined. A wider selection of countries might yield different results. However, the sample is fairly representative of several major regions of the world, including Eastern and Western Europe, North America and Latin America. The sample size – 1100 – is also sufficiently large to arrive at some conclusions.

The sample population – students – might also be criticized, since they might not be representative of the total population. Such a criticism has some validity. However, this same criticism could be made of the hundreds of other studies that have been conducted using student samples and published in major journals. Using student samples is a valid methodology, although it is not without some drawbacks.

CONCLUDING COMMENTS

Several things have been learned from this study. For one, there is substantial support for the view that tax evasion can be justified on ethical grounds in some cases. Also, some arguments are stronger than others. Tax evasion is perceived as being most justifiable in cases where the system is seen as unfair, where tax funds are wasted or where the government discriminates against some segment of the population. The weight of the various arguments differs by region. Western Europeans do not always place the same amount of weight on some arguments are do East Europeans, Latin Americans or North Americans, which was expected. Different cultural, historical and religious perspectives all have their influence.

ACKNOWLEDGMENTS

The authors would like to thank Marcelo Rossi, Christopher Lingle, Arkadiusz Bernal and Zeljko Sevic for their assistance in collecting the data for this study.

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CHANGE IN THE TAXPAYER-TAX PREPARER RELATIONSHIP: THE EFFECTS OF CIRCULAR 230

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ABSTRACT

Tax advisors have become the most recent profession to receive public investigation after being exposed for unethical and abusive practices. High profile cases resulting in costly penalties due to fraudulent tax activities have brought accounting ethics once again to the forefront.

As a result, US Treasury Regulations for those providing tax advice have been modified to provide stronger direction for practitioners and greater authority for implementation. These address a wide-range of topics, from probability analysis of tax positions to enforceable sanctions for noncompliance. The U. S. Treasury Department's Circular 230 provides detailed procedures for practice before the Internal Revenue Service – with a particular focus on curbing abusive tax shelters. This paper describes the requirements of Circular 230, reviews the taxpayer-tax preparer relationship, examines the anticipated effects on current practice, and concludes with suggestions for future research.

BACKGROUND

The professional environment of any specialized area consists of far more than technical skills. An implicit understanding of professional ethics is necessary to maintain confidence when working in the interest of the public (Becker, 1996). Yet recently, corporate malfeasance, medical malpractice, political and governmental fraud, and even scandals occurring in the clergy present an aggressive cultural environment that often ignores traditional standards of behavior and responsibility. Exposed ethical lapses often uncover the pressures and greed-based rationale surrounding these damaging occurrences.

The public accounting profession, created to be self-regulating with minimal government involvement, maintained a relatively positive public image until recent years. However corporate accounting scandals have drawn intense public scrutiny and created a profession forced to undergo a costly overhaul and continual investigation. The litigious nature of those using professional accounting services, often spurred on by the perceived deep-pockets of the service provider and malpractice insurance policies, has created even greater scrutiny from clients, watchdogs and stakeholders (Gardner et al., 2004b). Tax advisors have become the most recent profession to receive public investigation after being exposed for unethical and abusive practices. High profile cases resulting in costly penalties due to fraudulent tax activities have brought accounting ethics once again to the forefront.

Taxpayer/clients seeking aggressive tax advice create a unique dilemma for the tax practitioner. Noncompliance is growing at astounding rates due to the number of high-income taxpayers with high net assets who find that tax savings tactics are their most important investment strategy (Silverman, 2005). Taxpayers, aware of audit rates of less than one percent, are prone to play “audit lottery,” often insisting on aggressive or inappropriate tax positions when using professional tax services.

More than half of all taxpayers use a professional preparer, resulting in tax advisor fees exceeding $11 billion annually. Approximately one-fourth of all tax service providers receive preparer penalties during their careers (Yetmar and Rioux, 2004). Research suggests that the tax preparation fee charged is potentially higher if the taxpayer’s income -- particularly unearned income -- is high (Mauldin et al., 2002). In fiscal year 2006, civil penalties and interest for negligence (pre-abatement) totaled almost $27 billion and fraud penalties (pre-abatement) for tax filers added up to approximately $1.1 billion. The IRS (www.irs.gov) reports a noncompliance rate of over 16%.

In an attempt to prevent a large-scale reoccurrence of the problems experienced in the audit and assurance services area, the IRS has modified guidelines related to tax services to provide better direction for practitioners and greater authority for enforcement. All tax advisors practicing before the Internal Revenue Service are subject to the Treasury Department’s Circular 230 titled “Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service.” The provisions of these regulations specify technical and ethical restrictions on the tax positions a practitioner can take, as well as specific language required in client communication. Failure to comply could result in actions taken by the IRS in the form of censure (public), reprimand (private), suspension, or disbarment from practice. Additionally, penalty provisions of tax law provide sanctions for noncompliance - including monetary fines and imprisonment.

However the concepts contained in these regulations and standards are based on aspirational principles, not rules. Foundational ideals such as professional judgment, realistic possibility, best practices, and good-faith belief are subject to interpretation. The determination of the legislative intent as well as the terminology contained in these regulations and standards creates many challenges and compliance-related gray areas. As a result, the taxpayer-tax preparer relationship has been significantly modified through added uncertainties and sanctions for noncompliance.

This paper describes the requirements of Circular 230, reviews the taxpayer-tax preparer relationship, examines the anticipated effects on current practice, and concludes with suggestions for future research.

CIRCULAR 230

Circular 230, applicable to all tax preparers and federal taxing agencies, was designed to promote ethical practice among tax practitioners and advocate best practices in providing tax advice. The IRS stated goals for the guidelines are to re-establish public confidence in the work of tax professionals through new disclosure requirements related to the level of assurance provided in tax advice.

The foundation of Circular 230 is contained in federal tax law under Internal Revenue Code Section (IRC) 269 which cautions that taxpayers may not engage in transactions created for avoiding or evading taxes. This code section, dating back to 1940, introduces the concept of "principal purpose of a transaction," and is the basis for the concept of tax shelters. This law states that a principal purpose is one where more than fifty percent of a transaction's substance is tax avoidance or evasion (Bailey and MacIvor, 2006).

Previously, Circular 230 addressed tax shelter opinions and the tax practitioners' requirements to prepare returns that contained accurate, complete and relevant facts. Certain assumptions were allowed and guidance was very generalized (Becker, 1996). However, based on the changes of 2004 and 2005, the current regulations define shelters more clearly and delineate disclosures related to different types of opinions. Circular 230 now includes recommendations to advocate clear communication between tax adviser and client regarding the nature of the engagement, determine the reasonableness of facts before determining an appropriate conclusion, disclose potential penalties related to a position, and maintain integrity within practice (Tell, 2006). Incomplete advice requires specific disclosure. Circular 230 allows limited scope opinions where the tax service provider acknowledges assumptions in writing, so that the taxpayer is aware of the possibility of penalties or other sanctions.

Circular 230 requires tax preparers to use careful consideration when recommending a tax position for their clients. For proposed transactions with a less than 50% chance of being sustained under IRS examination, there are requirements for specific disclosure regarding compensation arrangements, the fact that the opinion is written to support a specific transaction, and the possibility of penalties. Low audit rates currently existing with the Internal Revenue Service may not be a factor in determining this probability. Thus tax practitioners must not sign returns if they determine that certain tax positions do not have a realistic possibility of being sustained on its merits if challenged. The term realistic possibility is defined as an approximately one-in-three or greater likelihood, a standard adopted from the American Bar Association (Kelliher et al., 2001).

Beginning in 2003, failure to disclose certain fee arrangements falls under the enforceable provisions of Circular 230. Compliance requires the filing of informational forms related to confidential contracts with restricted disclosure where the tax preparer receives at least $250,000 ($50,000 for individuals), arrangements where the taxpayer's fee is contingent on tax benefits from the transaction or subject to full or partial refund depending upon the outcome of the return, and losses exceeding certain thresholds (approximately $10 million for corporations and partnerships, or $2 million for individuals, S-corporations and trusts).

Criminal and civil penalties, including imprisonment, can be imposed for negligence, intentional disregard of rules, willful disobedience, or fraud. Failure to include required disclosures generally results in the assessment of the accuracy-related penalty. The IRS clearly intends to penalize tax preparers and taxpayers who fail to disclose certain fee arrangements as well as tax transactions that remotely resemble a tax shelter (Demmett, 2004). Circular 230 addresses written advice not only related to income tax, but also to insurance, estate and gift planning transactions that have the principal purpose of avoiding tax. Recent clarification by the IRS narrowed the definition of principal purpose to transactions in which tax avoidance or evasion exceeds any other purpose of a written plan, as opposed to tax benefits adhering to congressional intent.

Tax services firms must adhere to these standards diligently, including the understanding of listed transactions (readily known as abusive tax shelter issues), tax shelters, opinion types, and required disclosures. Violations potentially prohibit an entire tax department from practicing (Jones et al., 2005). The IRS Office of Professional Responsibility (OPR), created in January 2003 as part of the IRS Strategic Plan, enforces the tax professional's adherence to ethical and legal standards. From the time period 1999 – 2005, through the OPR and prior regulatory offices, 256 CPA's, 283 attorneys and 102 enrolled agents were either suspended, censured, disbarred, or voluntarily resigned due to disciplinary actions with the IRS. As seen by these statistics, IRS guidelines have a significant impact on the relationship of the taxpayer/tax preparer.

POTENTIAL EFFECTS ON TAXPAYER-TAX PREPARER RELATIONSHIP

The taxpayer-tax preparer relationship is exceedingly complex and various studies have examined this unique relationship. Taxpayers utilize professional tax preparers in order to minimize, to the extent possible, their tax liability through every legal method available, and to avoid penalty assessment (Raby and Raby, 2005b). Therefore, inherent in the client-tax preparer relationship is the government as the adversary, an unenviable position at best where adherence to ethical guidelines and federal regulations creates a challenging philosophical dilemma between tax compliance and client desires. Client demands create pressures on tax professionals as revealed by an accounting/marketing study that found 47% of accounting professionals considered their most difficult ethical issue to be client requests for aggressive tax positions (Finn et al., 1988).

Taxpayers want a tax preparer that will help them avoid taxes, but still do the right thing (Sakurai and Braithwaite, 2003). However, tax preparers respond to the pressure from their firm to comply with tax law more than the pressure from their clients to be aggressive (Cox and Radtke, 2000). It has been noted that the tax preparation fee charged was potentially higher if the taxpayer's income -- particularly unearned income -- was high (Mauldin et al., 2002). Studies show that taxpayers with a balance-due on their tax return are more risk-seeking than those who are in a refund situation at year-end, (Schmidt, 2001; Elffers and Hessing, 1997). Moreover, researchers found that client-taxpayers trust aggressive advice from CPA's more than from non-licensed practitioners. Further observations from these studies showed that if a paid preparer indicated uncertainty about the probability of the taxpayer being audited and receiving a penalty, the taxpayer estimated a much higher perceived audit rate than if the preparer was definitive in the expected penalty and audit probability. Under Circular 230, this desired tax preparer "certainty" will only be available at a much higher cost to the taxpayer, if available at all.

As noted by the Chair of the AICPA's Tax Executive Committee (Hoops, 2007), Circular 230 now "raises the tax return reporting standard for preparers above the standard for taxpayers ("substantial authority")" and "creates the potential for conflicts of interest between preparers and their clients." Consequently, the relationship shifts from the preparer being an "advocate" to being an "advisor" thereby limiting the taxpayer's right to have representation. In fact, further limitations are placed on the tax preparer's role as advisor due to Circular 230's restrictions on the types of communications allowed between the parties is seen by some as a violation of First Amendment rights (Brackney, 2005).

Furthermore, conflicts of interest arise when the tax preparer must choose between his or her personal concerns for avoiding penalties in the form of fines and/or sanctions by requiring full client disclosures, versus the client's desire to minimize disclosure (Hammer, 1996). This compliance through disclosures indicates to the taxpayer that advice cannot be relied upon, resulting in reduced client confidence (Lipton et al., 2005).

As a result, compliance with Circular 230 creates a costly and time-consuming burden on the tax preparers and their clients who do not engage in aggressive transactions, a presumably unintended consequence. This suggests the need for additional clarification regarding situations where the taxpayer receives penalty protection compared to situations where the tax practitioner is not providing clearly defined covered opinions.

POTENTIAL EFFECTS ON TAX PREPARER PRACTICE

The effects of Circular 230 on current practices will be varied. For example, most large firms, particularly international firms, are well-trained and prepared to adhere to the provisions, such as those that affect the firm's presentations, deliverables, etc. and will be especially sensitive in evaluating the type of opinion given by the firm. Moreover, client costs will increase as their clients seek appropriate and sufficient practitioner research to forestall the inclusion of language such as "clients may not rely on this opinion to protect them against penalties from the IRS." Conversely, many small firms and sole practitioners may not be aware of the new requirements and thus are exposed to the sanctions imposed by lack of compliance.

Ethical standards in Circular 230 provide more than general guidance. Probability calculations, the analysis of the legislative intent, consideration of sanctions and disciplinary proceedings, and use of written disclaimers extend beyond the typical tools used to direct the tax services provider in the issuance of tax opinions. The challenge of determining legislative intent of the ethics standard provisions has been termed "a futile endeavor" (Infanti, 2005). The concepts of professional judgment, realistic possibility, best practices, and good-faith belief contained in the standards are subject to risky interpretation. Legal terminology, principles and standards such as more-likely-than-not, substantial authority, economic-substance, sham-transaction doctrines, and even the required consideration of withdrawal from an engagement must be integrated into the practitioner's decision related to taking a tax position (Gardner et al., 2004a). US Tax courts recognize the subjectivity of the terminology in the law. Such language as "patently absurd," "legally unsound," "without legal merit," "false and fraudulent," "deceptive and indiscernible" are used by the courts to interpret the idea of realistic possibility and frivolous positions. Unfortunately, research has shown that reduced ambiguity (not more) is required to decrease aggressiveness in reporting (Cuccia et al., 1995). It is in these uncharted waters that the tax practitioner must now navigate.

Attorneys and CPAs frequently issue opinion letters indicating the validity of tax transactions for use in the event of IRS penalties for underpayment of tax. According to a past chairman of the ABA tax division, opinion letters on tax shelters must now address penalty avoidance and include an explanation for any penalties that appear possible. In the past, penalties for tax shelter opinion letters determined by the IRS to be abusive were only a fraction of potential fees to be earned – quite lucrative for the practitioner performing minimal work and charging large fees (Neil, 2004). Now however, Circular 230 requires tax service providers to heighten their professional judgment regarding the sustainability of tax transactions. Whether through statistical or nonstatistical determination, a conclusion must be made to quantify the purpose and viability of tax transactions, without regard for the likelihood of an audit. Complex approaches now require significant research. Determining the extent of research required to adhere to the standards requires an analysis of each tax position's facts and circumstances in addition to experience and professional judgment.

Written opinions have to consider all relevant facts of which the practitioner is aware, but the taxpayer may not want to pay for this extra work (Schippel, 2005). The tax savings that the taxpayer sought by using the professional tax preparer can be eroded by the higher tax preparation fees required to research all pertinent information. Furthermore, the practitioner may use one of the prescribed disclaimers which will likely be interpreted by the client as indicating that he cannot rely on the advice for which he is paying (Schippel, 2005). Given the stringency and complexity of Circular 230 requirements on written communications between taxpayer and tax preparer, it is not surprising that many practitioners have chosen to place a disclaimer on all written communications from their practices, even routine correspondence, advising clients that they will not be protected against penalties (Bailey and MacIvor 2006; Tell, 2006. Consequently, should the practitioner make an error, the taxpayer is still not protected from penalties. It has been suggested that the new regulations may result in driving "a wedge between tax professionals and their clients"

(Raby and Raby, 2005b). The Internal Revenue Service is now allowed to examine not just a taxpayer's position on a certain transaction, but also the tax practitioner's adherence to the requirements of Circular 230. Tax service providers must now fully disclose all potential penalties on tax positions, or include "readily apparent" disclaimers on all tax correspondence (Jones et al., 2005).

To be Circular 230-compliant and to provide an opinion that meets the criteria of the IRS guidelines without the disclaimer, the tax professional will have to prepare extensive and costly research (Simon, 2005). Most tax advice will not meet the rigorous requirements of such covered opinions. However, knowledgeable taxpayers may demand research results that omit the disclaimer in order to secure a more sustainable position. An increase in time-intensive and costly Private Letter Rulings may result. Thus it appears that the cost/benefit of a standard meant to target only a select group of tax advisors who advocate abusive tax shelters could potentially parallel the excessive costs associated with Sarbanes-Oxley compliance for those desiring a greater level of assurance on their tax advice. The requirement that tax preparers disclose incomplete advice creates an awkward situation for client relations. For example, the determination of reasonable possibility, in and of itself is, at best, an educated guess based upon the known facts and circumstances combined with the preparer's professional judgment. Complete advice regarding a tax issue to provide the necessary "guarantee" would price the cost of tax advice out of reach for all but the wealthiest taxpayers.

Lipton et al. (2005) expect that taxpayers using professional advice will adjust to the disclaimers and lack of protection from penalties. This means that taxpayers will now be responsible for ascertaining their susceptibility to litigation and will have to set up strategies to mitigate potential damages. Some would see this as consistent with what Hacker (2006) calls the Personal Responsibility Crusade in which the American culture has moved towards more individual responsibility with individuals being required to assume more of the risks involved in their financial dealings, as evidenced by the rise in 401(k) plans, privatized Social Security, Health Savings Plans, and the like.

It is important to note that compliance with Circular 230 provisions extends beyond the practitioner's written opinion to include educational materials, websites, textbooks, handouts and other written communications including promotional materials for small firms. Firms must have adequate procedures in place to ensure that employees adhere to the requirements required for compliance with the standards (Bailey and MacIvor, 2005). The importance of firm-wide compliance procedures is supported by Brien's (1998) research that found ethical failures can often be traced to organizational cultures.

Given that Circular 230 provides no guidance to the specific language of the disclaimer, Infanti (2005) has identified three likely practitioner approaches: 1) those who will attach a statement on all written correspondence saying that the advice cannot be relied upon for penalty protection, 2) those who will conclude that it does not affect the majority of clients in their practice, and do not attach the disclaimer to each piece of correspondence, and 3) those who have always been aggressive in their tax advice and therefore, although perhaps the intended recipient of Circular 230 constraints, will be aggressive in their interpretation that the new rules will not have an adverse effect on their current practice. Given these choices, taxpayer clients may want to re-evaluate their choice of tax preparers.

CONCLUSION AND FUTURE RESEARCH

Although famed Judge Learned Hand stated in 1934 that “There's nothing sinister in so arranging one's affairs as to keep taxes as low as possible”, questionable tax shelters created the need for Circular 230. Viable tax-savings strategies, specifically those arranged for an individual’s personal needs, will invariably cost more now due to the research required to avoid liability. The increased scrutiny of tax-avoidance strategies by the IRS should cause greater care for the taxpayer and tax provider regarding the adoption of aggressive tactics. Certain paper transactions, offshore trusts, life-insurance policies, retirement plans and nondisclosure agreements should raise a red flag for taxpayers seeking aggressive plans to reduce their tax bill, as these arrangements typically serve no true economic purpose other than tax avoidance (Silverman, 2005).

The AICPA has addressed their concerns to Congress related to the stringent regulations now required of what they consider to be “fairly routine tax advice.” They note the difficulty of interpreting new tax law when regulations are still forthcoming, or when unique facts and circumstances exist, and the threat of sanctions by the IRS creating a need for tax preparers to protect themselves through disclaimers due to the inherent uncertainty of many positions (Hoops, 2007).

The IRS desire to curb abusive tax avoidance transactions overrides the stated mission to improve ethical standards, reflect best practices, and maintain public confidence in tax professionals. Tax practitioners, as a result of these changes, must adjust to the added burden placed on their practice. Opinions must contain a greater level of confidence to ensure a more sustainable tax position. Additional tax preparer research will undoubtedly increase client fees. Disclaimers must accompany certain written communication. The increase in liability and potential litigation is inevitable. Taxpayer awareness, likewise, will play an important role in the enforcement of these guidelines and the likelihood of taxpayer requests for the omission of disclaimers. Similarly, practitioner familiarity with the professional standards will affect the application of these standards. The desired result will be stronger research on tax positions and potentially fewer aggressive practitioner opinions.

Additional research should be undertaken to understand the awareness of Circular 230 and the specific effects of the regulations on both tax preparer and taxpayer. A determination should be made of the level of taxpayer awareness of the regulations and their response to the new disclaimers used by the tax practitioners. Likewise, compliance with Circular 230 by small tax practices is currently unknown but presumed low and in need of investigation. Knowledge of awareness within these two groups could potentially modify the Internal Revenue Service's approach to enforcement. A study of tax preparer and taxpayer interpretation of subjective terminology such as "substantial authority," "substantially similar," "reasonable basis," "realistic probability," etc. would allow a better understanding of consistent application of Circular 230's requirements. An investigation into whether or not practitioners have been able to pass on the full cost of the added time required to review all mandatory considerations, based on firm size and average client income base, would reveal where the heaviest burden of this ruling lies. Current evidence of the ethical pressures on tax advisors might provide a basis for determination of the current environment of the tax professional given the added pressures imposed by Sarbanes-Oxley. Similarly, an update of the research of Finn, et.al. (1988) would provide evidence of the effects of pressure within the accounting profession as a whole, thus allowing a more clear understanding of the debate between taxpayer aggressiveness and tax preparer desires for increased fees.

Providing tax services was complicated prior to Circular 230. The added requirement of determining probabilities and adding opinion disclaimers only adds to the challenges of the client/tax preparer relationship. Yet establishing ethical guidelines to clarify a practitioner's judgment, responsibilities and obligations should provide a value-adding element that will offer many benefits to both users and providers of professional tax services.

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RECENT UNITED STATES SUPREME COURT DECISIONS AND HUMAN RESOURCE MANAGEMENT DECISION MAKING: THE 2007/2008 TERM

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ABSTRACT

Former Supreme Court Justice, Lewis Powell described the federal judiciary and the United States Supreme Court as perhaps "the most important instrument for social, economic, and political change" (Lazarus, 2008). Recent terms of the Supreme Court have produced a number of important decisions impacting decision making with respect to an organization's human resources. For example, in the 2007/2008 term, the Court issued important decisions involving age discrimination and retaliation. These decisions have been characterized as expanding an employer's burden of proof in responding to allegations and potentially increasing the cost to defend themselves in responding to allegations of discrimination (Smith, 2008-B & AHI's Employment Law Today, 2008). The purpose of this paper is to examine the Court's decisions in these two areas and to present policy and practice suggestions for organizations to reduce their exposure to litigation and cost in the future.

INTRODUCTION

Former Supreme Court Justice, Lewis Powell described the federal judiciary and the United States Supreme Court as perhaps "the most important instrument for social, economic, and political change" (Lazarus, 2008). The Constitutional origin of the Court is in Article III, §1, of the U.S. Constitution and provides that "the judicial Power of the United States, shall be vested in one Supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish" (A Brief Overview of the Supreme Court, 2008). The jurisdiction of the Court, Article III §2 of the U.S. Constitution, extends "to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority" (A Brief Overview of the Supreme Court, 2008). The term of the Court begins on the first Monday in October and runs until the first Monday in October of the following year. In recent years, the caseload of the Court has increased dramatically. While there were only 1,460 cases on the docket in the 1945 term, and 2,313 in 1960, recently there has been more than 10,000 cases on the docket per term (A Brief Overview of the Supreme Court, 2008). The court will only grant plenary review with oral arguments in approximately 100 cases per term with formal written opinions being delivered in 80 to 90 cases (A Brief Overview of the Supreme Court, 2008). In the 2007/2008 term, the court heard oral arguments for 70 cases and returned opinions in 69 of those cases (Ross, 2008).

In the 2007/2008 term, the Court issued important decisions involving age discrimination and retaliation. These decisions have been characterized as expanding employers' burden of proof in responding to allegations and potentially increasing the cost to defend themselves in responding to allegations of discrimination (Smith, 2008-B & AHI's Employment Law Today, 2008). The purpose of this paper is to examine the Court's decisions in these two areas and to present policy and practice suggestions for organizations to reduce their exposure to litigation and cost in the future.

BACKGROUND

In recent years, with respect to human resource decision making, the Court has been called on to rule on a number of important issues. Some of those rulings have been viewed as pro-employer and others as pro-employee. From the 2007/2008 term, eleven cases with human resource decision making issues were identified (see Exhibit 1). In those cases, the Court ruled in favor of employees seven times and employers/business four times (Ross, 2008).

