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CAREGIVER RESPONSIBILITY DISCRIMINATION AND THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION (EEOC) GUIDELINES: POLICY AND PRACTICE ISSUES FOR EMPLOYERS

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ABSTRACT

In May of 2007 in response to a perceived "potential for greater discrimination against working parents and others with caregiving responsibilities", the United States Equal Employment Opportunity Commission (EEOC) issued new enforcement guidance addressing Unlawful Disparate Treatment of Workers with Caregiving Responsibilities (EEOC-A, 2007). On April 22, 2009, the EEOC issued additional guidance to employers, Employer Best Practices for Workers with Caregiving Responsibilities, offering "proactive measures that go beyond federal non-discrimination requirements" (EEOC B, 2009). These guidelines are designed to reduce employers' exposure to litigation for "violations against caregivers, and to remove barriers to equal employment opportunity" (EEOC B, 2009). This paper examines the initial guidance provided by the EEOC with respect to individuals with caregiving responsibilities, recent court cases involving the issue, and the best practices suggestions recently issued by the EEOC.

INTRODUCTION

In May of 2007 in response to a perceived "potential for greater discrimination against working parents and others with caregiving responsibilities", the United States Equal Employment Opportunity Commission (EEOC) issued new enforcement guidance addressing Unlawful Disparate Treatment of Workers with Caregiving Responsibilities (EEOC-A, 2007). On April 22, 2009, the EEOC issued additional guidance to employers offering "proactive measures that go beyond federal non-discrimination requirements" designed to reduce employers' exposure to litigation for "violations against caregivers, and to remove barriers to equal employment opportunity" (EEOC B, 2009).

What is unlawful disparate treatment of workers with caregiving responsibilities? While there are no federal statutes that prohibit discrimination based "solely" on parental or other caregiver status, unlawful disparate treatment arises when an employee with caregiving responsibilities is subjected to discrimination based on a protected characteristic under federal Equal Employment Opportunity (EEO) law (EEOC A, 2007). The enforcement guidance from the EEOC provides a number of examples of circumstances under which discrimination against caregivers may violate federal EEO law (See Exhibit 1).

Exhibit 1 Examples of Circumstances that may Violate Federal EEO Law

- Treating male caregivers more favorably than female caregivers: Denying women with young children an employment opportunity that is available to men with young children.
- Sex-based stereotyping of working women:
- Reassigning a woman to less desirable projects based on the assumption that, as a new mother, she will be less committed to her job.
- Reducing a female employee's workload after she assumes full-time care of her niece and nephew based on the assumption that, as a female caregiver, she will not want to work overtime.
- Subjective decision making: Lowering subjective evaluations of a female employee's work performance after she becomes the primary caregiver of her grandchildren, despite the absence of an actual decline in work performance.
- Assumptions about pregnant workers: Limiting a pregnant worker's job duties based on pregnancy-related stereotypes.
- Discrimination against working fathers: Denying a male caregiver leave to care for an infant under circumstances where such leave would be granted to a female caregiver.
- Discrimination against women of color: Reassigning a Latina worker to a lower-paying position after she becomes pregnant.
- Stereotyping based on association with an individual with a disability: Refusing to hire a worker who is a single parent of a child with a disability based on the assumption that caregiving responsibilities will make the worker unreliable.
- Hostile work environment affecting caregivers:
- Subjecting a female worker to severe or pervasive harassment because she is a mother with young children.
- Subjecting a female worker to severe or pervasive harassment because she is pregnant or has taken maternity leave.
- Subjecting a worker to severe or pervasive harassment because his wife has a disability (EEOC A. 2007).

The EEOC has made it clear, that their guidance with respect to caregivers does not protect caregivers based on their caregiving status alone. In the past, that has meant that the unlawful disparate treatment must arise where a caregiver is discriminated in employment based on their sex or race. Action in this regard may also arise under the Americans with Disabilities Act (ADA) and under other federal statutes including the Family and Medical leave Act (FMLA) (EEOC A, 2007). While previous research would indicate that this has been primarily a problem for women in the workplace (See Still, 2006, Litigating the Maternal Wall: U.S. Lawsuits Charging Discrimination against Workers with Family Responsibilities) the EEOC guidelines cite numerous examples and case law involving discrimination against male caregivers.