Exhibit 1 2007/2008 U.S. Supreme Court Decisions with Human Resource Decision Making Implications

Case	Decided	Statute	Outcome
U.S. Chamber of Commerce v. Brown	6/19/08	NLRA	Pro Employer
Meacham v. Knolls Atomic Power Lab.	6/19/08	ADEA	Pro Employee
Kentucky Retirement Systems v. EEOC	6/19/08	ADEA	Pro Employer
Met Life Insurance v. Glenn	6/19/08	ERISA	Pro Employee
Allison Engine v. United States	6/09/08	False Claims	Pro Employee
Engquist v. Oregon Dept. of Agriculture	6/09/08	Constitution	Pro Employer
CBOCS West, Inc. v. Humphries	5/27/08	1866/Title VII	Pro Employee
Gomez-Perez v. Potter	5/27/08	ADEA	Pro Employee
Federal Express v. Holowecki et al.	2/27/08	ADEA	Pro Employee
Sprint/United Management Co. v. Mendelsohn	2/26/08	Technical	Pro Employer
LaRue v. DeWolff	2/20/08	ERISA	Pro Employee

Exhibit 1 2007/2008 U.S. Supreme Court Decisions with Human Resource Decision Making Implications
(Source: Ross, 2008) (NLRA - National Labor Relations Act; ADEA - Age Discrimination in Employment Act; ERISA - Employee Retirement Income Security Act; Constitution - Equal Protection Clause of the U.S. Constitution; False Claims - False Claims Act; 1866 - 1866 Civil Rights Act; Title VII - Title VII of the 1964 Civil Rights Act; Technical - Technical ruling by the court on Federal Rules of Evidence 401 & 403)

With respect to the purpose of this study, four cases will be examined. Three cases deal with age discrimination under the Age Discrimination in Employment Act (ADEA), Meacham v. Knolls Atomic Power Lab, and Federal Express v. Holowecki et al., are most relevant. The Gomez-Perez v. Potter case also involved the ADEA, but the key issue in the case was whether discrimination based on age includes retaliation under the ADEA. The CBOCS West, Inc. v. Humphries decision addressed the application of the 1866 Civil Rights Act in retaliation cases.

THE RETALIATION ISSUE

The Supreme Court first broadened the retaliation issue in 2006 in its Burlington Northern & Santa Fe Railway Co. v. White decision. In that case the Court ruled that employees could have a valid retaliation claim even if they did not experience an economic loss or suffer an ultimate employment decision, such as termination or demotion (Burlington Northern & Santa Fe Railway v. White, 2006). "The U.S. Supreme Court opened the door to retaliation claims wider on May 27, 2008" (Smith, 2008-A). Even before the 2008 Court decisions, complaints filed with the Equal Employment Opportunity Commission (EEOC) alleging retaliation have been on the rise. The EEOC saw the number of retaliation claims filed with the agency jump from 22,555 in 2006 to 26,663 in 2007 (EEOC, 2008). The overall number of charge filings with the EEOC increased to 82,792 in 2007 from 75,768 in 2006 (EEOC, 2008). If the observations by Smith and others are accurate, employers can expect even more claims in the future. Exhibit 2 contains the most recent retaliation charge statistics compiled by the EEOC.

Exhibit 2 – Retaliation charges as a Percentage of All Charges filed with the EEOC Fiscal Years 1997 – 2007, and Actual Number of Retaliation Charges.

1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
22.6	24.0	25.4	27.1	27.5	27.0	27.9	28.6	29.5	29.8	32.3%
18,198	19,114	19,694	21,613	22,257	22,768	22,690	22,740	22,278	22,555	26,663

Source: EEOC, 2008 Equal Employment Opportunity Commission, Charge Statistics

EEOC regulations note that there are three main terms that are used to describe retaliation and that "Retaliation occurs when an employer, employment agency, or labor organization takes an adverse action against a covered individual because he or she engaged in a protected activity" (EEOC, 2008-A).

The EEOC defines adverse action as an action taken to try to keep someone from opposing a discriminatory practice, or from participating in an employment discrimination proceeding. Examples include:

> *Termination, refusal to hire, and denial of promotion, Threats, unjustified negative evaluations, unjustified negative references, or increased surveillance, and Any other action such as an assault or unfounded civil or criminal charges that are likely to deter reasonable people from pursuing their rights*
>
> *(EEOC, 2008-A).*

RECENT RETALIATION CASES

The question before the Court in the Gomez-Perez v. Potter case was "whether a federal employee who is a victim of retaliation due to the filing of a complaint of age discrimination may assert a claim under the federal-sector provision of the ADEA" (Gomez-Perez v. Potter, 2008). Gomez-Perez was a 45 year old window distribution clerk for the United States Postal Service who filed an age discrimination complaint against the Postal Service. She alleged that she suffered numerous forms of retaliation as a result of filing the complaint, including "groundless complaints leveled at her, that her name was written on unit sexual harassment posters, that she was falsely accused of sexual harassment, that her co-workers told her to go back to where she belonged, and that her work hours were drastically reduced" (Gomez-Perez v. Potter, 2008). The District Court that initially ruled on Gomez-Perez's law suit granted summary judgment in favor of the Postal Service and the First Circuit Court of Appeals up-held that decision (Gomez-Perez v. Potter, 2008). The Postal Service argued that the United States had not waived sovereign immunity for ADEA retaliation claims and the ADEA federal-sector provision does not reach retaliation. A majority of the Supreme Court disagreed and held that the ADEA does prohibit retaliation against a federal employee who complains of age discrimination, and remanded the case for further proceedings consistent with the opinion (Gomez-Perez v. Potter, 2008). While this decision will expand the number of individuals who may bring retaliation claims under the ADEA, the impact of the CBOCS West Inc. v. Humphries decision will effect even more employers (Smith-A, 2008).

The question before the Court in the CBOCS West Inc. v. Humphries case was whether 42 U.S.C. § 1981 (the Civil Rights Act of 1866) "encompasses a complaint of retaliation against a person who has complained about a violation of another person's contract-related rights" (CBOCS West Inc. v. Humphries, 2008). Hedrick G. Humphries was an assistant manager of a Cracker

Barrel restaurant owned by CBOCS West, Inc. Humphries alleged that he was dismissed "(1) because of racial bias (Humphries is a black man) and (2) because he had complained to managers that a fellow assistant manager had dismissed another black employee, Venus Green, for race-based reasons" (CBOCS West Inc. v. Humphries, 2008). Humphries initial complaint alleged that CBOCS had violated both Title VII of the 1964 Civil Rights Act and § 1981 of the 1866 Civil Rights Act. The District Court dismissed his Title VII claims "for failure to pay necessary filing fees on a timely basis" and granted CBOCS request for summary judgment on the § 1981 claims (CBOCS West Inc. v. Humphries, 2008). Humphries appealed to the Seventh Circuit Court of Appeals, and while they upheld the District Court's decision with respect to the Title VII claim they upheld Humphries § 1981 claim and remanded it for trial (CBOCS West Inc. v. Humphries, 2008). CBOCS appealed to the Supreme Court to consider the issue. A majority of the Supreme Court agreed with the Seventh Circuit ruling, thus sending this case back for further consideration (CBOCS West Inc. v. Humphries, 2008).

IMPLICATIONS OF THE RETALIATION DECISIONS FOR EMPLOYERS

The most significant implication for employers associated with these two Court decisions is the broadening of employees' rights to file retaliation claims "under two laws that do not expressly state this right" (AHI's Employment Law Today, 2008). The CBOCS West Inc. decision is especially significant, because it now extends § 1981 of the Civil Rights Act of 1866 to include retaliation claims. "Section 1981 of the Civil Rights Act of 1866 ... is a post-Civil War statute that gives "[a]ll persons...the same...right...to make and enforce contracts...as is enjoyed by white persons" (AHI's Employment Law Today, 2008, CBOCS West Inc. v. Humphries). The CBOCS West Inc. decision will extend § 1981 protection from retaliation "to all private employers, even those that do not have the 15 employees needed to be covered by Title VII" (Smith-A, 2008). Additionally, under Title VII, individuals have 180 days (300 days in states that have "work sharing agreements" with the Equal Employment Opportunity Commission (EEOC)) to file complaints with the EEOC and 90 days to file a lawsuit once the EEOC has issued a right-to-sue letter (EEOC, 2008-B). Under § 1981, a four-year statute of limitations applies (Smith-A, 2008). Smith asserts that these differences may make it more difficult for employers to defend against retaliation claims under § 1981 "if key witnesses have departed" and, quoting Florida attorney Allan Weitzman, "will result in more old retaliation claims" (Smith-A, 2008). AHI's Employment Law Today notes even "more bad news for employers: Section 1981, unlike Title VII, does not place a cap on damages"(AHI's Employment Law Today, 2008).

AGE DISCRIMINATION ISSUE

Attention to age discrimination has received significant attention in recent years, and the EEOC saw the number of age discrimination claims filed with the agency jump from 16,548 in 2006 to 19,103 in 2007 (EEOC, 2008). While the increase in age discrimination allegations has drawn attention, some believe that the number of age discrimination cases relative to those in the workforce who are age 40 and older is relatively small. “In 2007, according to the U.S. Bureau of Labor Statistics (BLS), 76.9 million people in the workforce were age 40 and older. Last year, 99.98 percent of them did not complain to the EEOC about discrimination” (Grossman, 2008, 64). Exhibit 3 contains the most recent age discrimination charge statistics compiled by the EEOC.

Exhibit 3 – ADEA Charges as a Percentage of All Charges Filed with the EEOC Fiscal Years 1997- 2007 and Actual Number of ADEA Charges Filed.

1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
19.6	19.1	18.3	20.0	21.5	23.6	23.5	23.6	22.5	21.8	23.2%
15,785	15,191	14,141	16,008	17,405	19,921	19,124	17,837	16,585	16,548	19,103

Source: EEOC, 2008 Equal Employment Opportunity Commission, Charge Statistics

As a result of Federal Express v. Holowecki and Meacham v. Knolls Atomic Power Laboratory Supreme Court decisions, it has been reported employers can expect "more litigation" under the ADEA, and that claims under the ADEA will be "harder and costlier for employers to defend"(Hofmann, 2008, Smith-B, 2008, & Morris, 2008).

RECENT AGE DISCRIMINATION CASES

In Federal Express v. Holowecki, the central question before the Court was the "timeliness of the suit filed by one of the plaintiffs" and a "requirement in the ADEA that an employee file a charge of discrimination with the EEOC before pursuing a case in federal court (Federal Express v. Holowecki, 2008). Those requirements are "intended to give the EEOC a chance to notify the company, investigate the claim and seek conciliation between the employer and employee before lawyers and judges become involved"(Barnes, 2007). The plaintiffs in this case, 14 current and former FedEx couriers over the age of 40, alleged that two programs initiated by the company to make the "courier network more productive", were "veiled attempts to force older workers out of the company before they would be entitled to receive retirement benefits" (Federal Express v. Holowecki, 2008). One of the plaintiffs had filed EEOC Form 283, an Intake Questionnaire on December 11, 2001. The plaintiffs then filed their law suit on April 30, 2002. Federal Express moved to dismiss the suit, "contending respondent had not filed her charge with the EEOC at least

60 days before filing suit, as required by 29 U.S.C § 626(d)" (Federal Express v. Holowecki, 2008). The District Court granted Federal Express's motion but the Second Circuit Court of Appeals reversed (Federal Express v. Holowecki, 2008). Federal Express contended that because the EEOC did not act on the Form 283 filing, the lawsuit should be precluded (Hofmann, 2008). The Court rejected Federal Express's argument in a 7-2 decision. Critics of the decision, included Associate Justices Scalia and Thomas who wrote that in the decision, "the majority had decided that a charge of age discrimination under the ADEA is whatever the EEOC says it is" (Hofmann, 2008). Justice Scalia, and the justices were described as "unsparing in their criticism" of the EEOC and "the role it played in the tangled legal issues the court was picking through in the case"(Hofmann, 2008). Another critic of the decision noted that "if your an employer, it eliminates some of the procedural defenses that previously existed when employees did not jump through the correct hoops to access the EEOC's machinery"(Hofmann, 2008).

In Meacham v. Knolls Atomic Power Laboratory, the question before the Court was "whether an employer facing a disparate-impact claim and planning to defend on the basis of a Reasonable Factor Other than Age (ROFA) must not only produce evidence raising the defense, but also persuade the fact finder of its merit"(Meacham v. Knolls Atomic Power Laboratory, 2008). The plaintiffs in this case were twenty-eight former salaried employees of Knolls Atomic Power Laboratory. They were part of a group of 31 employees laid off in a reduction in force (RIF), "30 who were at least 40 years old"(Meacham v. Knolls Atomic Power Laboratory, 2008). The plaintiffs alleged that Knolls had "designed and implemented its workforce reduction process to eliminate older employees and that, regardless of intent, the process had a discriminatory impact on ADEA protected employees"(Meacham v. Knolls Atomic Power Laboratory, 2008). Responding to a change in demand for its products, Knolls was ordered to reduce its work force. After a number of employees had accepted the Knoll's buyout offer, they still had 31 jobs to cut. Knolls instructed its managers to select employees for layoff based on three scales, "performance", "flexibility", and "critical skills"(Meacham v. Knolls Atomic Power Laboratory, 2008). The employee "scores were summed along with points for years of service, and the totals determined who should be let go"(Meacham v. Knolls Atomic Power Laboratory, 2008).

The RFOA exemption under the ADEA creates exemptions for employer practices "otherwise prohibited under" the ADEA. The RFOA exemption is in § 623(f) of the statute and states "it shall not be unlawful for an employer...to take any action otherwise prohibited under subsections (a), (b), (c), or (e)...where age is a bona fide occupational qualification reasonably necessary to the normal operation of the particular business, or where the differentiation is based on reasonable factors other than age...."(Meacham v. Knolls Atomic Power Laboratory, 2008). At the District Court level, the jury found for Meacham on the disparate-impact claim. The Second Circuit Court of Appeals, while initially affirming the District Court decision, eventually ruled in Knolls favor and determined that Meacham "had not carried the burden of persuasion"(Meacham v. Knolls Atomic Power Laboratory, 2008). The Supreme Court, responded to a conflicting decision issued by the Ninth Circuit Court of Appeals, granting certiorari. The Supreme Court concluded that "the burden was improperly placed on the employees to show that the employer's criteria were unreasonable, since RFOA was an affirmative defense for which the employer bore both the burden of production and the burden of persuasion"(Meacham v. Knolls Atomic Power Laboratory, 2008). Further, the Court noted that "while employees were required to identify the challenged layoff factors, the employer that sought to benefit from the RFOA exemption was required to prove that the exemption applied"(Meacham v. Knolls Atomic Power Laboratory, 2008). The Court noted that the burden being placed on employers might "encourage strike suits or nudge plaintiffs with marginal cases into court" but, "such concerns have to be directed at Congress, which set the balance by both creating the RFOA exemption and writing it in the orthodox format of an affirmative defense"(Meacham v. Knolls Atomic Power Laboratory, 2008).

IMPLICATIONS OF AGE DISCRIMINATION DECISIONS FOR EMPLOYERS

For employers, the primary implication of the Federal Express v. Holowecki decision is that it may "eliminate some of the procedural defenses" that employers had available (Hofmann, 2008). The EEOC reported that "as the Court noted, the EEOC has taken steps to ensure timely notification to respondents of receipt of intake questionnaires or other correspondence that constitute charges" and, that they "will continue to review our procedures as the Court has suggested to ensure that they are clear to the public and consistent with our statutes and regulations" (Hofmann, 2008). Employers and their legal representatives must stay abreast of EEOC pronouncements and changes in regulations in light of this ruling. While the key question in this case focused on the timeliness of the suit, in light of the Meacham v. Knolls Atomic Power Laboratory decision, employers must be sure to check for adverse impact on older workers and employ procedures and criteria that will be perceived as reasonable. While that may be a tall and costly order for employers, the jury in the Meacham v. Knolls Atomic Power Laboratory case awarded the plaintiffs damages and attorney fees of more than $6 million (Meacham v. Knolls Atomic Power Laboratory, 2002). In developing RIF criteria, objectivity is a key element. Employers must "take a more critical look at their factors for reduction in force" and "that the more subjective the factors, the more they might be subject to challenge" (Smith-B, 2008).

POLICY AND PRACTICE SUGGESTIONS FOR EMPLOYERS

With respect to the retaliation issue, in light of the "broad stance on employment retaliation" taken by the Court, AHI's Employment Law Today provides an excellent list of suggestions for employers to follow "after an employee has filed a discrimination, harassment, or safety complaint in order to protect the company from the additional threat of a retaliation charge":

Avoid knee-jerk reactions. An aggressive reaction to a complaint could be seen as retaliatory in nature. Treat complaints as an opportunity to correct mistakes and avoid liability, and not to automatically consider the employee as a troublemaker.

Prevent further incidents of mistreatment. You must be even handed when separating employees who are at odds. Be careful not to penalize the complainant.

Implement your organization's system for receiving and investigating complaints.

Keep the investigation focused on the complaint, and avoid getting sidetracked by the complainant's performance. Even if your investigation reveals shortcomings in the employee's performance, keep the investigation centered on the allegations at hand.

Deal with the performance problems separately.

Orally review the entire complaint and your organization's retaliation policies with employees and subordinates when a complaint is filed, when an investigation is concluded, and as often as needed in between.

Don't punish an employee who files an unfounded complaint or grievance. Remember that even if an employee's complaint is groundless, if it was filed in good faith, he/she could still be protected against retaliation

(AHI's Employment Law today, 2008).

Joel Rice, prominent Chicago attorney adds, that "the added exposure to retaliation claims means that employers should take preventative steps" and that "any kind of complaint, external or internal, that could be construed as protected raises a huge red flag for employers"(Smith-B, 2008). In light of the Court's CBOCS West Inc. v. Humphries decision, employers "have to be even more certain that they can show that an adverse employment decision is well-founded" (Smith-B, 2008).

A number of the legal and professional "experts" since Burlington Northern have been busy advising employers what they should be doing, and in many respects it looks like more of the same. For example, instead of your policy simply stating discrimination and harassment will not be tolerated in your organization, the new policy suggestions is to make sure you "make it crystal clear that workplace retaliation will (also) not be tolerated" (Janove, 2006). Michael Patrick O'Brien a prominent Salt Lake City, Utah attorney recommends that your policy should include the following:

A clear statement that, like discrimination and harassment, retaliation is prohibited by both law and company policy, and that retaliatory acts will lead to discipline and/or discharge.

A brief illustration of types of conduct that might be prohibited by the policy.

A mechanism for reporting possible acts of retaliation.

A statement that complaints will be promptly investigated and resolved as appropriate

A statement that complaints will be maintained as confidential to the extent practicable, given the need to investigate and resolve issues

(Janove, 2006, 66).

Mary Jo O'Neill, regional attorney with the EEOC's Phoenix District Office recommends that employers provide "specific training on the subject of retaliation, including using the Burlington Northern (case) to explain what can constitute retaliation" (Janove, 2006, 67).

With respect to the age discrimination issue, with the current state of the American economy pushing more firms to tighten expenses, more employers have been looking to reduce their largest cost, people, by relying on reductions in force. Adrienne Fox sited two reports that support this trend. In a report from outplacement firm Challenger, Gray and Christmas in Chicago, found January 2008 layoffs rising 69 percent from December 2007(Fox, 2008). In another survey by Career Protection's Annual 2008 Layoffs Forecast, a 37 percent increase in layoffs for 2008 compared to 2007 was predicted (Fox, 2008).

As a result of the Court's age discrimination decisions, employers should put more resources into developing and implementing RIFs. A number of proactive options are available to employers to not only reduce their exposure to litigation when utilizing RIFs, but options that can also facilitate employers ability to retain their most talented and productive employees, employees who are critical when organizations are dealing with difficult times. Kirk Nemer, president and chief executive officer of Denver-based Career Protection, advises HR professionals that may decide to employ RIFs to utilize a "performance system and reviews to determine who can be let go"(Fox, 2008). Nemer adds that to do this, HR professionals must

Make sure appraisals are up-to-date.
Identify top performers and get them working on the company's future.
Have leaders committed to the company's turnaround

(Fox, 2008, 68).

Matt Angello of Bright Tree Consulting Group adds, "Organizations do themselves a disservice when they don't have a rigorous performance management system that supports HR decisions, particularly around layoffs"(Fox, 2008, 68).

Other legal issues that can arise when employers utilize RIFs include compliance with the Worker Adjustment and Retraining Notification (WARN) Act, the Older Workers Benefit Protection Act (OWBPA), and COBRA regulations. The WARN Act requires employers with at least 100 employees to provide 60 days notice before a plant closing or mass layoff. Under the WARN Act, a plant closing occurs when a single employment site or one or more facilities within a single site institute a layoff of 50 or more employees during a 30-day period. A mass layoff is defined as a reduction of at least 50 employees comprising at least 33 percent of the workforce or a layoff involving at least 500 employees. Employees entitled to advance notice under WARN include managers and supervisors as well as hourly and salaried workers. Failure to comply with the WARN Act can make employers liable to each employee for back pay, benefits, and attorney's fees (U.S. Department of Labor, 2008)

OWBPA regulations cover the use of releases and waivers of employees' right to sue. An employer may ask an employee to waive his/her rights or claims under the ADEA either in the settlement of an ADEA administrative or court claim or in connection with an exit incentive program or other employment termination program. However, the ADEA, as amended by OWBPA, sets out specific minimum standards that must be met in order for a waiver to be considered knowing and voluntary and, therefore, valid. Among other requirements, a valid ADEA waiver must:

Be in writing and be understandable;
Specifically refer to ADEA rights or claims;
Not waive rights or claims that may arise in the future;
Be in exchange for valuable consideration;
Advise the individual in writing to consult an attorney before signing the waiver; and
Provide the individual at least 21 days to consider the agreement and at least seven days to revoke the agreement after signing it

(EEOC, 2008-C).

The 21 day period to consider the agreement must be extended to 45 days if offered in a reduction in force (RIF) and the employer must "inform as to the eligibility as to class, unit, and time limits and the job titles and ages of all individuals eligible or selected for the program and the job titles and ages of those not selected for the program § 626(f) (1) (H)" (Peterson v. Seagate US LLC, 2008).

Employers and their legal counsel should be advised that courts hold employers to "strict compliance" with respect to OWBPA requirements. In Peterson v. Seagate US LLC, in invalidating the waivers employees had signed, the court noted that Seagate did not properly disclose the job titles and ages of all employees terminated in the RIF. The plaintiffs were able to identify two employees that were terminated from Seagate's Normandale facility, who could not identify themselves on the chart provided. Plaintiffs went on to "note that it remains unclear how many employees were terminated from the Normandale facility pursuant to the 2004 RIF. Initially, it was reported that 154 employees were terminated. In response to an EEOC inquiry, however, the number changed to 152" (Peterson v. Seagate US LLC, 2008). The Supreme Court has interpreted OWBPA as providing for a "strict, unqualified statutory stricture on waivers" and found that it incorporates no exceptions or qualifications (Peterson v. Seagate US LLC, 2008 citing Oubre v. Entergy Operations, Inc., 1998). "Thus, to comply with OWBPA, a waiver must comply with each prerequisite" (Peterson v. Seagate US LLC, 2008).

The Consolidated Omnibus Budget Reconciliation Act (COBRA) gives workers and their families who lose their health benefits the right to choose to continue group health benefits provided by their group health plan for limited periods of time under certain circumstances such as voluntary or involuntary job loss, reduction in the hours worked, transition between jobs, death, divorce, and other life events. Qualified individuals may be required to pay the entire premium for coverage up to 102 percent of the cost to the plan. COBRA generally requires that group health plans sponsored by employers with 20 or more employees in the prior year offer employees and their families the opportunity for a temporary extension of health coverage (called continuation coverage) in certain instances where coverage under the plan would otherwise end (U.S. Department of Labor, 2008-A).

One final bit of traditional advice for reducing a firm's exposure to litigation during a reduction in force involves the offering of terminated employees some assistance to reduce the negative effects of the RIF. Typical assistance suggested includes employment counseling, relocation assistance, resume preparation, and outplacement assistance (Collyer, 2008). There is support for these types of programs in the literature, and "some studies indicate that employees who receive these services are less likely to initiate litigation against their former employers"(Collyer, 2008).

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CRITIQUE OF A PREMISE: ILLUMINATING CRACKS IN THE AGENCY THEORY FRAMEWORK

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ABSTRACT

Agency theory has contributed much in explaining relationships between principals and agents. However, it is based on certain premises as its foundation. This paper offers a critiques of one such premise; namely, the information as a commodity premise. This premise is critiqued by considering (1) the tacit information literature and (2) logical inconsistencies of the assumption when outcome uncertainty is present in the agency relationship. This research considers the contingent validity and robustness of agency theory in situations in which the information as a commodity premise is violated.

INTRODUCTION

Suppose a great commotion arises in the street...about a lamp-post, which many influential persons desire to pull down. A grey-clad monk, who is the spirit of the Middle Ages, is approached upon the matter, and begins to say, in the arid manner of the Schoolmen, "Let us first of all consider, my brethren, the value of Light. If Light be good in itself—" At this point he is somewhat excusably knocked down. All the people make a rush for the lamp-post, the lamp-post is down in ten minutes, and they go about congratulating each other on their nonmedieval practicality. But as things go on they do not work out so easily. Some people have pulled the lamp-post down because they wanted the electric light; some because they wanted old iron; some because they wanted darkness...Some thought it not enough of a lamp-post, some too much; some acted because they wanted to smash municipal machinery; some because they wanted to smash something. And there is war in the night, no man knowing whom he strikes. So, gradually and inevitably, to-day, tomorrow, or the next day, there comes back the conviction that the monk was right after all, and that all depends on what is the philosophy of Light. Only what we might have discussed under the gas-lamp, we now must discuss in the dark.