The EEOC's perception for the potential for increased discrimination against those with caregiving responsibilities was the impetus for developing and issuing this guidance. This determination was based on a great deal of empirical evidence gathered by the Center for Work Life Law at the University Of California Hastings College Of Law, the National Alliance for Caregiving, and others. Their research resulted in important findings that have helped bring this issue to the attention of not only the EEOC but employers as well.

The MetLife Mature Market Institute National Alliance for Caregiving study published in July of 2006, focused on the productivity losses to U.S. business associated with employees who have caregiving responsibilities. The 2006 study is part of the continuing efforts by the MetLife Mature Market Institute, established in 1996, to examine issues and develop resources to help policy makers address this important issue. The 2006 study noted that the results of a 2004 Caregiving in the United States report, released by the National Alliance for Caregiving and AARP, that "over 44 million Americans or an estimated 21% of all U.S. households, provide care for an adult family member or friend age 18 or older"(MetLife, 2006). Other key findings from the 2004 report cited in the 2006 MetLife report include:

The majority of family caregivers (79%) are providing care to someone over the age of 50. Nearly 60% of those caring for an adult over the age of 50 are working; the majority of those work full-time.

- ♦ Nearly 40% of caregivers are men.
- ♦ The average age of the caregiver for a person over the age of 50 is 47.
- ♦ Most caregivers provide unpaid care to parent or grandparent.
- ♦ Approximately 15% of the caregivers were providing care to someone who lived at a distance of more than an hour away (MetLife, 2006).

Sixty percent of the employed caregivers reported making "work-related adjustments" including taking early retirement, periodically leaving work, reducing their hours from full-time to part-time and leaving work entirely (MetLife, 2006). The 2006 MetLife study estimated that nearly 16 million caregivers were employed full-time and had caregiving responsibilities for someone over the age of 18 (MetLife, 2006). The Met-Life study also identified a number of costs associate with intense caregivers, including replacement costs for employees who leave the workplace, absenteeism, workday interruptions, cost due to crisis in care, cost due to supervision, costs associate with unpaid leave, and costs associated with reducing hours from full-time to part-time. The study estimated that employers of full-time employed caregivers endured $33.6 billion in annual lost productivity (see Table 1).

Table 1: Total Estimated Cost to Employers of All Full Time Employed Caregivers

	Cost per Employee	Total Employer Cost
Replacing Employees	$412	$6,585,310,888
Absenteeism	$320	$5,096,925,912
Partial Absenteeism	$121	$1,923,730,754
Workday Interruptions	$394	$6,282,281,750
Eldercare Crisis	$238	$3,799,217,477
Supervisor Time	$113	$1,796,385,842
Unpaid Leave	$212	$3,377,082,202
Full-Time to Part-Time	$299	$4,758,135,522
Total	$2,110	$33,619,070,346

The MetLife Caregiving Cost Study: Productivity Losses to U.S. Business, MetLife Mature Market Institute National Alliance for Caregiving, July 2006, page 17.

The report of the 2006 study by the Work Life Law group at UC Hastings College of the Law entitled "One Sick Child Away from Being Fired: When "Opting Out" is not an Option", examined arbitration awards involving a variety of individuals who had employment disputes with their employers that involved work and family responsibilities (Williams, 2006). The study resulted in six major findings:

- Working-class families face inflexible schedules that clash with family needs.
- Mandatory overtime leaves single mothers, divorced dads, and tag-team families in jeopardy of losing their jobs.
- Working-class men often are unable or unwilling to bring up their family needs with their employers. Instead, they suffer in silence or to try to "come in under the radar screen" – with unhappy results.
- Many workers are one sick child away from being fired
- Employers' inflexibility may well defeat their own business needs.
- Flexibility is possible in working-class jobs (Williams, 2006).