G.K. Chesterton, 1909, in Heretics

Premises are needed to advance theory. They serve the valuable role of allowing researchers to test hypotheses and develop new theory, expanding the scope of our understanding. But a danger lurks when we too hastily accept premises. When theory becomes embedded in the scholarly literature, its premises often become widely accepted. We can fail to recognize situations where a theory's robustness may be compromised leading to inaccurate application. On the other hand, caution should be used when challenging the premise base of a theory that has stood the test of time. The people in the street failed to ask the obvious question: What will we gain by destroying the lamppost? The old monk may not have had the answer, but he certainly asked the right question. This research intends to keep this question in mind as it challenges one of agency theory's underlying premises.

Agency theory is built on several premises that will be outlined in a subsequent section. The agency focus is on the dyadic relationship between a principal and an agent and contributes much toward developing an understanding of these key relationships. However, if certain premises are not accurate, agency theory should be considered in light of this. The premise that will be challenged in this paper is that all information relevant to the agency relationship may be known and purchased—the information as a commodity assumption (Worsham, Eisner and Ringquist, 1997). It may be helpful at the outset to provide the basic arguments that will be presented. One, when tacit information is required to meet the information as a commodity premise and when that information cannot be purchased at any price, the validity of the premise is in question. The inability to purchase the relevant tacit information occurs when (1) suitable proxies for the tacit information cannot be found or (2) when the source of the tacit information is unable to adequately express the information in a way that is measurable. Two, logical inconsistencies exist when outcomes of the agency relationship are uncertain. If relevant information can be purchased, then outcomes need not remain uncertain. These arguments will be developed in the following sections.

This research is divided into five sections. First, it states the problem in terms of adverse selection, moral hazard, and the information as a commodity premise. Second is an overview of agency theory, focusing on the fundamental premise of information as a commodity. Third, tacit information research is offered to contest the information as a commodity premise. Fourth, arguments are developed to defend the view that the information as a commodity premise is valid only under certain circumstances. Fifth, the logical inconsistency between outcome uncertainty and the information as a commodity premise is addressed. Last, a summary of the basic tenets of the paper and theoretical implications are considered and future research directions are recommended.

THE PROBLEM

Agency theory offers potential solutions to the problems of adverse selection and moral hazard. Adverse selection exists when agents misrepresent themselves regarding their ability to perform agency contract specifications and the principal grants the contract to the agent based on the erroneous information (Mishra, Heide, and Cort, 1998). Moral hazard occurs when a competent agent is obtained, but then does not perform as agreed upon in the agency contract (Holmstrom, 1979). In both cases, the agent fails to achieve the goals of the principal. The principal-agent dyad assumes that adverse selection can be controlled if the principal has all available information. This ex-ante perspective, in its most basic form, balances the costs of obtaining information with the risks associated with failure to obtain the information.

The moral hazard problem can be controlled ex post through either behavioral or outcome-based contracts between the principal and the agent. Behavioral contracts are designed to control the activities of the agent. By monitoring agent behavior, the principal has assurance that the agent is performing the activities specified by the agent-principal contract. Conversely, outcome-based contracts measure specific results and attempt to align the goals of the agent with those of the principal rather than monitor specific behaviors (Eisenhardt, 1989). Details of the adverse selection and moral hazard problems will be addressed more fully in a later section.

The concerns of both adverse selection and moral hazard can be attenuated if the right information is available, and agency theory presumes that the right information is, in fact, available. The problem of adverse selection and moral hazard that agency theory attempts to resolve is that costs can exceed benefits. Ex-ante costs associated with preventing adverse selection and ex-post costs of designing a contract that allows for adequate monitoring of behavior or measurement of outcomes may exceed the benefits. The solution, however, depends on the validity of the information as a commodity premise. If all information is available for a price, then the issue becomes simply whether the benefit of acquiring information exceeds the potential costs of making a mistake. If, however, the needed information is not available at any price, then the efforts of principals to obtain such information may be in vain. Attempting to obtain that which is unobtainable is a poor utilization of resources. Further, if the required information is unobtainable, then the cost-benefit decision becomes a mute point.

Under certain conditions, this is precisely the case. There are principal-agent relationships in which it is not possible to obtain the information needed to prevent adverse selection nor to design a contract that will prohibit problems linked to moral hazard. Evidence drawn from the tacit information literature will be used to demonstrate the contingent value and robustness of agency theory when the information as a commodity presumption is violated.

In addition, outcome uncertainty is a characteristic of a number of agency relationships and is related to whether an agency contract focuses on outcomes or agent behaviors (e.g., Eisenhardt, 1989). However, inherent in outcome uncertainty is the lack of information concerning the potential results of the agency relationship. This is logically inconsistent with the information as a commodity premise. Arguments concerning this inconsistency will be presented in a later section.

AGENCY THEORY

Agency theory has enriched our understanding of transactions specific to the agency problem—the differences in goals and incentives of principals and agents and the risk preferences of these parties. In its most elemental sense, the agency problem deals with how principals arrange optimal contracts for agents' services (Eisenhardt, 1989). Agency theory may be generally defined as a relationship that "is present whenever one party (the principal) depends on another party (the agent) to undertake some action on the principal's behalf" (Bergen, Dutta, and Walker, Jr., 1992).

Empirical support for agency theory has been demonstrated in numerous settings. For example, Eisenhardt's (1988) studies of retail stores show support for agency theory in salaried and commissioned salespeople. Acquisitions and divestitures were the focus of a study by Argawal and Mandelker (1987). Conlon and Parks (1990) examined performance-contingent compensation as the dependent variable and found support for agency theory. Support has been found in interorganizational joint ventures (Balakrishnan and Koza, 1993) and franchising (e.g., Agrawal and Lal, 1995). Although not an exhaustive review, this brief list gives adequate evidence that agency theory has been empirically tested and supported in a variety of contexts from retail sales to manufacturing to joint ventures. Given this body of evidence, it would be naïve to claim that agency theory has not made a contribution to the principal-agent literature. Indeed, it has made a significant contribution. Thus, it is not my intent to discredit agency theory. However, a rational course is to separate the premises and examine them in a new light.

A primary value of agency theory is that it has expanded several well-founded predecessor theories that further our awareness of the problems encountered when individuals seek divergent goals with different attitudes toward risk. Specifically, it has expanded contingency theory, various economic theories (e.g., Ross, 1973) including transaction cost analysis (e.g., Willliamson, 1975) as well as organizational control theories (e.g., Ouchi, 1979). Clearly, each of these have premises on which are based the propositions upholding them. Agency theory is no different; it too rests upon premises.

Yet for a theory to be robust, certain premises must be true under a wide variety of conditions. Agency theory's specific premises are listed and defined in Table 1, which are drawn from Eisenhardt (1989), Aulakh and Genturk (1993), and Lasser and Kerr (1996). Of these, this paper challenges the robustness of agency theory by considering the validity of the information as a commodity assumption. If the information as a commodity assumption does not hold in all situations, then the theory should be considered contingently valid. In other words, it is valid only in those situations where violation of the assumption does not affect the accuracy of the conclusions.

Table 1: Agency Theory Premises and Definitions	
Assumption	Definition
Self-interest	Principal and agent act in their own best interest
Goal conflict	Principal and agent have different goals
Bounded rationality	All information is not known
Information asymmetry	Principal and agent possess different information
Preeminence of efficiency	The agency relationship focuses on cost-benefit analysis
Risk neutrality of the principal	The principal is neutral to risk
Risk aversion of the agent	The agent is averse to risk
Effort aversion of the agent	The agent exerts only enough effort to obtain rewards
Information as a commodity	All information can be known and purchased

THE INFORMATION AS A COMMODITY PREMISE

Agency theory assumes that all information is available for a price. A key decision rule relative to the efficiency preeminence premise—the assumption that the agency relationship focuses on cost-benefit analysis—is to collect the needed information if the benefits outweigh the costs. As noted previously, there are two facets of the information as a commodity premise, adverse selection and moral hazard. that will be considered in detail.

Adverse selection occurs when a principal selects an agent to act on the principal's behalf based on false or inaccurate information about the agent (Mishra et. al., 1998). A contract is negotiated based on the assumed factual and accurate nature of information about the abilities of the agent and the agent is subsequently hired to perform a certain task. If agent misrepresentation is material to the agent's ability to perform the task, then the principal has adversely selected the agent. This ex ante selection problem can be eliminated if (1) information about the agent's ability to perform the task is available and (2) the benefits of obtaining this information outweigh the associated costs of obtaining it. In other words, if the principal must pay more to prevent adverse selection than the potential harm done if an incapable agent is selected, the decision rule suggests that the information should not be purchased. Conversely, the information should be purchased (through more expensive forms of data collection regarding the abilities of the prospective agent) if the potential harm exceeds the costs.

The premise that all information is available for a price is foundational to the decision rule of obtaining versus not obtaining the information necessary to prevent adverse selection. If, in fact, accurate information is not available at any price, then the decision rule should be modified to include this situation. For example, if we momentarily assume that all relevant information about the prospective agent's abilities is unavailable no matter what the price, then the decision rule is contingent. The contingency rests on information availability and only secondarily on a cost-benefit decision. (I will elaborate on this point when the tacit information literature is addressed in a later section.)

Moral hazard occurs when a competent agent is selected, but then fails to perform according to the contractual agreement (Holmstrom, 1979). The principal then has sunk costs of selection and further costs associated with lack of adequate performance. Agency theory has two remedies for the moral hazard problem. Both remedies have sunk costs associated with negotiating and developing a suitable contract. In addition, each remedy has its own unique costs. The first remedy is the design of behavior-based contracts that monitor the ongoing actions of the agent. The distinct costs involved are those needed to effectively monitor the agent's behavior including, i.e., accounting measures specific to agent action, increased surveillance, or other such means. The second remedy is the design of outcome-based contracts that measure whether the agent accomplishes the results specified in the contract. The costs involved are those needed for accurate measurement of outcomes.

As in adverse selection, the moral hazard problem requires the premise that all information is available as long as the principal is willing to pay the costs associated with obtaining the information. If we momentarily assume that the information required to either monitor agents' behavior or measure outcomes is not available, then the information as a commodity premise, again, is only contingently valid. The assumption is supported if, and only if, all information is available for purchase. (I will return to the specifics of this argument in a later section). Table 2 summarizes the premises, costs, and contingent validity of the adverse selection and moral hazard problems.

Table 2: Adverse Selection, Moral Hazard, and Contingent Validity

Category	Specific Problem	Remedy	Associated Costs	Presumption	Contingent Validity
Adverse selection	Agent misrepresents relevant information	*Ex ante* purchase of relevant information	Cost of obtaining information	All information is relevant for a price	If principal cannot purchase information at any price, then the assumption is only contingently valid.
	Principal makes decision based on inaccurate information		Contract negotiation and development		
			Failure of agent's specific performance		

Table 2: Adverse Selection, Moral Hazard, and Contingent Validity					
Category	Specific Problem	Remedy	Associated Costs	Presumption	Contingent Validity
Moral hazard	Agent fails to perform in accordance with the contract	Behavior-based contract	Contract negotiation and development	Sufficient information is available to monitor agent's behavior	If sufficient information is not available, either (1) outcome-based contracts will be used or (2) the assumption is only contingently valid.
			Behavior monitoring costs		
			Failure of agent's specific performance		
		Outcome-based contract	Contract negotiation and development	Sufficient information is available to measure outcomes	If sufficient information is not available, either (1) behavior-based contracts will be used or (2) the assumption is only contingently
			Outcome monitoring costs		
			Failure of agent's specific performance		

TACIT INFORMATION

Tacit information, "the means by which explicit knowledge is captured, assimilated, created, and disseminated" (Fahey and Prusak, 1998: 268), is difficult to measure (Nahapiet and Ghoshal, 1998) and codify (Leonard and Sensiper, 1998). Tacit information "is subconsciously understood and applied, difficult to articulate, developed from direct experience, and is usually shared through highly interactive conversation, storytelling, and shared experience" (Zack, 1999: 46). The point to emphasize is that tacit information resides in the mind of individuals and in organizational processes, but it is not explicitly available to all members of a firm (Nonaka, 1994). This presents problems associated with the inability to inventory and quantify tacit information. Codified information, on the other hand, is definable, transmittable to others, and can be stored and inventoried (Kogut and Zander, 1993). Compared to tacit information which is "...inseparable from the individuals who develop it..." (Fahey and Prusak, 1998: 266), codified information is more easily assessed and evaluated for both quantity and quality.

Agency theory's premise that information is a commodity that can be purchased is difficult to reconcile with the tacit information literature, but on the other hand, much information is available to those willing to pay for it. In addition, even tacit information may, in certain instances, be measured using process or task outcomes as proxies. However, it is difficult to extend the reach of purchase price to all information in all circumstances. Furthermore, it is unlikely that satisfactory proxies may be found for all forms of tacit information.

When agency theory relies on tacit information to prevent adverse selection, then one must assume that all relevant information is available for purchase. One must further assume that information that is "...inseparable from the individuals who develop it..." (Fahey and Prusak, 1998: 266) must somehow be made available, at least if principals are willing to pay enough for the information. For this to be true, those who possess tacit information must be both willing and able to explicate it sufficiently so that the information is understandable and measurable. If the information cannot be adequately defined or explained, it would be difficult to put a price on that which can be neither seen nor measured. Thus, we are left with the option to substitute proxies for the required information. If this can be done, then agency theory's presumption of information as a commodity is left intact and unscathed. If not, the robustness of the theory under these circumstances should be questioned.

If, for the moment, we relax the information as a commodity premise, we may consider the ramifications should this assumption prove to be only contingently valid. If it is not possible to purchase all information, then the adverse selection trade-off between the costs of obtaining relevant information versus the benefit of avoiding adverse selection becomes irrelevant. Despite the fact that the information has value, there can be no cost for something that is unavailable for purchase regardless of its inherent value. Similarly, if we consider the moral hazard problem, the costs of monitoring are not applicable when that which we wish to monitor cannot be measured, thus rendering monitoring ineffective. The principal’s decision to write a behavior-based contract or an outcome-based contract can no longer hinge on the costs of monitoring behavior versus the costs of measuring outcomes.

To put the matter as straightforwardly as possible, it is possible neither to measure nor to purchase all information when that information (1) is tacit and the source of the tacit information is unable to adequately express it in a measurable form and (2) lacks suitable proxies to replace direct measurements. There are clearly many instances where the information required to make correct agency contract decisions is readily available. If all information is available, including tacit information, then the premise that information is a purchasable commodity is valid. If, as I suggest, all information is not available—specifically tacit information—there is little means to purchase the information. When the information as a commodity premise is violated, agency theory's robustness must be questioned.

To summarize this section, when tacit information is required to determine whether the agency relationship should be governed by a behavior or outcome-based contract, the validity of the information as a commodity premise and thus the robustness of agency theory, rests with whether or not the information is available for purchase. If it is not, then the information as a commodity premise is only contingently valid. Table 3 summarizes the key points presented in this section.

Table 3: Tacit Information and the Information as a Commodity Premise	
Type of information	Effect on Information as Commodity Assumption
Codified	No effect; codified information may be purchased
Tacit	No effect if suitable proxy is available; contingently valid if no suitable proxy is available No effect if source of information is able to express the information in a measurable form; contingently valid if information source cannot express the information in a measurable form

LOGICAL INCONSISTENCY

A characteristic of sound theory is logical consistency (Wilkinson, 1999). For example, when two different characteristics of a theory are inconsistent, then either (1) one is incorrect, (2) both are correct but only in certain circumstances, or (3) neither is correct. This section evaluates the logical inconsistency between outcome uncertainty and agency theory's information as a commodity premise by returning to the outcome uncertainty argument.

Outcome uncertainty describes situations where the results of an activity are known to neither the principal nor agent (Eisenhardt, 1989). Uncertain outcomes, in part, determine whether goal alignment between the principal and agent is better achieved through a behavior-based contract or an outcome-based contract. As explained previously, contract development is straightforward if all outcomes are known. When outcomes are known, a behavior-based contract should be used to govern the principal-agent relationship. A behavior-based contract focuses on monitoring the behavior of the agent to guard against moral hazard. If the moral hazard problem can be controlled through agent monitoring, the likelihood that the desired, known outcomes will be accomplished is increased (Arrow, 1985).

However, if it can be logically demonstrated that inconsistencies between outcome uncertainty and the information as a commodity assumption exist, either outcome uncertainty or the information as a commodity assumption is incorrect, both are correct but only in certain circumstances, or neither is correct. The position that will be established is the second—both are correct but the information as a commodity premise is only valid in certain circumstances. In other words, the challenge is not to the fact that outcome uncertainty is present in numerous principal-agent relationships, but that when it is present, the information as a commodity premise is logically inconsistent.

First, we must carefully consider the definition of outcome uncertainty. One of the first to do so was Knight (1921), who examined the distinctions between risk and uncertainty from an economic perspective. "It is unnecessary...that particular occurrences be foreseeable, if only all the alternative possibilities are known and the probability of the occurrence of each can be accurately ascertained" (Knight, 1921). Outcome uncertainty is a condition in which outcomes—alternative possibilities—are not known and therefore it is not possible to assign probabilities to the outcomes (Leroy and Singell, 1987). When alternative possibilities are known and it is possible to assign probabilities to those possibilities, there is no longer outcome uncertainty, but rather risk (Barzel, 1987). While sharing certain features in common, risk and outcome uncertainty are fundamentally different constructs. Risk assigns probabilities to possible alternative outcomes (Friedman and Savage, 1948). Outcome uncertainty cannot foresee all of the possible alternatives; thus, probabilities cannot be assigned.

This presents a logical inconsistency. When outcome uncertainty is present in the principal-agent relationship, by definition, outcomes are unknown. If all likely outcome possibilities are known and it is possible to assign probabilities to each of these, there is no longer outcome uncertainty, but rather risk. Inherent in outcome uncertainty is a lack of information concerning alternative outcomes. On the other hand, inherent in the information as a commodity premise is that all information can be purchased. If all information can be purchased, alternative possibilities concerning outcomes can be discovered. Therefore, there can be no outcome uncertainty if the information as a commodity assumption is valid in these situations, but prima facie, outcome uncertainty is evident in many agency relationships. The burden of proof therefore rests on the information as a commodity premise. When outcomes are uncertain (as they frequently are in agency relationships and particularly in outcome-based contracts), the information as a commodity assumption is only contingently valid. The robustness of agency theory is dependent on whether the implications of this logical inconsistency lead to the wrong decision with regard to agent selection and agency contract design.

SUMMARY: THEORETICAL IMPLICATIONS AND FUTURE RESEARCH DIRECTIONS

Agency theory is a useful concept for viewing the relationship between principals and agents in a numerous contexts. This paper is certainly not an attempt to cast doubt on the valuable insights that have been provided to the management, marketing, and economic literature though the lens of this theory. However, a theory is only as strong as its underlying premises and its logical consistency (Wilkinson, 1999). However, logically testing a theory's premises does not necessarily weaken the theory. Rather, theory may be strengthened when one is aware of the challenges to robustness that exists when premises are violated, thus allowing for correction of the threat to robustness.

This research has suggested that one of the underlying premises of agency theory, the information as a commodity premise, is valid only when all information is known and that, when information is tacit, there are circumstances when it can be neither known nor purchased. This occurs when (1) suitable proxies for the tacit information cannot be found or (2) the source of the tacit information is unable to adequately express the information in a way that the information can be measured. When agency relationships are considered, principals weigh the costs against the benefits of gathering the information needed to make the correct decision about agent selection and contract design. Specific remedies for the adverse selection and moral hazard problems are dependent on the premise that relevant information is available for purchase. When this information is tacit, agency theory may not be robust to violation of this assumption. If assumption violation decreases the robustness of agency theory, then agency theory should be considered contingently valid and steps taken to mitigate the damage that my result from incorrect conclusions.

Thus, the contingent validity of agency theory depends on the nature of the situation. If the correct decision can be made without obtaining the tacit information relative to the decision, then the theory is robust to violation of the information as a commodity assumption. On the other hand, if violation of the premise leads to incorrect decisions (adverse selection or moral hazard), then the robustness of agency theory should be re-evaluated. When incorrect decisions are made due to violations of the information as a commodity premise, agency theory must again be considered only contingently valid. In addition, a logical inconsistency between the information as a commodity assumption and outcome uncertainty has been discussed. In these situations, the robustness of agency theory is dependent on whether the implications result in a less than optimal contract design. There are managerial implications when agency theory is not robust to violation of the information as a commodity premise. These implications may be grouped into (1) the contract design and, (2) the adverse selection and moral hazard problems. First, the contract design problem suggests that primarily two types of contracts (or a mixture of these types) can be used in the agency relationship—behavior-based and outcome-based (Brown-Johnson and Droege, 2004). Prior research has suggested that behavior-based contracts are preferred when there is a risk that the agent may shirk his or her contractual obligations (Fama and Jensen, 1983). Outcome-based contracts are preferred when there is a high degree of outcome uncertainty and, in these situations, are intended to align the goals of the agent with those of the principal (Jensen and Meckling, 1976). Accurate information is required to make correct decisions in both cases. When accurate information is unavailable, managers must consider that an incorrect decision may be made regarding agent selection and contract design. A risk premium associated with an incorrect decision should be factored into the costs tied to this possibility. Adding a risk premium when needed information is unavailable will decrease the amount the principal should be willing to pay the agent, thus affecting principal-agency contract negotiations.

Second, adverse selection and moral hazard problems are affected by the inability to purchase the information needed to prevent the occurrence of these situations. Ex ante information is required to prevent adverse selection; ex post information is used to monitor for moral hazard. As in the contract design problem, the implications of selecting the wrong agent (the adverse selection problem) or the failure of specific performance by the agent (the moral hazard problem) must be clearly understood in assigning an appropriate risk premium in lieu of obtaining the needed information. The risk premium, by decreasing the amount the principal is willing to pay the agent, will partially mitigate the risk of adverse selection and moral hazard. (assuming labor market parity is maintained). Similarly, agency theory's robustness is challenged with respect to the contingent validity of the information as a commodity assumption in the presence of outcome uncertainty. The wrong managerial decision may result in less than optimal contract design.

Clearly, much research has focused on the agency relationship. However, future research should look at agency theory's underlying premises to determine the robustness of the theory when these premises are violated. For example, one such premise is the risk-aversion of the agent. In agency theory, the agent is presumed to be risk-averse while the principal is presumed to be risk-neutral (Eisenhardt, 1989). Risk aversion describes the tendency for the agent to avoid risk and opt for the safer route when such a route is available. "A risk-averse individual prefers security and therefore seeks some guarantee of the attainment of desirable outcomes or insurance against the occurrence of undesirable outcomes" (Bergen, et. al., 1992: 4).

The assumption of risk-averse agents and risk-neutral principals is, in part, the basis upon which goal discrepancy between agent and principal is founded. If it is discovered that agents are not risk-averse or are only risk-averse in certain situations, then the risk-averse agent presumption is should attenuate managerial decisions regarding agent contracts. Eisenhardt (1989) suggests that firms choose the least costly alternative between behavior control (behavior-based contracts) and outcome measurement (outcome-based contracts). However, this too is based on the presumption of a risk-averse agent. If future research relaxes the assumption that agents differ in their risk preferences, some having a propensity to accept risk and others being risk-averse, then the least costly alternative changes as the agent's risk preferences change. The agent will be willing to accept more risk, thus alleviating the principal of a portion of the risk burden if the agent is not risk-averse. Further, if a risk-averse agent requires a risk premium in exchange for acceptance of risk, then the agent's perception of risk will determine, in part, the cost to the principal of the risk premium. If the agent is not risk-averse, then the principal's risk premium expense may decrease.

Despite the vast contributions made by agency theory, when making managerial decisions regarding agency one must keep in mind the presumptions on which theory is based and the effect on robustness when those presumptions are violated. When we fail to critically assess the validity of our premises, we run the risk of making critical decision errors. The old monk in Chesterton's story warned: "Only what we might have discussed under the gas-lamp, we now must discuss in the dark." But if we are careful about challenging theoretical premises, we better see where agency theory works and where it does not. By realizing agency theory’s limitations, we can add to its strength.

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THE PUBLIC POLICY EXCEPTION TO EMPLOYMENT AT WILL: BALANCING EMPLOYER'S RIGHT AND THE PUBLIC INTEREST

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ABSTRACT

Despite the fact that employment at will remains the fundamental tenet in American employment law, more and more circumstances have served to remove the termination of an employee from the "at will" arena. The employer's power and control over the employee is now subject to numerous exceptions to the "at will" doctrine. Perhaps the most elusive exception requires the balancing of employers' right in controlling an employee and the public's right in assuring that employers do not act in a manner contrary to the public interest. In considering the public policy exception to employment at will, American courts find public policy in varying sources and apply the public policy exception to a wide variety of termination situations. In this paper, the courts' application of the public policy exception to employee dismissal disputes is examined.

INTRODUCTION

Workers in the United States are most commonly hired, and fired, based on the employment relationship deemed "at will." While England provided the foundation to most law in the United States, the questions regarding the duration of employment and whether a firing must be for cause have been answered in a distinctly American way. Historically, contract law defined the extent of the employment relationship. In England, absent specific contractual language, the term of employment was presumed to be one year (Summers, 2000). Early American courts were not sure if they should apply this rule; some courts followed the English rule, some not (Id). In 1877, Horace Wood, a jurist, proclaimed that the rule in the United States established a presumption opposite that of the English courts. In America, employment was of an indefinite period unless the employee could prove otherwise (Id).

Jay Feinman, in his article *The Development of the Employment at Will Rule,* argues that the "at will" doctrine was adopted as a means to promote capitalism in industrial America (Feinman, 1976, p. 118). This new age demanded workers who served only as a means for the business owner to advance commercial enterprise (Id., p. 123). In early applications of employment law, the employees bringing suit were often mid-level managers who wielded, for the times, substantial salaries and who often had ownership interests in the business (Id., p. 131). The industrial worker, however, became further removed from ownership and more under the authority of the employer/owner who used labor as a means to meet market demand (Id.) Capitalism demanded that workers had no control over their employment or over the manner of their work (Id., p. 133).

Regardless of its early history or the socio-economic factors supporting its use, the theory of employment at will as the basic employment relationship has stood the test of time, basically in tact. It remains a fundamental tenet of contemporary employment law: an employer is free to terminate employees without cause or consequence. When no duration of employment is expressed, both parties are free to hire and be hired only for so long as both wish to remain in such a relationship. “In the absence of any employment contract for a definite period, both employer and employee are generally free to terminate their association at any time and without reason” (*Salt v. Applied Analytical, Inc*., 1991).

EXCEPTIONS TO EMPLOYMENT AT WILL

While broad protections against unjustified termination have not been adopted in the United States, the power of employment of will has been somewhat restrained as exceptions to that rule have been established (Summers, 2000). “The terminable-at-will doctrine is not absolute however, and the interests of the people…are not best served by a marketplace of cut-throat business dealings where the law of the jungle is thinly clad in contractual lace” (*Hall v. Farmers Insurance Exchange,* 1985). The courts and legislatures have identified the bases of employment dismissals that violate law, regardless of the “at will” relationship, from civil rights to public policy.

Specific federal and state legislation prohibit the firing of an employee for particular reasons. For example, the Civil Rights Act of 1964 prohibits the taking of adverse employment actions against a person on the basis of her race, color, gender, religion or national origin. Later legislation prohibited adverse employment action against workers with disabilities or those of a certain age. The National Labor Relations Act prohibits the firing of employees for union activity. Other examples of statutory law providing protection for the at-will employee exist, often in the form of provisions that prohibit an employer from using termination as retaliation against employees who exercise their legal rights, such as filing for workers’ or unemployment compensation.

Express terms can also change the at-will relationship. Should the parties have an expressed agreement as to the duration of employment, that contractual provision will control the employment relationship. The employer, in such cases, can only terminate for cause within the contractual period. However, the duration of employment must be specifically expressed (*Meadows v. Radio Industries*, 1955). “All business men know they can make legal contracts to suit themselves, also the importance of saying what they mean in business matters in plain and definite terms” (*Edwards v. Seaboard and Roanoke Railroad Company*, 1897). Statements that an employee has a permanent position or that the employee has a “rosy future” with the employer are not held to be terms of an express contract (Perna, 2006). Moreover, permanent employment does not set the duration of employment, but merely establishes an “indefinite general hiring, terminable at will” (*Tuttle v. Kernersville Lumber Company*, 1964).

Another contractual theory, that of implied contract, also serves as an exception to employment at will. While this theory is less clear, a court can hold that certain actions or statements made by the employer establish an employment relationship outside of at will employment. These situations can arise as a result of statements made during interviews or on the job. Often, the question of implied contract stems from the use of employee guides or handbooks delineating disciplinary and termination procedures. A federal court, hearing a case based on Oklahoma law, outlined the factors that must be established for the court to determine the existence of an implied contract: consideration beyond the employee’s services, length of employment, handbooks and policy manuals, detrimental reliance on the part the employee and promotions and commendations (*Wood v. Handy & Harman Company and Continental Industries Inc*., 2006).

Many states also consider the covenant of good faith and fair dealing as an exception to the employment at will presumption. The argument is that in contracting to perform to the benefit of one another, parties also agree not work against each other and that each will not deprive the other of the rewards associated with their contractual performance (*Hall v. Farmers Insurance Exchange*, 1985). For example, it was bad faith for a company to fire an at-will salesman after he had made sales on behalf of the company but before he was paid his commissions (*Fortune v. The National Cash Register Company,* 1977). However, many states, including Oklahoma (Burk v. K Mart Corporation, 1989) and Kansas (*Morriss v. Coleman Co*., 1987), do not recognize this exception to employment at will.

One of the more elusive exceptions to the employment at will doctrine deals with what the courts and legislature deem public policy. The at-will doctrine will not be supported should the termination of an employee violate the public interest. Public policy, however, is not clearly defined. The Supreme Court of Connecticut identified the major issue in the application of the public policy exception when it stated that it was a

> *“problem of deciding where and how to draw the line between claims that genuinely involved the mandates of public policy…and ordinary disputes between employee and employer… “*
>
> (*Sheets v. Teddy’s Frosted Foods Inc*., 1980).

When applied by the courts, this exception, therefore, restricts the right of the employer to terminate employees at will and its application to specific cases requires the balancing of the employers’ right and that of the public interest.

PUBLIC POLICY EXCEPTION

In 1908, the US Supreme Court ruled that contracts for employment are

> "subject to the condition that no contract, whatever its subject matter, can be sustained, which the law, upon reasonable grounds, forbids as inconsistent with the public interests or as hurtful to the public order or as detrimental to the common good" (*Adair v. United States*, 1908).

Since then, courts have demonstrated flexibility in defining public policy and in identifying employee dismissals that contravene the public interest. A California court determined that "public policy has been defined as the principle of law which holds that no citizen can lawfully do that which has a tendency to be injurious to the public or against the public good" (*Petermann v. International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America Local 396*, 1959). The Oklahoma Supreme Court stated that the public policy exception "rests on the notion that in a civilized society the rights of employers to discharge at-will employees is necessarily balanced against the rights of the public at large as found in existing law" (*Clinton v. State of Oklahoma,* 2001). Moreover, courts have declared that what is considered public policy must be firmly established in law, the interest to protect fundamental and substantial (*Tameny v. Atlantic Richfield Company*, 1980) and one which impacts society as a whole (*Burk v. K Mart Corporation*, 1989).

The sources of public policy are diverse as well. Federal and state constitutions, federal and state legislation and common law can all be the source of public policy. Moreover, in some states, federal statutes can be the source of state public policy. The sources of public policy are not limited to laws. Ethical codes for professionals, such as those established for doctors, have also been held to be the source of public policy on which courts can base their decisions (*LoPresti v. Rutland Regional Health Services d/b/a Rutland Regional Physician Group Inc.*, 2004). Whichever rule a state or federal court follows to enforce public policy, the burden is still on the employee to identify the specific source for the policy; general references to law, including constitutions, regulations and legislation do not meet this obligation (*Wood v. Handy & Harman Company and Continental Industries Inc.*, 2006). A dismissed employee's court challenge of a termination based on the public policy exception requires that the public policy be

> (1) delineated in either constitutional or statutory provisions; (2) public in the sense that it insures to the benefit of the public rather than serving merely the interests of the individual; (3) well established at the time of the discharge; and (4) substantial and fundamental (*Costanza v. Simon Equipment Co., Inc.*, 2006).

For the courts, all the circumstances surrounding an employee's termination and the close study of applicable law is required to determine whether the public interest has been violated. It is a restriction on employers that must be applied sparingly. As stated by the Court of Appeals of Missouri, "The public policy exception is narrow enough in its scope and application to be no threat to employers who operate within the mandates of the law and clearly established public policy …"(*Boyle v. Vista Eyewear, Inc*., 1985).

WHISTLE BLOWING

Whistle blowing, an employee reporting wrongful acts of the employer, is often the circumstance in application of the public policy exception. In such cases, to whom the employee reports the wrongdoing and what the employee reports will play a crucial role in determining whether public policy has been violated. Generally, an employee who reports criminal activity on the part of the employer to the appropriate government authorities will gain some protection against an at-will firing. The Supreme Court of sas added one more factor: the employee's motivation in reporting the criminal conduct of must be based on a good faith concern "rather than from a corrupt motive such as malice, spite, jealousy or personal gain" (*Shaw v. Brown*, 1988).

Employees who engage in external whistle blowing, the reporting of the wrongful employer actions to authorities outside the workplace, generally are protected from termination under the public policy exception. This exception was considered in a case involving the firing of a lab technician at an eye wear company. The company routinely failed to test its eye glasses as required by federal regulations. After being repeatedly ignored in her efforts to get her employer to properly test, and after indicating that she would report the violation, the employee did report to the appropriate authorities (*Boyle v. Vista Eyewear, Inc.*, 1985). The court found that public safety, protected by the applicable regulations, was a public policy concern (Id.). In another case, the protection of the public from the dangers of hazardous materials was the basis for finding that the termination of an employee working at a nuclear reactor was unlawful (*Field v. Philadelphia Electric Company*, 1989). While working in a tunnel at the reactor, the employee was intentionally exposed to high levels of radiation. For months after the incident, employee was lied to about an investigation of the steam release and about the level of his exposure to radiation. Finally, the employee reported the incident to federal authorities and shortly thereafter, was fired (Id.).

An employee reported to law enforcement that his employer sold him a car with a fraudulent odometer reading (*Schriner v. Meginnis Ford Company*, 1988). After checking with the clerk and receiving information that the car had more miles than the employer indicated, the employee provided the authorities with information about his suspicions. The authorities failed to take action against the employer and the employee was fired. Even though no criminal charges were filed against the employer, the court found that the employee's discharge was wrongful and that public policy dictated that one who reports suspected criminal activity in good faith and based on a reasonable belief is protected from discharge (Id.).

Consumer protection statutes were the source of public policy in a West Virginia case (*Harless v. First National Bank in Fairmont*, 1978). A bank employee discovered that his employer had intentionally violated consumer credit protection laws. He reported his findings to supervisors and to the bank's board of directors and even retrieved files from waste paper baskets in order to preserve the documents for government investigators. West Virginia chose to recognize the public policy exception to employment at will in that "consumers of credit" were clearly entitled to protection and that firing employees attempting to ensure lawful conduct was to be protected as well (Id.).

Internal whistle blowing is more problematic. Reports to supervisors or others internal to the employer are not always protected. An employee discovered that his company's district manager was stealing from the company. Rather than report to a supervisor, the employee confronted the manager about his suspicions (*Faust v. Ryder Commercial Leasing and Services*, 1997). After that confrontation, certain responsibilities were eliminated from the employee's position and, eventually, he resigned. No violation of Missouri public policy took place since the report was made to the wrongdoer and not to authorities (Id.). No public interest was served from such an internal report. A similar outcome was reached when nursing home employee was fired form her position (*Wilburn and Shroyer v.Mid-South Health Development Inc*., 2003). The employee reported to another employee, not a supervisor, that she suspected yet another employee of stealing medications, using those medications and falsifying medication logs (Id.). Her termination was upheld in that she failed to identify the public policy interests her actions protected (Id.). A physician was fired from his employ when he repeatedly reported to his officers and the board of directors that the compensation formula used to determine his salary violated federal law (*Scott v. Missouri Valley Physicians*, 2006). His termination from at will employment was not deemed in violation of public policy since he failed to notify proper authorities, he only notified the possible wrongdoers (Id.). That, the court found, did not further a public policy mandate (Id.).

A firing that occurred after one employee reported to his supervisors that another employee was under investigation by law enforcement for crimes that might impact the current employer, was also found not to violate public policy (*Foley v. Interactive Data Corporation,* 1988). Since the information communicated to the supervisors was private in nature and of interest only to the employer, the employer was free to choose not to be so informed (Id.).

Occasionally, however, internal whistle blowing will involve a public policy interest. An inspector working for an employer in the aircraft industry noticed his company was selling air craft parts that the employer knew had not passed inspection. Over the course of years, he reported this behavior to supervisors and management (*Green v. Ralee Engineering Company*, 1998). Eventually, he was fired. While the report was internal, the court held that the pubic policy interest in safety in aviation was a substantial consideration.

Allowing defendant to discharge plaintiff with impunity after he sought to halt or eliminate alleged inspection practices would only undermine the important and fundamental public policy favoring safe air travel (Id.).

The Connecticut Supreme Court found for an employee who had reported to his supervisor that the food it was processing and packaging was, in part, substandard in violation of the state labeling statutes (*Sheets v. Teddy's Frosted Foods Inc*., 1980). Although the whistle blowing was internal, the Court found that since the employee was quality control director, it was a public policy concern that he report his findings to his company without fear of termination (Id.). However, that was not the result in a case involving a fired steel salesman who vocalized that his employer's product was unsafe (*Geary v. US Steel Corporation*, 1972). Since the employee was a salesman who had no expertise or special knowledge on which to make such allegations, the Court found no public interest to protect (Id.).

EMPLOYEE REFUSING TO ENGAGE IN CRIMINAL CONDUCT

Many courts have reviewed the public policy concerns that arise when an employee is fired for refusing to engage in criminal activities on behalf of the employer. The Texas Supreme Court determined that refusal of an employee to commit a crime, in this case a deck hand who refused to pump bilges into the water, was permitted a "very narrow" exception to the terminable at will doctrine (*Sabine Pilot Service v. Hauck*, 1985).

The Supreme Court of California also considered this question. An oil company employee refused to pressure independent gas stations to cut their prices as part of his employer's scheme to illegally fix gasoline prices (*Tameny v. Atlantic Richfield Company*, 1980). His firing violated the public interest in discouraging and reporting criminal conduct (Id.). In a North Carolina case, a truck driver was ordered by his employer to falsify his travel records, including information regarding the length of his shift and rest periods, in order to make it appear that the employer was complying with law (*Coman v. Thomas Manufacturing Co. Inc*., 1989). The driver was fired for refusing to obey. The Court found a compelling public interest in that the "legislature has enacted numerous statutes regulating almost every aspect of transportation and travel on the highways in an effort to promote safety" (Id.). An Indiana truck driver was fired for refusal to travel on Illinois roads when his truck weight exceeded that allowed by Illinois law (*McClanahan v. Remington Freight Lines, Inc*., 1988). In this case, the court found the firing in violation of public policy especially since the driver would have been personally responsible for the overload, not just the employer (Id.).

A gas station attendant was fired on the spot when he refused to pump leaded gasoline into the tank of a customer's car when the care required only unleaded fuel (*Phipps v. Clark Oil & Refining Corporation*, 1986). While the attendant was willing to pump unleaded gas, he believed the use of leaded gas in that situation violated law. While generally free to fire at will, employers "are not free to require employees, on pain of losing their jobs, to commit unlawful acts…" (Id.).

Two factory workers in North Carolina were fired when they refused to work for less then the minimum wage. While the employer argued that the wage issue was private between the parties and not a matter of public concern, the court disagreed and held that their firings violated public policy (*Amos v. Oakdale*, 1992).

Refusing to take a polygraph test has also been the basis of employee firings. In Pennsylvania, it is a misdemeanor to require a person to take a polygraph test as a condition of employment (*Kroen v. Bedway Security Agency Inc*., 1993). That statute was the source of public policy to protect an employee who had been constructively discharged after he refused to take the test (Id).

Can the employee be fired for refusing to engage in activity that may result in a future crime when there is no present criminal conduct? An accountant refused to engage in producing documents for his employer that he believed his employer was going to use to commit a crime (*Dunn v. Enterprise Rent-a-Car Company*, 2005). The comptroller had serious concerns about documents his employer was planning to use in preparation of an initial public offering of stock (Id.). He was vocal about aspects of the documents that he felt violated law and he was terminated from his position. While he did not report the improper financial activities to outside authorities, and neither he nor his employer actually engaged in criminal conduct, the Missouri Court of Appeals found his termination in violation of public policy (Id.). The Court held that the laws requiring honest financial disclosures by companies offering securities to the public was clear and that protection should be extended to "an employee who is terminated from his or her employment for objecting to practices he or she reasonably believes violate this policy" (Id.).

Being fired for refusing to give false testimony on behalf of employers has also been the basis of cases involving the public policy exception to employment at will. In a landmark California case, an employee was directed by his employers to make false statements to a committee of the state legislature, thereby perjuring himself (*Petermann v. International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helper of American Local 396*, 1959). Much to the dismay of his employers, at the hearing, the employee responded truthfully to all questions, and for his honesty, was fired (Id.). The firing, however, was found to violate public policy. To hold otherwise, the Court said,

> Would encourage criminal conduct upon the part of the both the employee and employer and serve to contaminate the honest administration of public affairs….The law must encourage and not discourage truthful testimony" (Id.)

A North Carolina Court also ruled on the question of public policy and truthful testimony. A nurse working in a hospital was told that she would "be in trouble" if she told all about what she had seen during an incident at the hospital that resulted in a malpractice case (*Sides v. Duke University*, 1985). The nurse witnessed a doctor administer drugs to a patient, despite the dangers in doing so, that caused the patient brain damage. The nurse told all and truthfully during the trial, rather than to perjure herself, and was fired. In finding in favor of the nurse on her claim for wrongful termination, the Court stated “that in a civilized state where reciprocal legal rights and duties abound the words ‘at will’ can never mean ‘without limit or qualification…An at will prerogative without limits could be suffered only in an anarchy, and there not for long…” (Id).

REFUSAL TO FIRE ANOTHER EMPLOYEE

A dismissal for filing a workers’ compensation claim, or for refusing to fire an employee for filing a workers’ compensation claim, has also been the basis for public policy discussions in the courts. A father and son worked at an automobile dealership, the father as the son’s supervisor (*Rothrock v. Rothrock Motor Sales, Inc*., 2005). After the son claimed he was injured on the job, another relative working at the dealership, told the father to get his son to file a waiver of his workers’ compensation claim releasing the dealership from any liability. When the son refused to sign, both father and son were terminated. While the son was protected under an earlier court ruling that prohibited the termination of workers for filing for workers’ compensation (*Shick v. Shirey d/b/a Donald L. Shirey Lumber,* 1998), the court ruled that the public policy exception protected the father as well. The Court held that “…it would be …repugnant for this Court to turn its back on such supervisors, who amount to innocent pawns in a conflict between employer and subordinate employee…” (*Rothrock v. Rothrock Motor Sales*, *Inc.*, 2005).

This theme continued when the Court of Appeals of Washington reviewed a case involving a supervisor who refused to follow directives to fire other employees. The five employees in question were injured in the course and scope of their employment and were considering filing workers’ compensation claims. When the supervisor refused to fire these workers, she was fired (*Lins v. Children’s Discovery Centers of American, Inc.,* 1999). Since the firing the employee who planned to file the claim was prohibited by statute, the supervisor refused to carry out an order she knew to be unlawful. The court determined that public policy would be jeopardized if an employee was not protected from termination by refusing to follow an illegal order (Id.).

EMPLOYMENT DISCRIMINATION

Despite federal legislation prohibiting workplace discrimination, it can still be the basis of litigation involving at-will termination and the public policy exception. Many federal statutes prohibiting discrimination require a minimum work force for its application. Moreover, not all states have anti-discrimination statutes. When an employee was fired from his employment solely on the basis of his age, the Supreme Court of Vermont reviewed the case (*Payne v. Rozendaal*, 1986). The

Court noted that at the time the employee was discriminated against on the basis of his age, no state or federal remedy existed (Id). The Court held that the firing on the basis of age only "is a practice so contrary to our society's concern for providing equity and justice that there is a clear and compelling public policy against it" (Id.).

Sexual harassment was also the basis of review of a termination. An employee who refused the sexual advances of her foreman and refused to sleep with him was fired (*Lucas v. Brown & Root Inc.,* 1984). The Court, in finding the dismissal wrongful, likened the situation to the crime of prostitution: "A woman invited to trade herself for a job is in effect being asked to become a prostitute" (Id.). Moreover, "it is implied in very contract of employment that neither party be required to do what the law forbids" (Id.).

Dealing with a similar issue, the Superior Court of Pennsylvania came to a similar conclusion. Pennsylvania statutory law prohibiting employment discrimination placed the required number of employers in the workplace at four. An employee was terminated, she claimed, after a year of sexual harassment and her repeated refusals of the advances of her employer (*Weaver v. Walter W. Harpster & Shipman Financial Services*, 2005). Even though the employer's workforce was less than four and statutory law did not apply, the public policy exception did.

To prevent an employee who is alleging sexual harassment from pursuing her claim in court only because her employer has less than four employees appears a direct contravention of clear public policy… (Id.).

The result is not always consistent. In a case involving a woman who sued after being fired from her job solely due to her age, the North Carolina Court of Appeals did not hold her termination to violate public policy (*Jarman v. Jim Deason d/b/a Deason Landscape & Irrigation*, 2005). The court identified North Carolina's position:

> It is the public policy of this State to protect and safeguard the right and opportunity of all persons to seek, obtain and hold employment without discrimination and abridgement on account of race, religion, color, national origin, age, sex, or handicap by employers which regularly employ 15 or more employees" (Id).
>
> Since the employer's workforce was fewer then 15 employees, her termination was not held to violate public policy (Id.).

FREE SPEECH

Constitutional guarantees, such as the protection of free speech, also can become the public interest on which courts review employee dismissals. Sexual activity by workers with patients in an alcohol rehabilitation center and concern over patient exploitation prompted an employee of the center to report her suspicions to a state law enforcement agency (*Lenzer v.Flahery*, 1992). The employee also made internal allegations that the employer was trying to cover up the sexual misconduct. While no criminal charges or disciplinary action resulted from the reports, the court held that a firing based on the employee's constitutional guarantee of free speech was found to be in violation of public policy; "public speech about suspected patient abuse in State facilities merits legal protection" (Id.).

Politics was the issue with a firing based on the employee's refusal to engage in lobbying activities on behalf of his employer, an insurance company. (*Novosel v. Nationwide Insurance Company,* 1983). At the time of the employment, Pennsylvania was considering "No-Fault Reform" legislation that was favored by the insurance company. It asked all its employees to participate in lobbying the appropriate legislative committee encouraging the passage of the statute. The employee refused to participate and personally indicated he did not support the legislation. Drawing its public policy source from the Pennsylvania Constitution that provides for the "free communication of thoughts and ideas," the Court determined that the employee was entitled to a trial to determine whether or not his actions justified termination. The court held that determining whether speech was protected required a consideration of several factors: whether the speech inhibits the employer's or the employee's ability to carry out their duties, whether the speech interferes with "essential and close working relationships" and whether "the manner, time and place" of the speech interferes with business operations (Id.).

The claim of free speech violations, however, was not sustained in a North Carolina case. During a primary election for sheriff, an employee of the department ran against the incumbent sheriff (*Hines v. Yates,* 2005). The sheriff won and the employee lost the election and his job. The Court did not agree with the employee that the firing was in contravention of the right to free political speech. During the election, the employee made public statements critical of his employer, the sheriff. The Court could not find any public policy on which to base the employee's claims. The Court pointed out that the employee had been free to run against his employer and to publicly criticize the sheriff. There had not been any restriction of his speech (Id.).

A lobbyist for an arms manufacturer working in the Capitol served as liaison between his employer and federal government departments (*Korb v. Raytheon Corporation*, 1991). As a member of the Committee for National Security, a non-profit organization, the employee made public comments critical of increased defense spending, much to the dismay of the Senate Armed Services Committee and his employer. He was fired. On appeal, the employer argued that the public interest that should afford him protection from dismissal was his right to free speech (Id.). However, the court held that his claim was unfounded. As a spokesperson for his employer, speaking against the interest of his employer, the employee adversely impacted his ability to perform on behalf of his employer. The employer was entitled to an employee that supported its position. The discharge was justified (Id.).

JURY DUTY

Firings based on an employees serving on juries has been the basis of litigation involving termination and the public policy exception. When an employee was dismissed after being called to serve on a jury, the Supreme Court of Oregon considered the public policy implications (*Nees v. Hocks*, 1975). The employee received a summons and advised the clerk that she wanted to serve on the jury. She made no attempt to be excused despite her employer's request that she do so. The Court determined that her firing violated the public interest; "the legislature and the courts clearly indicate that the jury system and jury duty are regarded as high on the scale of American institutions and citizen obligations" (Id.). Clearly, the demands of society to uphold the integrity of the legal system established fundamental public policy.

In a recent Pennsylvania case, an employee was fired for taking time off from work to serve on a jury (*Sheeran v. Kubert*, 2003). Since a Pennsylvania state statute allowed an employee of a small enterprise to be excused from jury service, the employer asserted that the employee should have availed herself of that option rather than to serve as a juror. The court did not agree. Quoting statistics and studies, the court held that the employee was only accepting responsibility for her civic duty by service on the jury (Id).