Discrimination claims brought by employees alleging discrimination involving their caregiving responsibilities have been increasing dramatically in recent years. Another report by the Hastings College of Law group "Litigating the Maternal Wall: U.S. Lawsuits Charging Discrimination against Workers with Family Responsibilities" reported a dramatic increase in the number of these cases. The report found that from 1996-2005 there were 481 court cases involving the issue compared to 97 cases in the prior ten year period – "an increase of nearly 400 %"(Still, 2006). The study found that the cases were being filed by a wide range of individuals, across a wide range of industries and occupational types. A large number of high profile "award winning" companies were also involved in litigation over this issue (See Exhibit 2).

Exhibit 2 – Award-winning companies facing litigation	
Abbott Laboratories	Aetna
AT&T	Baxter healthcare Corp.
Bell Atlantic	Bristol-Myers Squibb
Citibank	Ernst & Young
Exxon	General Motors
Hewlett-Packard	IBM
Massachusetts Mutual Life	McGraw-Hill Co.
Merck	Pfizer
Price Waterhouse Coopers	Sarah Lee Corp.
Sears	Smithkline Beecham
United Technologies	UPS
Wal-Mart	
Source: Still, Mary C. (2006). Litigating the Maternal Wall: U.S Lawsuits Charging discrimination Against Workers with Family Responsibilities, page 12.	

Many of these organizations had been identified as "Best Companies for Working Mothers" and good community citizens (Still, 2006).

A recently published report on the impact of the current economic downturn on family caregiving by Evencare by UnitedHealthcare and the National Alliance for Caregiving concluded that family caregivers had suffered a number of negative effects as a result of the current economic downturn. The study report found that caregivers were using more of their savings or incurring additional debt to cover caregiving expenses, "their living situations with regards to their care recipient and the impact to the caregiver's health, in terms of stress" were also being negatively affected (Evencare, 2009). In the workplace, the Evencare study found that "the financial burden of caregiving coupled with economic realities are causing caregivers either to be more reluctant to take time away from work for caregiving or to take on additional work to cover caregiving costs"(Evencare, 2009). The study also found that forty-three percent of working caregivers have had their work hours or pay cut, and one in six (15%) reported that the economic downturn had caused them to lose their job or be laid off (Evencare, 2009).

RECENT COURT CASES

The First and Ninth U.S. Circuit Courts of Appeal have issued recent decisions of note in regard to caregiver discrimination. In the First Circuit Court of Appeals case, the plaintiff had alleged that she was denied a promotion because of a sex based stereotype that women who are mothers, particularly of young children, neglect their jobs in favor of their presumed childcare responsibilities (Chadwick v. Wellpoint, Inc., 2009). The court reversed the district court summary judgment ruling in favor of the employer and remanded the case for further proceedings. In this case, Laurie Chadwick a long-time employee of Wellpoint was encouraged by her supervisor to apply for a promotion to a management position entitled "Recovery Specialist Lead" or "Team Lead" (Chadwick v. Wellpoint, Inc., 2009). Chadwick was already performing several of the responsibilities of the Team Lead position and in her most recent performance evaluation in 2005, received excellent reviews, scoring a 4.40 out of a possible 5.00. Chadwick was also the mother of an eleven year old son and six-year old triplets in kindergarten. Chadwick and another female in-house candidate Donna Ouelette were the finalist for the promotion. Ouelette had less experience and her most recent performance review score was a 3.84. The court of appeals also noted in its decision, that there was no allegation, insinuation, or matter of evidence that Chadwick's work performance was negatively impacted by any childcare responsibilities. Ouelette was ultimately selected for the promotion.