PROFESSIONAL CONDUCT

Workers in the professions often serve their employers at will. The conflict between employer demands and professional ethical codes can also provide the basis for court consideration of professional standards and public interest. A physician was fired when he refused to refer patients to other doctors within his organization (*LoPresti v. Rutland Regional Health Services d/b/a Rutland Regional Physician Group Inc.*, 2004). He was of the strong belief that the other doctors did not treat their patients with acceptable standards of care. In line with his ethical obligations, he refused to refer patients even when his employer pressured him to do so (Id.). On appeal, the doctor identified specific provisions of the American Medical Association Principles that guided the conduct that ultimately lead to his termination. The court readily held the doctors ethical code the source of public policy; the public interest in high standards for health care was clear (Id.).

A professional medical disagreement was also the basis of the firing of a research doctor (*Pierce v. Ortho Pharmaceutical Corporation*, 1979). In conducting research on a potential treatment, the researcher objected to the use of saccharin as an ingredient for a treatment. Her professional, yet personal, objection to the use of saccharin was based on the controversy surrounding the potential hazards of that ingredient. She believed that continuing to develop the treatment with saccharin violated the Hippocratic Oath. However, while the use of saccharin was controversial, the doctor had no basis to refuse the demands of her employers. The court found that the use of a controversial ingredient in the research and development of new treatments did not violate public policy. “To hold otherwise would seriously impair the ability of drug manufacturers to develop new drugs according to their best judgment” (Id.).

Differing opinions resulted in a nurse’s termination when she failed to comply with her employer’s patient medication policy (*Dulude v. Fletcher Allen Health Care, Inc*., 2002). The nurse’s medication philosophy differed from her employer’s, although the employer’s practices were in line with reasonable medical practice. The employee’s firing was based on the nurse’s failure to comply with her employer’s legal and medically acceptable directives, and, therefore, justified (Id.).

The policy declarations of legislation that established a state board of nursing did not provide the public policy on which to find a nurse’s dismissal wrongful. The supervisory nurse refused to reduce the number of nurses in an intensive care unit and for refusing to comply with her employer’s directives was fired (*Lampe v. Presbyterian Medical Center*, 1978). Her public interest argument that she had a duty to protect the patients was not supported by the legislation she identified (Id.).

Looking to ethical codes for public policy was also a factor for a CPA who refused to engage in practices requested that would have created a false financial picture of her employer and that violated accepted accounting principles *(Rocky Mountain Hospital and Medical Service d/b/a Blue Cross and Blue Shield of Colorado v. Mariani,* 1996). The Colorado State Board of Accountancy Rules of Professional Conduct was the source of the public policy that identified the termination to be in violation of public policy (Id).

OTHER FINDINGS OF PUBLIC POLICY VIOLATIONS

Cooperating with law enforcement has also been deemed to be in the public interest and the basis to negate an at will firing. A secretary working for a county district attorney was interviewed by law enforcement agents investigating her employer (*Caudill v. Dellinger*, 1998). For her responses to those questions, she was fired. However, the court held the termination wrongful in that “it is the public policy of this state that citizens cooperate with law enforcement officials in the investigation of crimes” (Id.).

In an Arizona case, a hospital employee refused to engage in activities that she felt were morally wrong, specifically participating in a parody of the song “Moon River” that included mooning the audience (*Wagenseller v. Scottsdale Memorial Hospital*, 1985). Her refusal to participate angered her supervisor, and the employee claimed it ultimately lead to her termination. “The interests of society as a whole will be promoted if employers are forbidden to fire for cause which is ‘morally wrong’” (Id.). The court gave no further directives as to how what is moral and what is not would be determined when considering morality as a public policy interest in employment (Id.).

Cigarette smoking in the workplace and the employee's efforts to end that practice lead to the employee's discharge (*Hentzel v. Singer Company* (1982). The employer made no effort to separate smoking and nonsmoking areas and the employee claimed he in feared for his health (Id.). In finding for the employee, the court reasoned that "a safe and healthy workplace for all employees required that employees be free to call their employers attentions to these conditions…" (Id.).

Interestingly, the courts have also reviewed the public policy questions surrounding a termination that resulted after an employee intervened to save another's life (*Gardiner v. Loomis Armored, Inc*., 1996). The employee was the driver of an armored truck and his employer's "fundamental" policy was that drivers were not to leave the truck unattended for any reason. While waiting in the truck, the employee saw the manager of the bank run from the bank screaming for help. The employee left the truck to see what was happening and then took action to assist in tackling a knife-welding man. He was fired for leaving the truck. The court acknowledged that both the employer and employee had legitimate interests to protect and engaged in a "balancing" of both interests. The court weighed the public policy placed on the protection of human life against the legitimate concerns of the employer in the protection of the drivers and minimization of robberies. The court made its decision in favor of the employee:

> "We find that …discharge for leaving the truck and saving a woman from an imminent life threatening situation violates public policy encouraging such heroic conduct" (Id.).

SOME FINDINGS OF NO PUBLIC POLICY

The desire to continue education can result in a lawful firing. When an employee announced his intention to attend law school at night, he was fired. The Court found no public policy to support the employee's claim of wrongful termination (*Scrogan v. Kraftco Corporation,* 1977).

Refusing to agree to a contractual arbitration clause resulted in the dismissal of a legal secretary (*Lagatree v. Luce*, 1999). The secretary argued, unsuccessfully, that his right to trial by jury was encroached by the arbitration agreement and, therefore, his termination violated public policy. The court ruled that since law allowed the right to trial by jury could be waived by a party involved in court proceedings, the right to a trial by jury could also be "bargained away" (Id.).

An automobile manufacturer department head was terminated, he claimed, because he urged his employer to correct misleading information involving work on alternate power plants that was conveyed to stockholders and the general public (*Percival v. General Motors Corporation*, 1975). The court found that being fired for urging the correction of "false impressions" was not one supported by the public policy exception to at will termination (Id.).

Love resulted in an employee's firing after he told his supervisory that he would continue a relationship with a co-worker outside of the workplace, in spite of the employer's dislike of the relationship (*Patton v. J.C. Penney Co., Inc*., 1986). While the employee argued his "fundamental, inalienable human rights were compromised" by the employer's conduct, the court did not agree. Employer policies against dating in the workplace did not violate any public interest, even though it impacts the "employe's [sic] personal lifestyle" (Id.).

A company's discrimination against African Americans and its management's bigotry bothered one worker. He claimed his termination was the result of a comment he made that "Blacks have rights too" (*Bigelow v. Bullard*, 1995). Although the "ugly practices" of the employer apparently took place, a comment of this nature made to another employee public policy concern (Id.). If the employer "did not want in her employ anyone…sympathetic to African-Americans," she could fire the employee at will *(Id.)*.

In narrowly interpreting the public policy exception, a Pennsylvania court determined that public policy interests had not been violated when a man was fired due his wife's religion (*Frankel v. The Warwick Hotel*, 1995). His supervisor objected to the wife and urged the employee to leave her. When he refused, he was fired. The court agreed with the employer that language in a state code, noting the public concern in the preservation of the family, was too vague to establish a clearly defined public policy mandate (Id.).

CONCLUSION

While many exceptions to the doctrine exist, employment at will still rules the workplace. In matters of public policy, though, the employer's at-will prerogative takes on a strong opponent, the public interest. While the application of the public policy exception requires a clear public policy interest, when one is discerned, the employer's conduct in terminating an employee will not be sustained. From jury duty to free speech, whistle blowing to refusing to engage in criminal conduct, the courts have found clear mandates to negate an employment at will termination on behalf of the public interest. As a result, more and more employment issues are no longer a private matter between employer and employee. In many cases, employment concerns are a matter of the public interest.

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ETHICAL VIEWS OF CHINESE BUSINESS STUDENTS: A THREE YEAR SURVEY OF ENRON'S EFFECTS

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ABSTRACT

This research details an exploratory three year survey of the ethical attitudes of Chinese graduate business (MBA) students. Our findings show that Chinese students know few details about the Enron controversy. Further, their knowledge has shown little affect in the attitudes of the students. We also summarize many of the difficulties of survey research in China, such as language barriers, cultural barriers, systemic barriers, and extreme test anxiety. We conclude by discussing the implications for further research in this area.

INTRODUCTION

Earlier generations of business research focused exclusively on America and Western Europe. The world has changed, as the large state-run economies have crumbled and capitalism has bloomed across the globe. Business leaders in American and Europe were concerned about the ethical views within the newly capitalistic nations and their next generation of business leaders. Our research attempts to explore these views in detail.

Our current project details an exploratory three year survey of the ethical attitudes of Chinese graduate business (MBA) students. In support of this project, we will first discuss the business climate in China. Next, we will give a brief overview of the Enron controversy. We will briefly summarize the past research in this area. We will then give a description of our current research and the findings. We will then detail many of the difficulties of survey research in China, such as language barriers, cultural barriers, systemic barriers, and extreme test anxiety. We conclude with implications for further research in this area.

THE BUSINESS CLIMATE IN CHINA

The new China has been described as "the modern day version of the 1849 Gold Rush" (Schwartz, 2005). China now has the second largest economy in terms of purchasing power (Zedillo, 2006). The economic growth in 2006 was the fastest level of growth in a decade (Browne, 2006b). While it seems hard to imagine, the future of China as a major economic power will only increase.

By 2016, China's workforce age population will be over 1 billion (SinoCast China Business Daily News, 2007). By 2033, China's overall population will exceed 1.5 billion (Xinhua News Agency, 2007).

China's growth was not unique to recent years. China's economy has boomed, steadily growing at 9% (Cox, 2004). China's economy has doubled since 1995 (Prince, 2004). In 2003, the industrial production grew by 50% (Sway, 2004).

China's growth has been fueled by outside investment. American companies have invested $40-50 billion into manufacturing (Cox, 2004). In 2002, China surpassed America as the world's destination of foreign investment (Cox, 2004). China attracted $50-70 billion during 2003 alone (Prince, 2004). In 2004, China experienced a net flow of $10 billion a month in foreign investments (Sway, 2004). Investments in fixed assets grew 27.7% in the first quarter of 2006 (Browne, 2006a). Many new investments are related to the 2008 Olympics (Yang, 2006).

In exports, China's economy has dominated the headlines. China's trade surplus in 2006 should exceed $130 billion, breaking the record from 2005 (Browne, 2006a). China's trade surplus in 2006 grew 55% in one year (Batson, 2006). By itself, Wal-Mart is the sixth largest export market for Chinese goods with annual total of $18 billion (Elliott and Powell, 2005).

To keep up with China's business growth, their educational system has also had to expand. The number of students in higher education in China doubled from 1998 to 2001, and their numbers are rapidly approaching the total number of students in America (Ruiwen, Guoliang, and Hongxiang, 2004). The number of colleges offering an MBA in China has swelled from nine in 1991 to fifty-two in 1997 (Yijun, 2002). MBA programs in China saw a 60% increase in applications from 1999-2000 (Yan, 2002). But with China's strong economic growth, even more MBA programs are needed (Chandler et al, 2005). China will need an additional 350,000 business managers. With current MBA graduation rates, China will not produce the needed managers for 170 years (Yan, 2002).

The MBA students are not just the leaders of China's future industries, but are poised to be the leaders of the world's biggest economy in the future. Wang and Lin's (2003) survey found that 63.9% of Chinese students want to work for a foreign enterprise after graduation. Working for a foreign enterprise brings not only higher wages, but higher social status within China. As of August, 2006, 422 of the Fortune 500 have factories in the Pudong New Area, a free enterprise zone near Shanghai (Ping, 2006). China's MBA students are the world's future business leaders.

China is having ethical crises. Recently both the vice-mayor of Beijing and the secretary general of China's arbitration commission have been charged with taking bribes (Chen and Batson, 2006). Businesses within China have been slow to enact ethical guidelines and see them enforced (Chen and Chen, 2005). Problems of corruption have worsened, and have been compared to the robber-baron days of post-communist Russia (Chen and Batson, 2006).

The current MBA students are their future business leaders. Jaffe and Tsimerman (2005) explained that the ethical attitudes of current business students indicate the future moral climate of business.

ENRON CONTROVERSY

The demise of Enron would rival any Grisham novel for deceit and disaster. Enron went from the pinnacle of influence to the very bottom in a dramatic fashion. Enron executives were heavy donors to President Bush's 2000 campaign (Mintz, 2001). They were the sweethearts of Wall Street. Academics lauded their praises. Then the bottom fell out.

Enron's troubles began on November 9 2001, when the company admitted to over-reporting earnings by $586 million (Feeley, 2002). Less than a month later, Enron filed for bankruptcy protection on December 2, 2001.

Congressional hearings began. Enron employees shredded documents after the SEC announced its investigation. On January 25, 2002, the accountants at Arthur Anderson refused to testify about the shredding, increasing the public belief that something was terribly wrong at Enron. The following day, Clifford Baxter, formerly second in command of Enron, committed suicide in his home.

In February 2002, the GAO filed an unprecedented lawsuit against Vice-President Cheney to release information relating to the White House's actions on behalf of Enron (Milband, 2002). From April to October 2002, the Enron problem was front and center of the public, as daily reports from Congressional hearings, criminal investigations of Enron employees, its accountants, its stock traders, and its political friends kept coming (Behr and Johnson, 2003).

The attention to Enron shifted from curiosity to criminal investigations. Michael Kopper, former Enron executive, pled guilty to money laundering and wire fraud. Andrew Fastow, former CFO, plead guilty to 78 counts of conspiracy and fraud. Kenneth Lay, former CEO of Enron, died on July 5, 2006, after being convicted of six counts of fraud and conspiracy (McLean and Elkind, 2006). His co-defendant, Jeffrey Skilling was convicted of 18 criminal charges (Farrell, 2006).

As the finale to this story, Kenneth Lay did not face criminal forfeiture proceedings because he died while awaiting his appeal (Farrell, 2006). Although Lay claimed to be nearly bankrupt, the Justice Department managed to seize $40 million from him (Farrell, 2006). The seized money will likely be returned to his family.

SURVEY OF RECENT LITERATURE

There is a large body of research on ethics in China. However, great majority of that research involves current business managers, who experienced the state-controlled economy. Further, most of the studies compare Chinese business managers with their adult counterparts in other regions.

Lim (2001) found that Chinese employees have a different attitude towards bribery and corruption than Singaporean employees. Tan and Snell (2002) and Snell and Tseng (2001) interviewed and compared the ethical views of ethnic Chinese and expatriate managers. Pang et al

(2003) compared the ethical views of nurses from China, Japan and USA. Patel, Harrison, and McKinnon (2002) compared the ethical views of auditors from China, India, and Australia.

Many authors have explained both the benefits and pitfalls of Chinese dependence on close relationships (guanxi) to conduct business (Vanhonacker, 2004; Lovett, Simmons and Kali, 1999; Bruner, et al, 1989; Chan, Cheng, and Szeto, 2002; Chan and Lau, 2000; and Davies et al 1995). Leung and Wong (2001) examined the ethical dimensions of guanxi.

Ip did case studies on a Chinese corporation (2002) and a state owned enterprise (2003) and examined their corporate culture of ethics. Gul, Ng and Tong (2003) found that ethical attitudes affect behavior among Chinese auditors. Islam and Gowing (2003) found similar results when surveying industry leaders and academicians in China. Harvey (1999) found that while the Chinese lack an understanding of Western business ethics principles, they follow a similar behavior based on their cultural teachings.

Redfern and Crawford (2004) examined the effect of modernization on the ethical decisions of Chinese managers. Brand and Slater (2003) examined Australian managers within China. Hofstede et al (2002) compared business leaders from fifteen countries, including China, on their goals and beliefs. Fok, Hartman, and Kwong (2005) surveyed business professionals in Jamaica, China, and the US over a ten year period.

There are few studies using current business students in China. Whitcomb, Erdener and Li (1998) found that Chinese students have a different ethical reasoning than their American counterparts, even if they reach the same conclusion. Bu & McKeen (2000) found Chinese students have a greater dedication to work than Canadian students.

In some research, Hong Kong students are studied as a surrogate of Chinese nationals. For example, Cheung (1999) found that exposure to business ethics theories affected the views of business students in Hong Kong.

However, none of these studies attempted to measure the effects of the Enron controversy on Chinese business students. Further, none of these studies related their findings to student knowledge of ethical theory or knowledge of the Enron controversy. The current research sought to find the effect of being educated under a state-run economy and whether the ethical attitudes would change for a new generation.

METHOD

The respondents were from Tianjin, an industrial city in the northwest of China. They attended a private southwestern American university's Master in Business Administration (MBA) program. The program lasted 12 months, and the students completed the courses as a set. The students completed the survey during the same course in three different cycles. As a result, there should have been no overlap of students between groups. The first group was surveyed in

November, 2003 (n=40). The second group was surveyed in August, 2004 (n=39). The third group was surveyed in November, 2005 (n=50).

The survey was offered during class time and all students participated. The survey instrument was written in English, which was also the language of all the courses, the instructors, the textbooks, exams, assignments, and lectures.

The 129 respondents were evenly split between males and females. About one-third were married, and 75% were full time employees while taking the MBA program. They were overwhelmingly young, with 80% in their 20s. Surprisingly, tobacco use was a demographic difference among respondents. China has 350 million smokers, more than any other nation (Fairclough, 2007). Unlike Americans, the Chinese smokers are almost all male (Fairclough, 2007). Within our samples, none of the women reported tobacco use.

DISCUSSION

The issues this research attempts to clarify are whether Chinese business students understand the Enron controversy. We also wanted to see if that knowledge affected their views toward ethical business behavior. We attempted to find the answers.

H1: MBA students should have a greater understanding of the Enron controversy than the public.

We originally estimated that 75% of the MBA students would demonstrate knowledge of the Enron controversy. This estimate is high, but these are graduate students, already possessing a business degree, and most working full time. They should be well aware of current events in business. We began with three superficial questions to explore the depth of their knowledge. First, students were asked to select the former CEO of Enron. The choices were: Kenneth Lay, William Sanders, Kenneth Norton, William Bennett, and Paul O'Neil. Only one in five students could correctly identify Kenneth Lay, a result equal to random chance.

Next, we asked students to complete this sentence: "Enron got in trouble for?" The choices were: false financial reports, hiring illegal immigrants, polluting rivers, refusing to pay taxes, unsafe working conditions. The overwhelming majority (93%) knew that Enron had submitted false financial information. This result was very positive. However, 7% of the MBA students still do not understand the basic controversy over Enron.

Finally, we asked to choose Enron's primary industry. The choices were: Oil and electricity; medical supplies; real estate development; sporting goods; clothing-apparel; and agriculture. The results were not as promising as we had hoped. Only half the students (58.9%) knew that Enron was involved in oil and electricity.

Overall, the findings are very distressing. We did not even get close to our estimate of 75% passing. Fewer than one in ten (9%) of the MBA students could correctly answer all three basic questions about Enron. Obviously, the students' understanding of Enron is shallow.

Table 1. Correct Answers		
Question and Correct Answers	Number	Percentage
Who is the former Chief Executive Officer of Enron? (Lay)	25	19.38%
Enron got in trouble for: (False Financial Reports)	120	93.20%
Enron was primarily involved in what industry? (Energy)	76	58.91%
Answered all three questions correctly:	12	9.30%

H2: Students' demonstrated knowledge should equal their perceived level of knowledge.

We wanted to see if students were confident in their knowledge of Enron. We asked students to describe their personal understanding of the Enron problem. See Table 2 for complete results. Fewer than 7% of students considered themselves familiar with Enron. This was very close to the percentage of students who got all three questions correct (9.3%). In other words, students are not deluded into thinking they are knowledgeable when they are not.

Twice as many students (18.5%) indicated they either knew very little, or had never heard of Enron. This is alarming. Many people in society paid passing attention to this controversy. However, for graduate business students to be unaware of this highly publicized controversy was a concern.

Table 2. Self-reported knowledge		
How knowledgeable are you about the events of the U.S. company called "Enron"?	Number	Percentage
I am very familiar with it	9	6.98%
I know a little about it, but not many details	95	73.64%
I don't know anything about it, but I have heard of Enron	19	14.73%
I've never heard of Enron	5	3.88%

ATTITUDES/ETHICAL BELIEFS

H3: The majority of respondents would consider the events of Enron to be an aberration.

We asked students if the only difference between the executives at Enron and those at most other big companies was that those at Enron got caught. A slight majority (52%) agreed or strongly agreed. Less than a third (28.69%) disagreed or strongly disagreed. Nearly two in ten had no opinion. The findings support, but do not prove that Chinese students thought Enron's behavior to be typical of American businesses. This was a surprise. This finding may also explain why the respondents had so little knowledge about the Enron controversy. If they viewed Enron as typical behavior, it would not be remembered.

We also were curious whether Chinese students would work for an unethical business. We asked students if they would want to work for a company that had been accused of unethical business practices. Just over 10% responded affirmatively. About a quarter of the students were unsure. A strong majority (65%) indicated they did not want to work for a company accused of unethical behavior. The students have made a strong statement for the importance of ethical behavior.

THE LANGUAGE BARRIER

One problem which we experienced was a language barrier. While most of the graduate students spoke English, they often lacked an understanding of American culture and customs, as well as our educational traditions. Past research indicates that many MBA students lack enough language skills to participate in a class discussion. Du-Babcock (2006) found nearly 75% of Chinese MBA students had limited English proficiency. Even those who can translate have difficulty with embedded cultural context in language (Du-Babcock, 2006).

Within our research, the Chinese students were proficient in translating, but much of the information was lost. They were not familiar with educational terminology used by Americans. For example, while this was an MBA program, over 30% percent (39/127) of the students said they were not "business" majors. In the November, 2005 sample, 60% (30/50) did not describe themselves as graduate students. Clearly, there is a problem which translation alone cannot solve.

THE CULTURAL BARRIER

The Chinese classroom is a reflection of their society in general, which emphasizes unequal power structure (such as ruler and subject) to keep stability (Rodrigues, 1997). In Chinese culture, teachers are authority figures and students are expected to be passive learners (Rao, 2006). Hofstede & Bond (1988) described this as "Confucian Dynamism." Confucianism has greatly influenced the Chinese learning culture (Flowerdew, 1998; Oxford, 1995). Offering your opinion is considered bold and immodest (Holmes, 2004) if not egotistical and selfish (Kennedy, 2002). This minimizes interaction in the classroom.

The Chinese students only shared their views if they felt certain they were correct (Thompson, 2000). They expected the classroom to be a very formal environment (Watkins, 1988). As such, they were uncomfortable when asked their opinions. Chinese people (especially the young) were not expected to give their opinions (Yun, 1994).

The Chinese educational system emphasized one correct answer, which must be learned by memorization from the masters, and repetition (Rao, 2006; Hammond and Gao, 2002; Thompson and Gui, 2000; Carson, 1992; Redding, 1980; Cragg, 1954). Chinese students expected issues to be straightforward, without dispute (Watkins, 1991). They tended to be passive in the classroom (Kumaravadivelu, 2003). They did not like confrontation among their peers (Carson and Nelson, 1996) or with their professors (Liu, 1998). The tradition of repetition stemmed from the teaching of writing Chinese characters, which must be practiced until they were perfect (Rao, 2006).

In our research, most students were extremely apprehensive about discussing anything in class. Students would not respond to open-ended questions or discussion starters. As a result, most students get little interaction with the instructor, and more importantly, little interaction in English, which only complicates the language barrier.

EXTREME TEST ANXIETY

China's long tradition of education emphasized examinations. Over a thousand years ago, China used an imperial civil service exam (ke ju) to select government officials. The ke ju was an important (if not the only) way for a Chinese family to raise their income and social status (Rao, 2006). The ke ju was replaced in modern times with the National Matriculation Examination, which affected the student's career for their lifetime (Rao, 2006). The pressure on students was very strong. Culture motivated the people and failure reflected not just on their students, but on their entire family and social group (Rao, 2006).

In our research, the students panicked while conducting the survey. They were worried they would not have "the correct" answer, even with an anonymous survey. The students had to be reassured several times that the answers would not affect their grade in any way. Even so, there was widespread "sharing of information" among students. To avoid complete chaos in the classroom, the proctors stood back. Students collected the surveys, ensured no one had put names on them, and mixed them before returning them to the proctor.

THE SYSTEMIC BARRIER

The Chinese educational system made survey research difficult. Large scale surveys required cooperation and permission from authorities, which rarely occurred (Thompson & Gui, 2000). The dramatic political and social changes clashed with China's new openness. Chinese workers expected to get permission for any new or novel action. Often this took months. After the reforms, there was no one to ask for permission. Without the approval of someone in the educational hierarchy, many would not participate. This prevented a lot of wide scale survey research, especially related to ethics (Smith, 2004). To compensate, surveys used students from Hong Kong (Leung and Wong, 2001; Thompson, 2000; Thompson and Gui, 2000) or expatriates (Lim, 2001; Patel et al, 2002; Tan and Snell, 2002) to represent the views of those in mainland China.

In our research, we faced this problem at every turn. We desired to have a much broader group of respondents, possibly including undergraduate students at the same school and other nearby universities. Each time, we were welcomed and freely discussed the matter with our academic peers. However, once we mentioned surveys to be given to the students, our peers instinctively sought permission. After talking with many administrators, no one knew who to contact, so the large scale survey could not proceed.

IMPLICATIONS FOR FURTHER RESEARCH

Several lines of future research are possible. First, these results should be viewed as preliminary because of the small sample size. When the respondents were divided by demographic factors, the groups were too small to draw any significant comparisons. The findings need to be replicated with a much larger sample involving multiple schools. We have previously mentioned the difficulty of acquiring a large sample in the Chinese student community.

The scope of students being surveyed also should be expanded. All the students in this sample were graduate students in business. Were their views distinct from undergraduates and non-business majors in China? The choice of major has shown some differences in previous studies (Tse and Au, 1997; Rawwas and Isakson, 2000; Ludlum and Moskaloinov, 2005; and Whipple and Swords, 1992). A diversity of majors should be examined in future research.

Ethics differ across cultures, even if within the same country (Alas, 2006). As the culture developed over the generations, the values and behaviors within that culture changed (Ahmed, Chung, and Eichenseher, 2003). There are many differences among the 56 ethnic groups within China (Xiulan, 2005). The Chinese people are not a homogeneous group. While Mandarin is the most common language and the official language of the government, there are six other dialects which are used in different regions (Xiulan, 2005). Even their currency shows their multilingual culture, with writing in traditional Chinese characters, Hanyu, Pinyin, Zhuang, Tibetan, Uyghur, and Mongolian. Future research should examine the cultural differences within China.

Another line of inquiry should explore the effects, if any, of business ethics courses. Future research should investigate whether a business ethics course indoctrinated students into certain ethical views, and whether those views translate into business behavior after schooling. In America, taking an ethics course had not translated into changed ethical views (Ludlum and Moskaloinov, 2004). As ethical studies expand in China, we should examine the effect of business ethics teaching on the beliefs of students.

CONCLUSION

China's recent economic expansion has been unlike anything in history. China will continue to be a dominant economic player for the next century. China cannot be ignored. The attitudes of China's future business leaders will determine the ethical state of this new world economy.

As educators and world citizens, we should keep our attention on the development of business ethics in China as it emerges into the dominant economic power in the world. We also share a responsibility for shaping this ethical climate, since many of these future business leaders will be trained by American business professors. We should not and cannot assume that exposure to American textbooks will mean exposure to and support or our ethical ideals. We must take responsibility for sharing our ethical traditions which underpin our business philosophy.

If we are to be business partners with China in the future, and all indications point in that direction, we must educate these future business leaders not just on our principles, but on our practices as well, and that includes our failures, such as Enron. We cannot assume everyone in the world, even graduate students in business, will have an understanding of the recent ethical crisis and the resulting changes in our accounting and procedural rules of business. We must educate these future leaders that many of our policies are formed after failures in the market. These failures are not the conclusion, but rather a point of learning and a way of improving the system in the future.

ACKNOWLEDGMENTS

The authors wish to express their thanks to two blind reviewers who gave helpful comments on a draft of this paper. Any errors or omissions are solely that of the authors.

The authors would also wish to express thanks to Lea Ann Hall and Kristi Fields for their many hours of input on the survey results. The authors would also like to thank Jenean Jones for her assistance with the spreadsheet calculations. A previous draft of this research was presented to Southern Academy of Legal Studies in Business, March 9-11, 2006, San Antonio, Texas

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CYBER-PLAGIARISM:
DIFFERENT METHOD-SAME SONG

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ABSTRACT

How does one change the actions of someone who is determined to engage in academic dishonesty? The following suggestions range from attempts to change character and the academic culture to redesigning the educational environment. Cheating occurs in the online environment in addition to the traditional environment. This essay discusses cheating-reduction methods that can be used in either or both types of learning environments.

HONOR CODES

The recent corporate scandals represented by the bankruptcy and criminal prosecutions of officials from Enron, WorldCom and other apparently successful corporations have raised the question whether business ethics education should hold an increased presence in business school education. These scandals have resulted in increased regulation, e.g. Sarbanes-Oxley (Sarbanes-Oxley, 2003), increased visibility and examination of corporate codes of conduct (Berensen, 2004) and revamped professional codes of conduct for accountants and boards of directors' members (Berensen, 2004). These reactions reflect society's justifiable concern that corporate executives and managers had not fulfilled their fiduciary responsibilities when managing shareholders' money.

Just as the ethical and legal lapses in the business world have resulted in increased scrutiny of business conduct and a renewed interest in ethics and legal sanctions, increases in students' academic dishonesty have resulted in increasing efforts to curb it . Schools have considered developing student conduct or honor codes as one method to curb the rising tide of dishonesty (Donald L. McCabe, 2005; "Nevada Schools to Adopt Code of Honor to Curb Student Cheating," 2005; Schulman, 1998). This renewed interest is due in part to studies that show that cheating during tests is one-third to one-half lower in schools that have honor codes as contrasted to schools that do not (Donald L. McCabe, 2005). In addition, in these schools, students are more likely to report cheating by the peers than in non-honor code campuses.

One explanation for the reduction in cheating in schools with honor codes maybe be because the institutions focus on character and the school's culture. If the institution successfully makes a shift to encourage increased academic integrity, then students may conclude that everyone is not cheating and feel less justification to cheat or condone others' cheating. In a small, relatively homogenous group, a values-based honor code might be an effective way to change conduct (Berensen, 2004). It would be easier to change, in part, because the group is starting from a common value base.

Changing an academic environment is a long-term strategy that may be difficult to implement in large state universities. Large universities do not have a homogenous student population. The difficulties in changing culture in that environment are much more intractable because of that diversity in values.

Because it may be difficult to change ethical values, the more effective codes may be regulatory codes that are designed to proscribe behavior coupled with the imposition of sanctions when the rules are violated. In the legal profession, the code of professional responsibility has moved from a code based on general ethical rules that lawyers pledged to follow to a more regulatory-oriented code which defines proscribed and prescribed behavior, contains examples of appropriate and inappropriate behavior and establishes sanctions for failing to follow those rules (Berensen, 2004).

Because students in online courses hail from any geographic location, fostering similar values may not be practical, possible or an efficient use of time (Moore, 2003). For example, the University of North Carolina's Instrument of Student Judicial Governance states that it is "adopted in furtherance of the University community's shared commitment to the pursuit of truth, and the dissemination of knowledge to succeeding generations of citizens devoted to the high ideals of personal honor and respect for the rights of others. These goals can only be achieved in a setting in which intellectual honesty and personal integrity are highly valued; other individuals are trusted, respected, and fairly treated; and the responsibility for articulating and maintaining high standards is widely shared"(University of North Carolina, 2003). This code is an imposes an obligation to act with integrity without limiting it to only traditional courses.

AUTHENTICITY STATEMENTS

Requiring that students require an authenticity statement is a variation of the honor code theme. The authenticity statement is a declaration from the student that the work is his or her own. Students thus make a written commitment that the language used in a project is their own and that if it is not, there has been proper attribution (Boyd, 2005). Requiring authenticity statements are practical for all courses, whether online or traditional courses. Such a statement could be incorporated into assignments through course announcements, requiring that students manually sign and scan a document submitted to the professor, a digital signature through making an authenticity statement a requirement before each assignment is submitted or requiring such a statement at the beginning of a course (Student Judicial Affairs).

PROVIDE CLEAR DEFINITIONS OF CHEATING AND PLAGIARISM

A significant amount of cheating and plagiarism occurs because students do not clearly understand what constitutes cheating and plagiarism (McMurtry, 2001). Most students know that surreptitiously glancing at and copying another student's answers during a proctored exam is cheating. Most students know that making an identical copy of another student's work or copying another's author's work is cheating. Students do not have equally clear beliefs regarding other types of academic dishonesty. Students have alleged, for example, that using the same paper from one semester to the next is not cheating and that copying someone's work and changing a few words and/or changing the order is not cheating.

An institutional and/or instructor-based explanation of the policy for the course can clarify acceptable uses of previous semesters' work for a current course. In this author's experience based on anecdotal evidence, students believe that changing a few words constitutes writing the work themselves and does not constitute cheating. In an appeal, a student alleged that he had not cheated because he reorganized part of the other student's work and that that was not academic dishonesty. This appeal was denied at every stage.

Students may not clearly understand that "cutting and pasting" resources from the internet is plagiarism. Students may not clearly understand the parameters of acceptable collaboration on group projects. The university, school and instructor must establish and publish clear definitions of academic dishonesty. This may even require that faculty provide examples to buttress and clarify their definitions or create course-specific definitions. In addition to the institution's definition, this author provides a detailed definition of academic dishonesty in the course syllabus for each course (See Appendix A). To clarify permissible and impermissible collaboration for group assignments, this author specifically defines acceptable collaboration.

USE VIGILANCE IN DETECTING INCIDENTS OF CHEATING AND PLAGIARISM

Using technology to detect plagiarism is one way to minimize students' submission of plagiarized assignments in online and traditional courses. A professional service company such as Turnitin (http://www.turnitin.com/static/home.html) will check students' papers for plagiarism. Turnitin keeps a database of billions of pages copied from a variety of sources including journals, Internet resources and papers submitted by other students through Turnitin. Turnitin can be used in two ways. First, students can submit their papers through Turnitin and review their originality score. Students can use those results to properly cite sources or can revise their papers so that they paraphrase material appropriately. In the alternative, or in addition, faculty can require that students submit their assignments to the faculty member through Turnitin and the faculty member can use the resulting originality score to detect plagiarism. Because the papers submitted by students become part of the Turnitin database, the faculty member has a database of past papers to check for plagiarism. That feature allows faculty to identify whether other students have submitted that same work for any course that also who requires submission to Turnitin.

Note that services such as Turnitin generally require that the university obtain a license so that any faculty member (and student) can use the service or requires that the faculty member obtain an individual license. Because Turnitin keeps a copy of the student's paper to use for future searches, faculty and instructors should include a disclaimer in their syllabi that allows the instructor to use Turnitin. This should be enough to address any copyright issues that arise when Turnitin keeps a copy of the student's creative work. If a student reading the syllabus notice objects, the faculty member can decide whether to use another method to check for plagiarism.

An alternative (and additional) method of checking assignments and papers is to use Google (www.google.com) or another search engine to detect plagiarism (McMurtry, 2001). In this situation, the instructor can select phrases from a paper about which the instructor is suspicious (or from all papers, depending on the instructor's preference). By pasting the selected phrases into Google, for example, and using quotation marks around the phrase, the instructor can usually find any internet sources used by the student. Selecting several phrases from several different parts of a paper will usually permit the instructor to find out whether students used publications available on the internet in whole or part to write their paper. Sometimes merely announcing that faculty will use such tools can be a deterrent.

Some faculty require that students submit all copies of all resources the students used for the paper. The faculty member can use those resources to check whether the student had plagiarized from the resources. This assumes that students will be truthful about the resources he or she used to write the paper. Instructors are more likely to find evidence of cheating or plagiarism through using a combination of several of these methods.

STATE AND ENFORCE SANCTIONS

Deterrence through clearly defining what actions constitute academic dishonesty is one component of an effective policy to minimize cheating. Another component is to impose sanctions on those who have been determined to have violated the policy. A policy is only as effective as its enforcement against those who violate it. Faculty must be willing to take substantive action when students have cheated, especially when cheating has been clearly defined. In fact, students who want to cheat may choose to take courses from faculty members who do not effectively police cheating. Schools must also support faculty efforts to reduce cheating by endorsing sanctions imposed by faculty and not obstructing the faculty's efforts.

This is true for the online environment also. Students communicate with each other in a variety of ways, including e-mail, personal conversations, instant messaging and through websites such as ratemyprofessor.com. Thus, although students may not have taken a course face to face with a professor, the student can still communicate with classmates regarding the professor's diligence in detecting and minimizing cheating.

RE-DESIGN COURSES

A more comprehensive strategy for reducing academic dishonesty is to develop and employ pedagogically sound teaching techniques and assignments (Hinman, 2002; Waterhouse, 2004). This is a more substantive, time-consuming and effective method of preventing plagiarism and cheating. Traditional assignments and testing methods are based on the assumption that the faculty member can supervise students' activities, at least in the classroom. To teach effectively and to do so while minimizing cheating and plagiarism, the course should be re-examined by reviewing objectives and goals to determine whether the goals and objectives can be accomplished using another method.. In online courses, the instructor should consider whether there are additional or different ways to accomplish those goals in the online environment where the instructor does not personally witness students' performance. For example, in online courses, one way to reduce the opportunity to cheat is to require more online discussions using asynchronous or synchronous discussion features of a course management system. There are several benefits of such discussions, including:

> *Students can be encouraged to discuss concepts with each other. They can collaborate with and learn from each other through this interaction.*
>
> *Students can practice using critical thinking skills to identify, analyze and solve the problem.*
>
> *Students have an opportunity to review others' comments and reflect upon those comments.*
>
> *Students have an opportunity to carefully craft responses rather than commenting "on the fly" as required in an oral discussion in class. Quieter students in class and students whose first language is not English benefit from the enhanced opportunity to review comments before posting them.*
>
> *Instructors have an opportunity to carefully review comments and, as appropriate, provide clarification and ask follow-up questions to enhance critical analysis.*
>
> *Instructors have an opportunity to know their students in online classes and to recognize individual students' online personalities.*
>
> *Instructors can immediately refer students to online resources to supplement course materials and online discussions*
>
> (Madhumita Bhattacharya, 2000; Ngeow, 1998).

Another option for redesigned courses is to reduce the value or weight of online testing, especially where the testing involves objective questions or traditional/global short answer questions. Instructors can use such tests as self-tests (where students receive credit for taking the tests, but not for a specific grade). Instructors can also reduce the value of the tests in relation to the course grade. The result of these modifications would be that there would be no significant advantage to students to engage in academic dishonesty during tests. A subsequent section presents other alternatives for modifying the testing environment.

Redesigning courses specifically for the online environment is a time-consuming but effective way to minimize academic dishonesty. By considering the differences between the online and traditional classroom environments and by taking advantage of the difference in designing courses, the opportunities for academic dishonesty can be reduced and learning opportunities can be increased (Waterhouse, 2004).

MODIFY ONLINE TESTS & THE TESTING ENVIRONMENT

For those using online tests composed of objective questions, there are several actions that can to reduce the likelihood of cheating and unauthorized collaboration. One is to use large pools for each test, so that it is unlikely that each student will be asked identical test questions. This minimizes serial test-taking by students who might cooperate on exams. Each students takes an exam composed of different questions on the same material.

There are pedagogical considerations that might weigh against this option. If each student is tested using a different set of questions, the testing conditions are not identical. The students' scores are partially a function of pure chance whereas if each student is tested using identical questions, comparing results among students is simpler and perhaps the test has more validity as a determinant of what students have learned.

Another possible action is to limit the amount of time each student has to complete the exam. If a student is attempting to collaborate and/or use unauthorized resources, but has a limited time to respond to the test questions, the student will not do well unless he or she has knowledge of the material.

Making exams open book and open resource in that context would still require that students read and study the book in order to answer the questions. This is especially true if the questions require application of concepts and not merely recognition of material that is in the textbook. A corollary to limiting the actual test time is limiting the time that the test is available. Some instructors use a 4, 5 or 6 hour window within which the test will be available. Because flexibility is one of the hallmarks of an online course, though, this information about time limits must be disclosed to the students when they enroll, so they know whether they would be available to take the test during that time.

Requiring proctored exams permits the instructor in an online course to simulate the testing conditions of a traditional course. Requiring proctored exams requires that the instructor set specific times for the exams and to make arrangements for students to take exams in the presence of a disinterested, unrelated proctor. There can be logistical problems with this approach when students enroll in the course from locations throughout the globe. Similarly, a proctored final exam could be required for all students in the online course and the course grade dependent in some way on the results of that exam.

This author requires that students in all classes (traditional, hybrid and online) pass a comprehensive final exam with a "C" or better in order to receive the grade they earned in the course. For example, the syllabus in the Summer 2005 graduate business law/legal environment course that was totally online stated: "The final will be comprehensive. You must pass the final exam with a "C" (70%) or better to receive the grade you earned in the course. If you receive a "D" on the exam, your course grade will be lowered one grade. If you receive an "F" on the final exam, you will receive a "F" for the course, depending on whether you were passing the course."

There can also be logistical problems with using proctored exams. To employ these approaches, the faculty member may have to work in consultation with administration to establish the appropriate environment for the proctored exam(s) and must notify students at the time they enroll that certain specific times must be set aside for the exam(s). This requirement also has an impact on one of the hallmarks of an online course—flexibility to take the course anytime from anywhere. The institution's policy on online courses may affect availability of this option.

Another option is to use short answer or essay questions for all exams. To be effective at preventing academic dishonesty, exam questions should be as course-specific as possible. Thus, the questions should be based on required course readings, on online class discussions or both. Time to respond could be limited or students could be given all questions in advance and the specific questions to be answered could be randomly selected when the student logs on to take the exam. None of these actions prevent a student from employing a surrogate from beginning to end of the course; however in a traditional course a surrogate could also be employed unless the faculty members routinely check identification cards for students that are enrolled.

Biometrics, the science of using biological characteristics to verify identity, promises additional means to verify the identity of test takers (Erica Frazier, 2005; Foundation, ; Robert A. Wisher, 2002). Biometrics-based devices depend on fingerprints, retinal scans, voice recognition or other characteristics to verify identity and to limit access to the materials connected to those devices. In essence, these devices attempt to rely on immutable biological, personal characteristics to verify the identity of the test-taker. To prevent fraudulent activities such as checking in but allowing another to take the exam, some devices require more complete scans of several biological characteristics and regular re-checking points to verify the identity of the person taking the exam. For example, there are some retina scan devices that regularly check the retinas of the individual taking the exam. It would be more difficult (but not impossible) for someone other than the person whose retina has been scanned to successfully take the test. Other devices require fingerprint identification prior to taking the exam or cameras attached to the students' computers that that record the entire testing environment in order to see whether the student used unauthorized resources. These devices may require that students purchase this equipment so there can be cost considerations. Other issues that arise with these uses of technology include privacy issues relating to proper use, storage and access to this biological information.

MODIFY WRITTEN ASSIGNMENTS

Increasing the weight of properly designed written assignments can reduce the impact of academic dishonesty during exams. If the value of objective exams is decreased relative to the students overall grade, then student cheating on the exams would not guarantee a passing grade in the course. Students would have to also perform appropriately in the other areas on which the students are assessed.

What is a properly designed written assignment? It is one that helps instructor determine whether the course objectives have been accomplished through the student's effort. For example, if the objective is to determine whether students can properly brief a case, the faculty member can ask students to brief relatively recent cases which are less likely to be available on the internet. The instructor can require that the student explain similarities and differences between the case(s) briefed and the text's discussion of the topic. Faculty can ask students to explain in their own words so that students must paraphrase rather than repeat the exact words of the opinion. Faculty can "test" student comprehension online by requiring group discussion of the cases briefed and to report on similarities and differences. Faculty can limit the length of the brief, thus requiring that students identify key issues within a relatively short space.

For faculty who require term papers, there are several methods for limiting the students' use of unauthorized resources. Explaining the research process and specifically discussing how to paraphrase is one step. A second step is defining and giving examples of plagiarism. A third step is requiring that students submit papers a stage at a time, e.g. topic, outline, list of resources and a summary of their key points, and attaching copies of (or links to) all resources used. Faculty members could limit the resources used for a paper (e.g. to articles from a certain journal or from a certain time period) and thus faculty could more easily check to determine whether plagiarism occurred. Instructors should also increase their awareness of the material that is available online. The more generic or global the topic, the more likely students can find a paper online. To test this, select a topic and type it into a search engine to find out what is available.

Faculty should give students adequate time to complete an assignment and provide periodic reminders of due dates, especially in an online class where demands of traditional classes might supplant regular student involvement in the online class. Submission of assignments in stages helps this process. Faculty could also request electronic submission of all assignments and keep those in a data file to check for future plagiarism.

One key to reducing cheating and plagiarism on written assignments is that faculty must vary assignments each semester. Even if the assignment is intended to accomplish the same objectives each semester, the type of assignment, the resources used or the timing of the cases must be altered to minimize cheating. Limiting the topics each semester helps to minimize the ability of students to use a previous semester's assignments. Because there are a breadth of topics in legal environment and business law courses, faculty could use a different set of topics each semester without duplication. Faculty can assign more structured topics and require course-specific information in the assignment.

Using the same tests and assignments each time the course is taught may increase exponentially the likelihood that students can successfully cheat in traditional and online courses. Most faculty have heard about the "frat house" test banks accumulated through the years or tales of students from one section of a course telling students in another section of the course what to study. Similarly, if an instructor assigns the same paper to students each semester, then students who are predisposed to cheat will consult with previous semesters' students to obtain papers to submit. Additionally, because papers can be bought and sold so cheaply on the internet, the opportunities for cheating are increased. If the instructor ties assignments and exams to material discussed in the online class, limits the resources that students must use and/or ties assignments to the readings required for the course, it is more difficult for students to successfully submit a "cookie cutter" paper purchased from a paper mill.

USE AN ALTERNATIVE APPROACH: ASSIGNMENTS OUTSIDE THE BOX

In a provocative essay based on his book Free Culture, Lawrence Lessing argues that students should be permitted to use their ability to cut and paste in a way that is creative and is rewarded (Lessig, 2004). He argues that there is a creative commons that should exist and that should allow individuals to improve upon previously made/copyrighted material. Thus, educators would develop assignments that require that students take existing materials and convert them to new uses.

How would that work? Faculty could start with assigning topics from the textbook. Each student (or group) could be assigned to copy passages from the textbook and compare to one or two sources from the internet. Specifically, students could be asked to copy (cut and paste) verbatim, then discuss the similarities and/or differences. Another alternative would be to ask students to take material from the text and from other sources and create a new document that contained elements of all sources. This approach takes the "cut and paste" activities that are so common for students and asks them to do so in a way that requires more critical thinking. Depending on the course objectives, modifying course assignments using this approach could be effective.

CONCLUSION

Preventing cheating in online classes requires that faculty adapt to the new technology through, in part, recognizing that students may have more and different opportunities to cheat.

Careful crafting of assignments in the online environment can limit students' ability to engage in academic dishonesty in online and in traditional courses. Will these techniques reduce cheating to none? Probably not, but adapting traditional courses to the online environment in a way that acknowledges the different characteristics of the online environment can reduce the opportunities for academic dishonesty.

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APPENDIX A

SYLLABUS STATEMENT REGARDING ACADEMIC DISHONESTY AND CHEATING

This author's syllabus includes the following statement regarding academic dishonesty: "Academic dishonesty, including cheating and plagiarism, will not be tolerated. It is a violation of ethical principles and university policy. Plagiarism involves taking or using the writings or inventions of another and claiming them as one's own. It also means quoting directly from any source without giving credit to the true author and without using quotation marks. In this course, pay special attention to information you obtain from the Internet and do not claim it as your own (this means you must use quotation marks and note the internet source of the quote). This means no "cutting and pasting" information from the Internet or from your textbook or other readings, except in rare instances where you give attribution.

To avoid plagiarism, you should learn to paraphrase ideas in your own words. First, read the textbook or other reading material. Second, without looking at the text or reading material, write a summary of what you've read. After you've done that, then look at the reading material to be sure you have clearly explained and understood the material. Add any clarification necessary. Using that method greatly decreases the likelihood that you will plagiarize material.

Cheating is defined as any intent to deceive your instructor in her effort to grade you fairly based on your own effort and work. Cheating involves anything that can possibly affect the fairness of grading. This also means that when you collaborate, as is permitted in many of the work for this course, you may not use the words of your classmates or anyone else from whom you obtain information. Instead, you may consult, but you must write in your own words.

To reiterate, academic dishonesty includes, but is not limited to:

- *Copying another persons' examination, paper, research or creative project;*
- *Submitting another's work as one's own, a previous semester's paper for the current class without instructor permission; a paper from another class without permission or helping another student to do so;*
- *Using materials, notes, sources or materials not authorized during an examination;*

- *Employing a surrogate to take an examination or to do the work for this course;*
- *Using dishonest means to obtain credit for academic work; and*
- *Plagiarizing or attempting to obtain or obtaining credit for academic work by representing the work of another as one's own. Plagiarism includes copying ideas, words of sentences, paragraphs or parts of those without appropriate acknowledgement.*

If you have doubt whether an action constitutes academic dishonesty, please contact the professor.

Anyone caught cheating or plagiarizing can suffer any of the following sanctions: 0 for an exam or assignment, F for the course, and/or expulsion from the university. Additional potential penalties include suspension, probation, and termination of financial aid, and any other University remedies. At a minimum, cheating or plagiarism in this class will result in a zero for the assignment involved and a report of the incident to the Dean of Student Affairs. More severe penalties, including seeking expulsion from the University, may be imposed if warranted and permitted by University policy."

THE PROPOSED EMPLOYEE FREE CHOICE ACT: IMPLICATIONS IN THE WORKPLACE

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ABSTRACT

Card check elections are being touted by various pro-union groups as a "fairer" way of determining employee representation wishes than the NLRB representation election specified in the National Labor Relations Act (Wagner Act). They argue that with the traditional NRLB representation election, management can fire, coerce, and intimidate employees into voting against the union. Pro-business groups argue, in turn, that many employees may feel pressured by union organizers to sign authorization or pledge cards, and that management should have an opportunity to respond to a union organizing effort. In this paper, we review some of the implications of the proposed Employee Free Choice Act, should it be eventually passed into law.