Evidence presented by Chadwick in support of her claim included the fact that she was significantly more qualified for the promotion than was Ouelette and three statements made by management around the time of the promotion decision. Nanci Miller, Chadwick's immediate supervisor and the decision maker regarding the promotion stated two months before her decision in an e-mail to Chadwick "Oh my – I did not know you had triplets. Bless you" (Chadwick v. Wellpoint, 2009). During Chadwick's interview, one of the interviewers who was unhappy with one of Chadwick's responses replied "Laurie, you are a mother. Would you let your kids off the hook that easy if they made a mess in their room? Would you clean it or hold them accountable" Chadwick v. Wellpoint, Inc., 2009). The third statement, and most important in the eyes of the court, was when Miller informed Chadwick that she did not get the promotion. Miller explained: "It was nothing you did or didn't do. It was just that you're going to school, you have the kids and you just have a lot on your plate right now" (Chadwick v. Wellpoint Inc., 2009). In reversing the District Court's ruling, the Appeals Court concluded that a reasonable jury could infer from the explanation offered by Chadwick's supervisor for her not getting the promotion was because Miller and others assumed that as a woman with four young children, Chadwick would not give her all to her job (Chadwick v. Wellpoint Inc., 2009). The Appeals Court also concluded that based on the common stereotype about women with children and job performance and the surrounding circumstantial evidence presented by Chadwick, the Court believed that a reasonable jury could find that Wellpoint would not have denied a promotion to a similarly qualified man because he had "too much on his plate" and would be "overwhelmed" by the new job, given "the kids" and his schooling (Chadwick v. Wellpoint, Inc., 2009).

In Gerving v. OPBIZ, LLC (doing business as Aladdin Resort and Casino) 2009, the Ninth Circuit Court of Appeals reversed a district court's grant of summary judgment on her claims of gender discrimination and retaliation under title VII of the 1964 Civil Rights Act and Nevada state law. In the Gerving v. OPBIZ, LLC case Karen Gerving, a stepmother of three young children, was able to show that her supervisor, Jim Lauster, began to give her poor performance reviews after she became a stepmother. Gerving was also able to establish the Lauster told her that working mothers could not perform as well as men or women without children, that mothers should stay at home, and that she would have to choose between being a mother and a sales manager (Gerving v. OPBIZ, LLC, 2009). Additional evidence presented by Gerving also showed that Lauster had similarly treated another female employee during her pregnancy and subsequently declined to consider her for a promotion. Gerving was also able to show that when she was reprimanded for telephone calls to her children, male coworkers with children were not (Gerving v. OPBIZ, LLC, 2009). With regard to the retaliation allegation, evidence presented showed that after Gerving complained to OPBIZ, LLC Human Resources about Lauster's comments, Lauster became angry and attempted to fire her less than two weeks later (Gerving v. OPBIZ, LLC, 2009).

While the majority of court cases involving caregivers have been filed by females, one of the largest verdicts involving a caregiver in an FMLA suit involved Chris Schultz, a 45 year old male maintenance worker who was caring for his father who was suffering from Alzheimer's disease and his ailing mother (McAree, 2009). Schultz was awarded $10.75 million in damages against his employer, Advocate Health and Hospitals Corporation, with additional awards of $450,000 from two supervisors. While the verdict was appealed and a settlement of an undisclosed amount was paid, the case highlights that this issue is not just about females McAree, 2009). The EEOC also noted in issuing it's Employer Best Practices for Workers with Caregiving Responsibilities guidance, that while…

Currently, many workers juggle both work and caregiving responsibilities. Those responsibilities extend not only to spouses and children, but also to parents and other older family members, or relatives with disabilities. While women, particularly women of color, remain disproportionately likely to exercise primary caregiving responsibilities, men have increasingly assumed caretaking duties for children, parents and relatives with disabilities (EEOC B, 2009).

EMPLOYER BEST PRACTICES

The rationale for the EEOC's advancement of Employer Best Practices for Workers with Caregiving Responsibilities guidance is not just anchored to the rise in discrimination allegations. The EEOC cites numerous studies that show that employers that adopt flexible workplace policies that enable employees to achieve a satisfactory work-life balance also have been able to add to their customer base and their bottom line (EEOC B, 2009). The EEOC also cited additional studies that flexible workplace policies enhance employee productivity, reduce absenteeism, reduce costs, aid recruitment and retention, and provide employers with more alternatives when dealing with workforce reductions (EEOC B, 2009).

The EEOC suggestions of best practices for employers go beyond federal nondiscrimination requirements designed to remove barriers to equal employment opportunity and cover three areas: General suggestions regarding organizational policies and practices; suggestions regarding recruitment, hiring, and promotion; suggestions as to terms, conditions, and privileges of employment.