INTRODUCTION

In May, 2006, janitors at the University of Miami ended a two-month strike which included hunger strikes and a short take-over of an administration building. The janitors are employed by the university's cleaning contractor, Unicco Service Company, headquartered in Newton, MA, which also employs janitors at Miami International Airport. The janitors at Miami International are represented by the Service Employees International Union, while the janitors at the University of Miami were not represented by a union at the beginning of the strike. The strike centered around three major issues: (1) pay rates, (2) health care coverage, and (3) a card check election.

After several weeks of protests and demonstrations, the University of Miami and Unicco agreed to raise wages by at least 25% and offered healthcare coverage at reasonable rates. However, the card check election issue caused the strike to continue. Workers and the SEIU wanted union representation to be determined by means of a "card check election" where if a majority of the workers sign authorization cards, the company agrees to recognize and bargain with the union. Unicco wanted a representation election to be conducted by the NLRB. Eventually, in early May, 2006, Unicco agreed to the American Arbitration Association (AAA) verifying pledge (authorization) cards signed by employees. The agreement stipulates that if at least 60% of the employees sign these cards by August 1, 2006, Unicco agrees to recognize the union as the exclusive bargaining agent for the janitors. By the middle of June, 2006, 290 of the 385 (75%) janitors had signed pledge cards. On June 15, 2006 the AAA announced that more than a supermajority (60%) of the workers in the bargaining unit (290 out of 385 votes, or 75%) had signed cards asking that SEIU be designated their exclusive bargaining agent.

Card check elections are being touted by various pro-union groups as a "fairer" way of determining employee representation wishes than the NLRB secret ballot representation election specified in the National Labor Relations Act (Wagner Act). They argue that with the traditional NRLB representation election, management can fire, coerce, and intimidate employees into voting against the union. Pro-business groups argue, in turn, that many employees may feel pressured by union organizers to sign authorization or pledge cards, and that management should have an opportunity to respond to a union organizing effort.

Other unions are pushing for card check elections. In May 2006, workers at a St. Louis, MO, area Peabody coal mine demanded a card check election. In April, 2005, a neutral outside arbitrator verified that a majority of the employees at the Goodyear Tire plant in Social Circle, GA, chose to unionize. Under an agreement between the United Steel Workers and Goodyear, the company will now recognize and bargain with the union. Between 2003 and 2005, several other Goodyear plants, including plants at Fayetteville, Georgia, Statesville, North Carolina, and Ashboro, North Carolina, have become unionized through card check elections.

The labor movement appears to have decided that one means of turning around the decline in unionization is the card check election. Legislation has been proposed, the Employee Free Choice Act (EFCA), which would add to the current NLRB supervised representation elections a procedure for elections by signed authorization cards, and make other changes to the organizing process. It has been suggested that if the Democratic Party wins the White House in 2008, and maintains control of the House and Senate, there is a very good chance that the EFCA will become law. This paper will outline the current method of obtaining union representation, list the perceived inadequacies of the current law, describe the proposed legislation, review its current status, and suggest several implications of the proposed legislation, if it were to become law.

NLRB REPRESENTATION ELECTIONS

Currently, the process of determining employees' wishes regarding their representation in negotiating with their employer is mandated by the National Labor Relations Act (NLRA). After union organizers have determined sufficient employee interest in being represented by their union, they will typically ask employees to sign authorization cards documenting this interest. If at least 30% of the employees in the proposed bargaining unit sign authorization cards, the union may present them to the NRLB as evidence of sufficient interest and ask that a representation election be held. In practice, many unions will not petition the NLRB for a representation election unless 50% or more of employees in the proposed bargaining unit sign authorization cards. This is due to the typical erosion between the authorization card drive and the representation election. More employees typically sign cards than actually vote for union representation.

Once the NLRB determines that there is sufficient employee interest in being represented by the union, the NLRB will certify an appropriate bargaining unit, and schedule an election, usually within 60 to 90 days. Sometimes the election is delayed beyond 60 to 90 days if management questions the proposed bargaining unit. The NLRB must then investigate the proposed bargaining unit and determine if it is an appropriate unit. During the time leading up to the election, both management and the union will typically campaign and attempt to convince employees to vote for or against union representation. If a simple majority (50% plus 1 vote) votes for the union in the secret ballot representation election, the NLRB will certify it as the exclusive bargaining agent for the employees in the bargaining unit.

PERCEIVED PROBLEMS WITH THE CURRENT LAW

For some time, labor leaders have complained that the current system is faulty in several respects. Supporters of the new legislation summarize the major complaints as follows:

- Current election procedures often result in delays of months or years, as employers resisting union formation use procedural options to stretch out the process;
- While the procedure is in limbo, employers have unlimited access to employees, while union representatives have almost none;
- During this time, employers are inclined to use their coercive powers to discourage employees from joining a union.
- Even after union representation is chosen, negotiations to establish a first contract can be stretched a year or more, further delaying union representation, and eroding support for the union.[i]
- Remedies for unfair labor practices are so toothless as to be ineffectual. For some violations, all the employer must do is promise not to do it again. For others, it is cheaper for the employer to pay the fine than to obey the law.

Representative George Miller, who introduced the Employee Free Choice Act (EFCA) in the House, reported that workers who attempt to join to form unions are "spied on, harassed, pressured, threatened, suspended, fired, deported or otherwise victimized in reprisal for their exercise of the [constitutional] right to free association… Labor law enforcement efforts often fail to deter unlawful conduct. When the law is applied, enervating delays and weak remedies invite continued violations."[ii] In fact, Representative Miller contends, "the law has become so weakened and so easily manipulated that it is one of the greatest hindrances to the right of Americans to form and join unions."[iii]

Others have observed the decline in enforcement under the current law. “The empirical evidence clearly reveals the crisis in National Labor Relations Act (NLRA) enforcement. On the one hand, the number of employer violations and the volume of discrimination charges against union supporters during election campaigns have soared. At the same time, union win rates in elections and unions’ success in obtaining first contracts have plummeted. These related developments cry out for revamping the NLRB remedial scheme. [iv] “To every union activist, the National Labor Relations Act (NLRA) has not been fulfilling its intended purpose of protecting workers’ section 7 rights (i.e., rights to form, join or assist labor organizations) for at least the last 40 years. The core problem is that the traditional National Labor Relations Board (NLRB) remedies are ineffective in deterring violations of the Act. If a person violates worker rights, the NLRB sanction is to require the wrongdoer to sign a written statement pledging not to do it again. The findings from one recent study indicate that employer threats and promises are shockingly routine in election campaigns. [v]

The Bronfenbrenner study[vi] was commissioned by the U.S. Trade Deficit Review Commission[vii] with Cornell University and conducted by Dr. Kate Bronfenbrenner. It is the most comprehensive study so far undertaken concerning union organization elections, illegal conduct by opposition management (especially the threat of plant closing), and the success or failure of formation of first contracts. Detailed data was taken of a random sampling of 400 NLRB proceedings during a two year time frame. The study concluded:

- More than half of all employers made threats to close all or part of the plant during an organizing drive. The threat rate was significantly higher (68%) in mobile industries such as manufacturing, communication and wholesale/distribution, compared to a 36% threat rate in relatively immobile industries such as construction, health care, education, retail and other service.
- Threats of plant closing were very effective. The union election win rate in cases where plant closing threats were made is 38%, while it is 51% in units where no threats were made. Win rates were lowest (32%) in mobile industries where such threats were more credible.
- Threats of plant closing were unrelated to the financial condition of the company. Such threats occurred no less frequently in companies in a stable financial condition than in those on the edge of bankruptcy.
- More than three quarters of the campaigns where threats occurred also involved aggressive legal and illegal employer behavior such as discharges for union activity, electronic surveillance, illegal unilateral changes in wages or benefits, bribes, threats to refer undocumented workers to INS, promises of improvement, and promotion of union activities out of the unit.

- Despite the high percentage of plant closing threats during organizing campaigns, after the election, employers actually shut down all or part of their facilities in fewer than 3 percent of the campaigns.
- The Bronfenbrenner results suggest that employers typically engage in questionable behaviors which influence employee' votes in representation elections.

The Bronfenbrenner study recommends that changes be made to U.S. law to provide for substantial financial penalties and injunctive relief for violations of the NLRA, as well as *amendments that allow for card check elections and first contract arbitration.*

THE PROPOSED EMPLOYEE FREE CHOICE ACT

In plain and simple language, the proposed Employee Free Choice Act[viii] would provide for the following changes to the current law:

- Add to existing methods for union recognition a procedure for card check or "signed authorization" elections, without the requirement of an NLRB election. (This would eliminate the sometimes lengthy delay between the first attempts at union organization, and the official NLRB election, a period during which union organizers and supporters may be subject to intimidation and harassment, and threats of plant closing.)
- Authorize the NLRB to develop "guidelines and procedures" for such elections.
- Provide that negotiations for a first contract must begin with 10 days of a written request for collective bargaining. (Eliminates delay.)
- Provide that if no agreement is reached on the terms of a first contract within 90 days, either party may notify the Federal Mediation and Conciliation Service of the existence of a dispute, and request mediation. (Eliminates delays of up to a year.)
- Provide that if such mediation fails to reach agreement, the dispute be referred to an arbitration board established for this purpose. (Eliminates delay.)
- Provides that the ruling of the arbitration board on the first contract shall be binding upon the parties for 2 years, unless amended by their agreement. (Eliminates delay.)
- During the time prior to initial organization, or after initial organization but before first contract formation, if a charge of unfair labor practices is made, such charge shall receive priority over all other cases. (Eliminates delay.)
- For violations made during this same time period, in addition to any make-whole remedy ordered, the employer shall be subject to a civil penalty not to exceed $20,000 for each violation. (Gives tooth to sanctions.)

- ♦ Triples the amount of back pay to be awarded for violations of the Act. (Gives tooth to sanctions.)

Status of the Legislation

The Employee Free Choice Act (S. 842/HR. 1696) was introduced in the United States Senate by Senator Edward Kennedy (D-MA) and Senator Arlen Specter (R-PA), and in the U.S. House of Representatives by Representatives George Miller (D-CA) and Peter King (R-NY). The Senate and House bills were introduced simultaneously on April 19, 2005. On the same day, in the House, H.R. 1696 was referred to the House Committee on Education and the Workforce. On May 9, 2005, the House bill was referred to the Subcommittee on Employer-Employee Relations. No further action on the House bill has been taken since that date. In the Senate, S. 842 was read twice, and referred to the Committee on Health, Education, labor and Pensions. No further action on the Senate bill has been taken since that time.

In the House, there are a total of 215 co-sponsors, including 199 Democrats, 15 Republicans, and one Independent. Most of the Republican co-sponsors of the House bill represent industrial states in the northeast. In the Senate, Senator Arlen Specter is the sole Republican co-sponsor of the bill.

IMPLICATIONS OF THE PROPOSED LAW

One of the basic purposes of the Wagner Act is to "promote industrial harmony." It was initially passed in order to more equally balance the power between management and unions. The Taft-Hartley Amendment was passed a few years later to again equal the balance between these two parties as Congress decided the balance of power had swung too far in favor of labor unions. The Wagner Act itself recognizes a primary purpose to "eliminate the causes of certain obstructions to the free flow of commerce." This is accomplished when labor and management have relatively equal power and are "free to shape their own substantive contract terms."[ix] The Wagner Act as amended also, of course, guarantees employees rights to form labor unions of their own choosing, or refrain from joining labor unions. Historically, both sides (labor and management) have been able to communicate their beliefs, wishes and facts about unionization to employees considering union representation. In the absence of coercion, intimidation, promise of benefit or threats, employees could then vote their conscience in the NLRB held representation election.

Implication of the EFCA on Communications during an Organizing Campaign

Under the current law and NLRB policy, both sides have a right to communicate their wishes and beliefs regarding the benefits and/or drawbacks on unionization. They also may communicate facts about unionization and unions. Section 8c of the NLRA states: "The expressing of any views, argument, or opinion, or the dissemination thereof, whether in written, printed, graphic, or visual form, shall not constitute or be evidence of an unfair labor practice under any of the provisions of this Act, if such expression contains no threat of reprisal or force or promise of benefit." Thus, campaigning by both unions and management is permitted under the current law.

In practice, unions often attempt to keep their initial organizing efforts secret. This allows the union to be the sole source of communication and information about the benefits of unionization for the length of time they are able to keep their efforts from management's attention. Once management becomes aware of a union organizing effort, they can begin a counter campaign against unionization. The EFCA appears to be silent on the issue of management notification. Theoretically, it would be possible for a union to mount an organizing campaign, get a majority of employees in the proposed bargaining unit to sign authorization cards, and present them to management requesting that management recognize and bargain with the union, *before management becomes aware of the organizing drive!*

The stated purpose of the current law is to allow employees *free choice* in deciding whether they want union representation. Free choice implies informed choice. This requires that both sides be allowed to fully communicate with employees before they make a decision about union representation. One method of ensuring employee informed choice would be to require unions to notify management, perhaps through the NLRB, when they begin an organizing campaign, so that both the union and management have equal opportunity to communicate with employees. The EFCA as currently written would enable unions to communicate with employees before management may become aware of their activity. This may be the goal of proponents of the EFCA in an attempt to assist unions be more successful in their organizing efforts. However, to allow one side to have greater ability to communicate with employees before they make a decision about representation results in persuaded choice, not free choice. It also does not meet the current NLRB election policy of *laboratory conditions doctrine.* This doctrine holds that the NLRB's responsibility is to conduct a representation election "under conditions as nearly ideal as possible, to determine the uninhibited desires of the employees."[x]

Implication of Election Delays

Supporters of the EFCA act cite election delays as a problem the proposed law would solve. However, one primary source of election delay is management contesting the proposed bargaining unit. Each side would obviously like employees included or excluded so as to affect the representation vote. The NLRB is still legally responsible for determining an appropriate bargaining unit. When management contests the proposed bargaining unit, the NLRB investigates and issues a ruling. It is difficult to see how the proposed law would change this process. The NLRB must still be responsible for determining "an appropriate bargaining unit," or the union could simply identify a pro-union group of employees and ask them to sign authorization cards guaranteeing the union would become the exclusive bargaining agent for those employees. Thus, even if the EFCA were passed, and a union presented management (through the NLRB) with authorization cards signed by a majority of employees, the issue of an appropriate bargaining unit may still be raised. The NRLB is the ultimate authority on whether a bargaining unit is appropriate. While the union may propose a bargaining unit, the NRLB is under no pressure to accept it if it is inappropriate. Further, management should not be required to simply accept any bargaining unit proposed by a union.

Implications of Requiring Mediation/Arbitration to Reach a First Contract

The EFCA would require that if no agreement is reached on a first contract within 90 days, either party may request the Federal Mediation and Conciliation Service to provide a mediator. If mediation fails to produce a contract, the dispute would be submitted to arbitration. The ruling of the arbitration board would be binding upon the parties for two years, unless amended by their agreement. A practice much more common in the public sector than in the private sector, *interest arbitration* occurs when an outside third party listens to disputes about contract terms, and then *imposes* a settlement on both parties. In fact, the legality of interest arbitration in the private sector has been questioned.[xi]

Section 8d of the NLRA describes the obligation to bargain collectively and states in part that "such obligation does not compel either party to agree to a proposal or require the making of a concession."[xii] Interest arbitration would impose a settlement on issues in dispute, thus requiring the parties to agree to a proposal and make concessions. The current law and NLRB policy is to allow the parties to peacefully reach an agreement without outside interference.[xiii] Forced interest arbitration would be a major change of law/policy. In fact, when an arbitrator forces contract terms on the parties it would precisely be requiring them to "agree to a proposal and make concessions." While the NLRA attempts to eliminate third party influence in contract negotiations, the EFCA would ensure it.

Implication of EFCA on Additional "Elections"

Currently, the NLRB will not allow more than one valid election in a 12 month period. This gives a newly elected union a year to negotiate a first contract before employees can file a decertification election. It also prevents other unions from attempting to organize the employees in the bargaining unit and petitioning for a representation election which would be contrary to the NLRA's purpose of promoting industrial harmony. The EFCA is silent on this issue. Once a union was recognized as a result of a card check election, would this prevent employees from filing for a decertification election within the first 12 months? Would it prevent other unions from attempting to organize the employees in the bargaining unit? In addition, if interest arbitration results in a contract, employees would be prevented from requesting a decertification election for two years since the current language of the EFCA makes an arbitrator's ruling binding on the two parties for two years. Currently, if a newly elected union is unable to produce a contract after 12 months of negotiations, employees may petition the NRLB for a decertification election. The "Contract Bar Doctrine" of the NRLB holds that a valid election protects the certified union for 12 months. With the EFCA policy of requiring interest arbitration and the stipulation that the resulting contract is binding on the two parties for two years, employees lose this option of decertifying a union which either could not produce a contract without outside influence (interest arbitration).

Secret Ballot Election vs. Public Authorization Card Signing

The current law provides for a secret ballot representation election under "laboratory conditions." This means that conditions should be created so that employees are free to vote their free choice, without outside pressure or influence. The EFCA would allow the secret ballot election process to be replaced by a "card check election." When employees vote in the secret ballot election, they do so alone. The NLRB is responsible for ensuring that employees are free from undue influence so that they can vote according to their true beliefs and wishes.

When employees sign authorization cards, they do so in the presence of a union organizer, and perhaps a fellow employee who is serving as an inside organizer. They may also sign this card just after being exposed to a union organizing campaign series of communications extolling the benefits of union representation. There have been cases where employees reported feeling pressured to sign an authorization card under the current law. Unless management is guaranteed some means of communicating with employees before they are asked to sign authorization cards, some employees may sign cards under pressure or under the recent promise of benefits of being represented by a union. In a best case, employees will be asked to sign authorization cards without hearing management's views on union organizing.

History of Authorization Cards

Up until now, signing an authorization card meant, for all intents and purposes, that the employee wanted a representation election. In fact, part of some managements' campaign communications made it clear to employees that even though they signed an authorization card, they were still free to vote against the union in the election if they so wished. There is a long history of authorization cards really representing employee wishes that an election will be held to determine their representation status. Unless some significant communications campaign is mounted by the NLRB or some other agency to educate employees that the meaning of signing an authorization card has changed to mean something different than it has in the past, there may be some employees who sign authorization cards, should the EFCA be passed, without fully understanding the impact of their actions. Should the EFCA be passed, signing an authorization card will have the effect of voting for union representation in a secret ballot election.

Access to Employees

One argument used by supporters of the EFCA is that a major problem with the current system is that employers have much more access to employees than do unions. They argue that, at least until 24 hours before a representation election, management can hold unlimited (captive audience) meetings with employees to communicate reasons to vote against the union. However, under the Excelsior ruling, employers are required to provide the union a list of names and addresses of the employees eligible to vote in an election within seven days of a union request for a list. Union organizers may then mail information to employees, and even visit employees at their homes, something management is prohibited from doing.[xiv] A recent study found that 58% of unions make house calls during organizing campaigns, and 39% made house calls to at least half of the bargaining unit.[xv] Interestingly, the very purpose of the Excelsior rule is to ensure that employees are free to exercise their Section 7 rights under the NLRA *by giving them ample opportunity to hear both sides* of the issues during an organizing campaign. The EFCA [xvi] seems to reduce the ability of one side (management) to communicate with employees about union organizing.

Secret Ballot Protection Act of 2005

In response to the EFCA, Representative Charles Norwood of Georgia proposed the Secret Ballot Protection Act (H.R. 874) introduced in February 2005. This act is intended to protect the right of employees to a secret-ballot election conducted by the NLRB. Specifically, this act would make it an unfair labor practice for management to recognize or negotiate with a union that has not been selected by a majority of employees in a secret ballot election. It would also be an unfair labor practice for a union to cause or attempt to cause an employer to recognize or negotiate with a union that has not been selected via a majority of employees in a secret ballot election. This bill is in the first stage of the legislative process, and was referred to the Subcommittee on Employer- Employee Relations on March 24, 2005. This is a subcommittee of the House Education and the Workforce Committee.

DISCUSSION

While a great deal of attention is being given to the Employee Free Choice Act by union activists, there are some significant implications to the labor organizing process should this bill become law. One of the most significant changes involves the replacement of a secret ballot election, conducted by the NLRB, with a "card check election," basically conducted by the union.

Associated with this change is the issue of management's ability to communicate with employees during an organizing campaign. It is conceivable that under a card check election system that union organizers would attempt to keep their activities hidden from management for as long as possible. This is, in fact, typical under the current system. However, under a card check election system, it is conceivable that union organizers would have greater opportunity to communicate with employees than would management. In fact, it is possible that the only communication some employees may have before being asked to sign an authorization card, is from union organizers. In the current system of NLRB conducted secret ballot elections, management would still have time to communicate with employees once the union petitioned for a representation election. Under the EFCA, however, signing an authorization card becomes equivalent to voting for union representation in a secret ballot election.

Another very significant implication of the proposed Employee Free Choice Act is the requirement that if no agreement is reached on a first contract within 90 days, a mediator would then be brought in to assist the two sides reach agreement. If mediation does not produce an agreement, then the contract issues would be submitted to binding arbitration. Historically, interest arbitration has been rare in the private sector because it seems to conflict philosophically with one of the underlying themes of the National Labor Relations Act. Specifically, this theme is that the two sides should be free to reach agreement on contract terms without outside interference. In the case of interest arbitration, it is an outside third party (i.e., the mediator) who determines contract terms, and not the two parties themselves.

A third significant issue is the number of times a union would be allowed to attempt a card check election within a year. If the union attempts a card check election and fails, would they be allowed to simply continue their efforts immediately? If so, some organizations could be under constant union organizing efforts, until the union eventually wins an election.

These and other implications of changes to the current law and NLRB policy must be given careful consideration before passing this legislation. It is clear that the proposed legislation would help unions be more successful in their organizing efforts. But one of the goals of previous Federal labor law has been an attempt to keep the playing field level. Passage of the Employee Free Choice Act would appear to tilt the field toward the union goal line.

ENDNOTES

i American Rights at Work; Employee Free Choice Act Fact Sheet: Why Card Check is needed; http://www.americanrightsatwork.org/takeaction/efca/cardsummary.cfm?&bsuppresslayout=1 last visited 7-15-06

ii Excerpted from the speech of the Honorable George Miller, Representative of the State of California, upon introduction of the Employee Free Choice Act in the U.S. House of Representatives; available at http://thomas.loc.gov/; last visited 7-14-06

[iii] Ibid.

[iv] Garren, Brent, (2000). When the Solution is the Problem: NLRB Remedies and Organizing Drives *Labor Law Journal,* 51(2), 76-89

[v] Page, Leonard R.(2005). The NLRA at 70: Perspectives from the office of the General Counsel *Labor Law Journal*, 56(3), 186-192

[vi] Bronfenbrenner, K. (2000) *Uneasy Terrain: The Impact of Capital Mobility on Workers, Wages, and Union Organizing*, [Electronic version]. Ithica, NY: Author; http://digitalcommons.ilr.cornell.edu/reports/3/ last visited 7-15-06

[vii] Ibid.

[viii] U.S. Trade Deficit Review Commission website (archive), http://govinfo.library.unt.edu/tdrc/index.html last visited 7-15-06

[ix] The US Senate version of the law, which is identical to the House version, is available at http://thomas.loc.gov/ Last visited 7-15-06

[x] General Shoe Corp., 77 NLRB, 124, 127 (1948).

[xi] Doan, Michael, (1981), When Workers Took On Uncle Sam, *U.S. News & World Report*, August, 17-20.

[xii] NLRA, Section 8d , 29, USC 157

[xiii] Kochan, T.A., H.C.Katz, & R.B. McKersie (1989) *The Transformation of American Industrial Relations,* New York: Basic Books; Taylor, G.W. (1948) *Government Regulation of Industrial Relations*, Englewood Cliffs, NJ: Prentice Hall.

[xiv] Ibid.

[xv] Ibid.

THE IMPACT OF EARNINGS MANAGEMENT ON CAPITAL MARKETS: ETHICAL CONSIDERATION OF THE PLAYERS

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ABSTRACT

This research investigates the post market effects created by the various earnings management schemes perpetrated from 1995 through 2002. The study compares stock price movement trends of 30 companies with the movement of the three major stock price indices; the DOW, NASDAQ, and S & P 500. The comparison was made over a six year time frame, January 1, 2001 to January 1, 2007. The research has an emphasis point of April 1, 2002, which was the approximate date of the culmination of media announcements involving reported earnings management schemes of the culprit companies.

The study indicates that approximately 43% of the companies sampled were engaged in some kind of earnings management scheme during this period of time. The paper concludes with a summary of ethics reforms currently underway by the players involved in the free market system to correct the economic anomalies created as a result of earnings management schemes.

INTRODUCTION

In light of media attention to corporate scandals and numerous restatements of financial statement that occurred during 2001-2002 one common demand on company chief executive officers and chief financial officers became evident. This was to beat earnings forecasts by attainment of double-digit returns which subsequently drove up share prices of their respective companies. Why did this push for rapidly increasing stock prices that were experienced from the mid-1990s to the beginning of the 21st century evolve? Some (Jennings, 2004) say pressure on top management to inflate revenue and earnings figures was so great that CEOs and CFOs began to manage earnings in their quest to meet unrealistic demands of stockholders and other potential investors.

This paper discusses the rise of the earnings management concept widely present during that time and its subsequent impact on stock price movement. The research then investigates situations that contributed to the earnings management schemes. Next, it compares stock price movement of

30 companies with three major stock market indices in an attempt to uncover management earnings situations. Finally, there is a discussion of ethics training of the parties involved that is aimed at elimination of earnings management schemes as they apply to annual financial statements.

EARLY EARNINGS MANAGEMENT DETECTIONS

Random isolated instances of corporate impropriety by CEOs, CFOs, and other top management officials surfaced during the first half of the 20th Century. The McKesson and Robbins Case in 1939 involved material overstatements of accounts receivable and inventories (Zeff, 2003). After that, all was fairly quiet until the middle 1960s when bankruptcies of Penn Central and Four Seasons Nursing Centers generated huge losses for investors. These were followed by the Equity Funding scandal in 1973 and W. T. Grant bankruptcy in 1975 (Largay, 1980). Corporate investors began to look suspiciously toward CEOs and external auditors, who had power and ample opportunities to manage financial statement information for personal gains. These improprieties now seem mild when compared to the ones of Enron, WorldCom, Adelphia, Global Crossing, Tyco, and K-Mart.

EARNINGS MANAGEMENT FROM 1995-2002

In February 2001, Sunbeam Corporation received extensive media publicity involving the financial restatement process when the corporation filed for bankruptcy (Government Accountability Office, 2002). Shortly thereafter former CEO, Al Dunlap was charged with securities fraud. Sunbeam's management was involved in earnings management during the years 1996-1998. Dunlap came to the company in 1996 with promises to turn the company around. Liberal reserves were set up in 1996 to inflate the loss that year. The reserves produced overstatements of 1997 and 1998 earnings thereby giving the impression that Dunlap had turned the company around.

Four former executives of General Re Corp. and a former executive of American International Group Inc. were convicted of inflating AIG's (New York Times, 2008) reserves through reinsurance deals that amounted to $500 million in 2000 and 2001 in order to artificially boost company stock prices. Reinsurance policies are backups purchased by insurance companies to completely or partly insure the risk they have assumed for their customers.

Enron's problems first surfaced in the latter part of 2001. Global Crossing and WorldCom followed in early 2002 and not far behind was Adelphia, Tyco, and K-Mart among others. The market continued the growth trend of the late 1990s through early 2002, but finally gave way to the wave of corporate scandals around the first of April 2002. The market appeared to bottom out in September, made some recovery through the latter part of 2002, but then hit bottom again in early 2003.

Enron's collapse was perhaps the first major shock for the investing public. Questions about its operations and declining stock price began to surface in early October 2001. A conference call to address investor concerns was held on October 22 in which Ken Lay attempted to downplay investor alarm. Then on November 8, the merger discussions with Dynegy were aborted. Enron was well on its way to collapse and the corporate investing world was set on its heels. Even so, the market did not suffer too greatly over this isolated incident of corporate fraud. The DOW Index was at 10073 on January 2, 2002; the S & P 500 at 1149; and the NASDAQ at 1610.

A Government Accountability Office report was highly critical of corporate improprieties that had begun to surface in the late 1990s. The report noted that the number of publicly held companies that restated financial statements increased by 147% from January 1997 through June 2002. The report listed four factors that caused companies to use questionable accounting practices, including (1) corporate pressure to meet quarterly earnings projections and thus maintain stock prices during and after the market expansion of the 1990s, (2) perverse executive compensation incentives, (3) outdated accounting and rule-based standards, and (4) complex corporate financing arrangements. Based on the number of restatements as of June 30, 2002, the increase was expected to exceed 170 percent by the end of the year (Government Accountability Office, 2002).

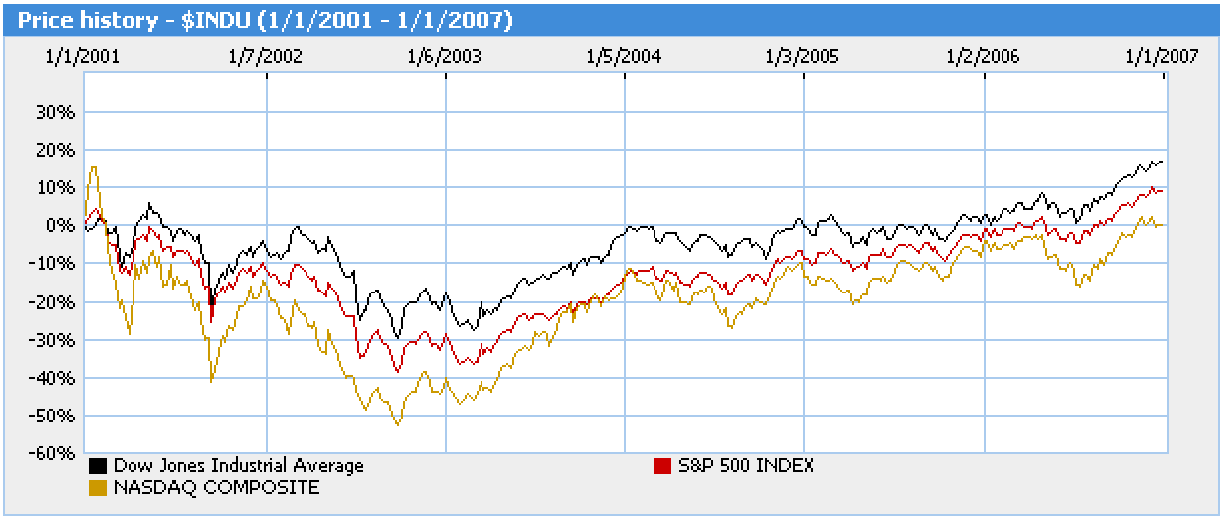
All of these corporate failures and financial restatements by those corporations that did not fail during the 1995-2002 time period indicate a common theme of "earnings management" in efforts to boost earnings to shareholder expectations and consequently also boost stock share prices of the respective companies involved.

IMPACT ON THE MARKET

Literature (Jennings, 2004) attributes the rapid fall of the markets beginning in early 2002 to a misplaced focus on ethics as part of business school curricula at the time which seemed to encourage management students to smooth earnings in order to maximize shareholder wealth. The impact of financial statement manipulations on the market is evident when one observes stock price movement of the three major indices from January 1, 2001 to January 1, 2007 illustrated by Figure 1. Figure 1 shows a fairly sharp decline in April 2001, then a slight recovery until the 911 attacks in September 2001. A rapid recovery occurred following 911. The prolonged drop in stock prices began in April 2002, and bottomed out in late 2002. The indices indicate that these few months (April-November, 2002) reflect the deterioration of market prices related to the numerous adverse media reports of corporate earnings management schemes.

The market did not recover to the pre-April 2002 levels for approximately two years. This two year recovery period is believed to have been caused primarily by adverse media releases that resulted in investors losing confidence in annual financial statements published by the companies and audited by CPAs.

Figure 1
Stock Price Indices: Dow Jones, NASDAQ, and S & P 500



Source: http://moneycentral.msn.com

Most of the previously mentioned improprieties related to earnings management were not perpetrated by top management alone. Internal accountants, CFOs, and independent auditors played vital roles in the earnings management schemes. Additionally, Wall Street officials contributed to the problem by lobbying for the Private Securities Litigation Act of 1995. This act made it more difficult to sue executives, auditors, and financial analysts for securities fraud. CEOs could "pipe up" their company prospects with the new breed of financial statements known as forward-looking financial statements without fear of legal action.

The media reported almost daily on unethical behavior by Wall Street officials (Scherer, 2003). Four high-ranking officials of a major Wall Street firm were indicted along with Enron officials for insider trading and stock price management schemes.

Jennings (2004) notes two common threads in the collapse of corporations during this time frame; financial pictures painted of the companies were grossly distorted and the companies were deeply involved in double-digit growth. The pressure to increase the numbers as the economy took a downturn increased with each passing quarter.

OBJECTIVES OF THIS STUDY

In this study it is hoped the research will accomplish three objectives. First, it will impress upon the readers the seriousness of impact that earnings management has on the free market system.

Secondly, by the use of research methodology, it will provide an estimate of the percentage of companies that managed earnings during 2001-2007. Finally, it is hoped the research will determine what the major participants in the securities market have done to reestablish confidence of the investing public in financial reporting.

METHODOLOGY

The methodology in this study is based on the semi-strong form of the efficient market hypothesis (EMH) theory (Copeland and Weston, 1980). The proponents of this form of EMH believe that markets are totally efficient and investors will pursue the highest yielding investments regardless of the amount of publicly available information about the securities (Investopedia, 2008). In other words, share prices always incorporate and reflect all information about the value of the company. It is hypothesized that if all available information has been incorporated in share prices, then the general market trend reflects share price movement of those companies that have not engaged in earnings management practices.

The chart shown in Figure 1 that plots stock price indices (DOW, NASDAQ, and S & P 500) from January 1, 2001 to January 1, 2007, is used as the benchmark for comparison of selected companies for the period. Stock price movement of 30 publicly held companies were compared with the three major stock price indices for this period. Companies that showed stock price movements that were similar to or better than the indices immediately after April 2002 were considered to be free of earnings management during the time frame leading up to April 1, 2002. Companies that showed stock prices consistently below the market averages were considered to have participated in some type of earnings management scheme prior to 2002.

These hypotheses can be stated as follows:

$H_{0:}$ *Earnings management is not present if the share price movement on n company stock equals or exceeds the average market share price movement over the six year period.*

H_1: *Earnings management appears to be present if the share price movement on n company stock is consistently below the average market share price movement over the six year period.*

RESULTS AND FINDINGS

Summary results of the 30 companies sampled are presented in Table 1. Seventeen (17) of the companies surveyed showed no evidence of earnings management during the time frame included in this study. On the other hand, nine companies showed trends that indicate earnings management of some sort existed. Three companies reflected stock price movements that indicate earnings management prior to April 2002 followed by lack of earnings management present from 2004 until the end of the date of this study. Finally, one company had stock price movement that indicated no earnings management immediately after April 2002 but some earnings management present after 2005.

Table 1: Earnings Management Findings

Trend	Number	Number	Number	Number	Total
None indicated	17				17
Indication of EM		9			9
Yes-2002; No-2004			3		3
No-2002; Yes-2005				1	1
Total	17	9	3	1	30

REMEDIAL EFFORTS BY THE PLAYERS

Literature indicates that the various players involved in revitalization of ethics requirements in their respective areas are currently engaged in the process of initiating new ethical guidelines for their professions. The Association to Advance Collegiate Schools of Business (AACSB) has placed a much needed emphasis on integration of ethics education into the curriculum of business schools during recent reaffirmation visits (Griffin, 2006). This emphasis could have resulted from studies (Griffin, 2007) that indicate a small percentage of AACSB accredited schools of business require stand-alone ethics courses in both graduate and undergraduate programs. Griffin's study included the 2005-2006 academic year and found that only 30% of undergraduate programs and 28% of graduate programs of member schools required ethics courses as part of the curriculum. Even more disturbing, is the fact that only 16 member schools who offer the Master of Accountancy Degree required ethics courses.

The American Institute of Certified Public Accountants (AICPA) and National Association of State Boards of Accountancy (NASBA) are beginning to make moves to require up to nine hours of ethics courses in business school programs (Flesher, 2007). Flesher reports that a draft proposal for changes in Rules 5-1 and 5-2 of the Uniform Accountancy Rules requires a college education for persons to sit for the Uniform CPA exam, but additionally, encourages "university accounting programs to devote more attention to ethics in their programs." However, this may be more talk than action as Griffin (2008) reports in 2007 that only two of the 54 state boards of accountancy presently require a three hour ethics and responsibility course for licensure as a CPA.

In 2002, the Federal government passed the Sarbanes-Oxley Act that, among other things, placed independent auditors under the control of a newly created government organization known as the Public Company Accounting Oversight Board (PCAOB). The PCAOB requires that a company's board of directors select independent auditing firms thereby ensuring a separation of the audit function from the control of top management of the company.

The only thing that seems to be missing from the picture is a concerted effort on the part of Wall Street to correct ethical violations of the past. Previous violations include collusion with internal and external auditors in financial statement presentations, insider trading, and outright fraud in securities deals. Ironically, this missing part could well be the key to reestablishment of confidence of the investing public in information generated by the accounting profession, that is the publication of and the audits of annual financial statements.

CONCLUSION

This study indicates that approximately 43% of the sampled companies managed earnings to some extent during the time period covered by this research. This number is excessive when one considers that it includes only companies that continue to be in existence today. Enron, WorldCom, and Adelphia, are companies not included in the research because they are no longer active. Even so, everyone is aware of their schemes that involved earnings management while they were in operation. Clearly, there is no doubt as to the damage earnings management and financial statement misrepresentation does to the free market system. It behooves all the players in the free market system to do everything possible to restore investor confidence in the integrity of our financial reporting system and the impact of such reports on the securities market. This will involve a revitalization of ethics guidelines by all of the professions involved.

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THE TIME IS RIGHT – OR IS IT? THE SUPREME COURT SPEAKS IN *LEDBETTER V. GOODYEAR TIRE & RUBBER CO.*

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ABSTRACT

In a 5-4 decision, the U.S. Supreme Court ruled that an employee may not sue their employer under Title VII unless they have filed a formal complaint with the Equal Employment Opportunity Commission (EEOC) within 180 days after the alleged unlawful employment practice occurred (Ledbetter). The majority opinion, written by Justice Alito, will likely bar many of the 40,000 pay discrimination cases brought between 2001 and 2006. In her scathing dissent, read aloud from the bench, Justice Ginsburg invited Congress to overturn the decision, stating that "The court does not comprehend, or is indifferent to, the insidious way in which women can be victims of pay discrimination" (Ledbetter).

FACTS

The plaintiff, Lilly Ledbetter ("Ledbetter"), began her career at Goodyear Tire and Rubber ("Goodyear") in 1979. For most of her twenty year career at Goodyear, Ledbetter was the only female manager. Initially, Ledbetter's salary was the same as that of the male managers. However, over time, Ledbetter's salary slipped relative to that of the male managers. By 1997, Ledbetter was not only the sole woman manager, she was also the lowest paid manager. Ledbetter's monthly salary at the time of her departure was approximately $3,700 per month. Similarly situated male managers at Goodyear made between $4,200 and $5,200 per month.

In 1998, Ledbetter filed an administrative claim of discrimination with the Equal Employment Opportunity Commission ("EEOC"). She alleged that Goodyear violated Title VII of the Civil Rights Act of 1964 by paying her a lower salary because of her sex. Ledbetter's claim eventually went to a jury who found in her favor. The District Court (in Alabama) entered judgment for Ledbetter for back pay, damages, attorney fees, and costs.

APPEAL

Goodyear appealed to the Eleventh Circuit and the victory for Ledbetter was reversed. The Eleventh Circuit, quoting Title VII, held that her claim was time-barred.

> *Title VII provides that a charge of discrimination shall be filed within [180] days after the alleged unlawful employment practice occurred . . . Ledbetter charged, and proved at trial, that within the 180-day period, her pay was substantially less than the pay of men doing the same work. Further, she introduced evidence sufficient to establish that discrimination against female managers at the Gadsden plant, not performance inadequacies on her part, accounted for the pay differential (Ledbetter).*

Nevertheless, the Eleventh Circuit found the evidence unavailing, holding that Ledbetter should have filed charges year-by-year, each time Goodyear failed to increase her salary commensurate with the salaries of male peers. "Any annual pay decision not contested immediately (within 180 days)… [is] a fait accompli beyond the province of Title VII ever to repair"(Ledbetter).

U.S. SUPREME COURT REVIEW

The U.S. Supreme Court's 5-4 decision was written by Justice Alito. Justice Alito describes the case as one that "calls upon us to apply established precedent in a slightly different context"(Ledbetter). Justice Ginsburg's dissent, however, frames the issue as one with two possible responses to the question "What activity qualifies as an unlawful employment practice in cases of discrimination with respect to compensation?" (Ledbetter). One response (the one chosen by the majority) is to answer that the pay-setting decision alone is the "unlawful practice." Under this scenario, each pay-setting decision is discrete and separate from subsequent decisions. As such, each discrete act of pay-setting would necessarily have to be challenged within 180 days of the date of the decision. After that 180 day period has ended, any claim of discrimination has been forfeited.

A second response, and the one argued from the bench by Justice Ginsburg, is that both the pay-setting decision, and the actual payment of a discriminatory wage, are unlawful practices. Using this approach, each payment of a discriminatory wage is also an "unlawful employment practice." Decisions made outside the 180 day period would not be actionable, however, they would be considered relevant in determining the lawfulness of conduct that occurred within that 180 day period. Ginsburg's dissent argues that the second response is more faithful to precedent.

The majority opinion insists that immediately contesting a pay-setting decision is the best course of action. This, however, overlooks the realities of many pay disparities. The dissenting opinion argues that pay disparities are different from adverse actions such as termination, failure to promote, or failure to hire. Terminations, for example, are fully communicated, discrete acts. Conversely, pay disparities occur in small increments. It may not be obvious for months, or even years, that a pay discrepancy exists. Moreover, especially in the context of managers' salaries, employers attempt to hide comparative information from employees.

Finally, even if an employee does discover a pay discrepancy, there may be legitimate reasons for not complaining within 180 days. In the case of a new employee, the employee may be afraid to make waves about salary early in her employment history with that company. Additionally, pay discrepancies may start out small at first, but build over time (Thompson, Leigh, 2005). A lawyer may not be willing to take the case of a potential client with a small pay differential (and therefore small damages) and the employee may not be able to afford to pay an attorney for work on an hourly basis.

SUPREME COURT PRECEDENT?

Of critical importance in this case was the effect of timing under Title VII. In determining when a practice has "occurred," Supreme Court and lower court precedent suggest that the "unlawful employment practice" is the current payment of salaries infected by gender-based (or race-based) discrimination (Ledbetter). In the Bazemore case, the employee, prior to passage of Title VII, had a Negro branch and a white branch of workers. The employees in the Negro branch were paid less than the white workers. After Title VII was passed, the two branches were combined, however the Negros were still paid less than the whites (Bazemore). In 1986, the Supreme Court unanimously held that the employer committed an unlawful employment practice each time it paid black employees less than similarly situated white employees (Bazemore).

The Supreme Court in Bazemore rejected the Court of Appeals' conclusion that the black plaintiffs could not prevail because the disparities were a continuing effect of a decision that was lawfully made prior to the effective date of Title VII (Bazemore). Citing Bazemore, the dissent in the Ledbetter case reasoned that "each week's paycheck that delivers less" based on discrimination is a wrong actionable under Title VII. Alito's majority opinion in Ledbetter disposes of Bazemore by arguing that Ledbetter has provided no evidence that Goodyear initially adopted its performance-based pay system in order to discriminate based on sex or that it later applied this system within the charging period with discriminatory animus (Ledbetter). Alito's "explanation" directly contradicts the jury's finding that it is "more likely than not that [Goodyear] paid [Ledbetter] an unequal salary because of her sex" (Ledbetter).

UNLAWFUL EMPLOYMENT ACTIONS: DEFINING "DISCRETE ACT"

The dissent argues that in National Railroad Passenger Corporation v. Morgan, unlawful employment acts were divided into <u>two categories</u> for purposes of Title VII: <u>discrete acts</u> (those easy to identify, such as termination, failure to promote, denial of transfer, refusal to hire, etc.); and acts that recur and are cumulative in impact. A "discrete act" occurs on the day that it happens and it is clear that has happened (e.g., a termination). An example of the other type of claim, those based on the cumulative effect of individual acts, is a claim of hostile environment (Ledbetter). The nature of such claims is repeated conduct. A hostile environment claim cannot be said to occur on a particular day – "it occurs over a series of days or perhaps years, and, in direct contrast to discrete acts, a single act of harassment may not be actionable on its own" (Morgan). In Morgan, the Supreme Court held, in pertinent part, as follows:

> *...it does not matter, for purposes of the statute, that some of the component acts of the hostile work environment claim fall outside the statutory time period. Provided that an act contributing to the claim occurs within the filing period, the entire time period of the hostile environment claim may be considered by a court for the purposes of determining liability (Morgan).*

Justice Ginsburg argues that pay disparities like the ones experienced by Ledbetter are closer to hostile work environment claims than to charges of a single episode of discrimination. Using this reasoning, Ledbetter's claim was based on "the cumulative effect of individual acts," not one particular paycheck (Ledbetter). Even though the unlawful conduct began in the past, "a charge may be filed at a later date and still encompass the whole" (Ledbetter).

How does Justice Alito's majority opinion deal with the Morgan precedent? The majority opines that the term "employment practice" generally refers to "a discrete act of single occurrence that takes place at a particular point in time" (Ledbetter). The majority opinion never once mentions the second type of "unlawful employment practice" from the Morgan case – those based on the cumulative effect of individual acts.

A discrete act is known not only to the employee it involves, but also to coworkers. Promotions, hirings, firings, and transfers are public events that are easy to identify. Conversely, compensation disparities are typically hidden for "privacy" and other reasons. Companies often refuse to publish pay levels and employees often keep their salaries private. The evidence presented in the Ledbetter case demonstrates that Goodyear kept employee salaries confidential (Ledbetter). Assuming that both the male and female employees got raises, it would be difficult, and sometimes impossible, for a female to discover that her pay raise was less than that given to the male employee. Moreover, if the discrepancies in the raise are small at first, the case may be seen as either ambiguous or unwinnable. Either way, the employee receiving a small pay increase for discriminatory reasons is put in an untenable situation. Justice Ginsburg put it best:

> The court today does not comprehend, or is indifferent to, the insidious way in which women can be victims of pay discrimination. Today's decision counsels: Sue early

on, when it is uncertain whether discrimination accounts for the pay disparity you are beginning to experience (Mears, Bill, CNNMoney.com).

Justice Ginsburg went on to say that women who do just that would likely lose such a "less-than-fully-baked case" (Ledbetter). Of course, if women sue only after the pay disparity becomes large enough to mount a winnable case, they will be cut off by the court's threshold for suing too late (Ledbetter).

The majority opinion in Ledbetter relies on several Supreme Court decisions in which the employee suffered an obvious "discrete act" of discrimination (See, e.g., United Airlines; Delaware State College; and Lorance). These decisions are not on point. Moreover, one of the cases, Lorance, was superceded by the 1991 Civil Rights Act! (42 U.S.C. section 2000e5(e)(2)). The Supreme Court has never previously relied on the Lorance decision – until now.

Finally, the dissent argues that the majority's harsh application of the 180 day filing rule is not supported under Title VII, precedent, or even the EEOC's own compliance manual.

TITLE VII AND BACKPAY

Title VII's back pay provision expressly permits back pay for up to two years before the discrimination charge is filed (Ledbetter). "If Congress intended to limit liability to conduct occurring in the period in which the party must file the charge, it seems unlikely that Congress would have allowed recovery for two years of back pay" (Morgan).

APPELLATE COURTS

Additionally, the appellate courts have overwhelmingly held that the payment of wages infected by discrimination is a present violation. In other words, each paycheck that is less than the amount it would be absent discrimination is a recognizable harm. For example, in Anderson v. Zubieta, "[T]he Courts of Appeals have repeatedly reached the . . . conclusion that pay discrimination is actionable upon receipt of each paycheck."

EEOC COMPLIANCE MANUAL

The EEOC's Compliance Manual provides that "repeated occurrences of the same discriminatory employment action, such as discriminatory paychecks, can be challenged as long as one discriminatory act occurred within the charge filing period" (EEOC Compliance Manual). Moreover, the EEOC provision has been implemented in a number of administrative decisions. "Under its longstanding interpretation of the statute, the commission actively supported the plaintiff, Lilly M. Ledbetter, in the lower courts (Ledbetter). However, once the Supreme Court decided to hear the case, the Bush administration disavowed the EEOC's position and filed a brief on the side of the employer (Greenhouse, Linda, 2007).

THE FUTURE OF THE SUPREME COURT AND EMPLOYEE RIGHTS

According to an expert on the Supreme Court, "[C]onservatives finally got their Court" (Chemerinsky). Out of 68 cases decided this term, 24 were resolved by a 5-4 margin, and Justice Kennedy was the majority in all 24, including Ledbetter (Chemerinsky). According to Erwin Chemerinsky, the Ledbetter case was in important victory for business.

> *The Court made it much more difficult for employees to sue for pay discrimination under Title VII of the Civil Rights Act of 1964. The Court said that the statute of limitations for such pay discrimination claims . . . begins to run when the salary is set . . . the Court did not decide whether the statute of limitations is tolled until a plaintiff reasonably could know of the discriminatory salaries in the workplace or how that is to be determined (Chemerinsky).*

Given the current conservative majority on the Supreme Court, it is unlikely that any case dealing with tolling the statute of limitations would be decided in a pro-business fashion. As in the past when the Court has handed down unpopular decisions, the public will need to look to legislation to overturn the Court's decision. Within hours after the Ledbetter decision was made public, Senator Hillary Rodham Clinton of New York announced her intent to submit a bill to overturn the Court's decision (Greenhouse, Linda, 2007). In the meantime, victims of pay disparity should look to other than Title VII for relief.

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