The first general example of an employer best practice in this area covers a basic theme that the EEOC and the courts have been advancing for a number of years – management training. Employers should already be training their managerial personnel in regard to EEO basics. Given these new guidelines, employers would be well advised to review their training efforts to be sure to include the obligations that may impact decisions about treatment of workers with caregiving responsibilities. The list of federal statutes where allegations of discrimination involving caregivers is contained in Exhibit 3. In addition there are state and local laws which may also provide employees with protection.

Exhibit 3: Federal Employment Statutes and Regulations that may give rise to an allegation involving care givers include the following:

- ♦ Americans with Disabilities Act of 1990 as Amended
- ♦ Equal Pay Act of 1963 as Amended
- ♦ Pregnancy Discrimination Act
- ♦ Title VII of the Civil Rights Act of 1964 as Amended
- ♦ Family Medical Leave Act (FMLA)
- ♦ Employee Retirement Income Security Act (ERISA)
- ♦ U.S.C. §1983
- ♦ Executive Order 13152

Source: EEOC B, (2009).

The University of California WorkLife Law center reports that over 60 localities include "familial status," "family responsibilities," "parenthood," or "parental status" in their employment discrimination protections, and two states and the District of Columbia have enacted statutory prohibitions on family responsibilities discrimination (Center for WorkLife Law, 2009). The WorkLife Law Center also reports that "several states and New York City are currently considering, or have considered, legislation to explicitly prohibit Family Responsibility Discrimination" (Center for WorkLife Law, 2009).

While training of all managerial personnel is imperative, organizations should also make sure that they have strong EEO policies in place that clearly addresses the types of conduct that might constitute unlawful discrimination against caregivers. These policies must also be effectively communicated to all employees, provide examples of prohibited behavior, identify easy to access complaint procedures, and prohibit retaliation against individuals who report discrimination or harassment based on caregiving responsibilities or who provide information related to such complaints (EEOC B, 2009).

The EEOC's advice with regard to recruitment, hiring, and promotion is also consistent with themes the agency and courts have been advancing for a number of years. Number one is to focus on applicant's qualifications for the jobs in question and avoid inquiries regarding the applicant's children, plans to start a family, or other caregiving responsibilities. Additionally, the EEOC goes on to encourage employers to review their employment policies and practices, develop specific, job-related qualification standards, identify and remove barriers to re-entry for individuals who have taken leaves of absence from the workforce because of caregiving responsibilities, and to effectively document and retain records relevant to all employment decisions at least for the length of time required by statute (EEOC B, 2009).

The list of suggestions in regard to terms, conditions, and privileges of employment provides employers with an opportunity to audit a wide range of issues including compensation practices, performance appraisal, and the use of flexible work arrangements (EEOC B, 2009). Flextime, flexible work week options, telecommuting, and reduced-time options are not new ideas. The field of Human Resource Management has produced a tremendous amount of research dealing with the effectiveness of these suggestions (see EEOC B, 2009 notes 5-8).

SUMMARY AND CONCLUSIONS

Given the well publicized demographic characteristics of today's work force, the rapid rise in litigation, and the EEOC's guidance in regard to caregiver discrimination, employers should allocate additional resources to deal with an issue that is not likely to go away any time soon. Employers should be taking "proactive steps to avoid allegations of discrimination against caregivers" (Proskauer Rose, LLP, 2009). Caregivers are not a protected category under Federal Statues – yet. Given the EEOC guidance and recent court decisions, "courts are finding that where evidence of stereotyping is present" employee caregivers are garnering more favorable outcomes in courts (Proskauer Rose, LLP, 2009). Employers genuinely looking to reduce their exposure to litigation with regard to allegations of caregiver discrimination must initiate policy and practice review, develop and execute effective communication and training, and regular assessment of all of the above to be in position to effectively address this important emerging workplace issue.

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HAS THE US ECONOMY EXHIBITED LESS UNCERTAINTY DURING THE GREENSPAN ERA?

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ABSTRACT

The U.S. economy during Greenspan's tenure as the Federal Reserve Chairman exhibited the lowest unemployment rate, the most stability in terms of real GDP growth, employment, inflation, and interest rates when compared to Canada and United Kingdom. This indicates that the Fed did manage to minimize uncertainty and maximize employment during the period. However, while the U.S. economy is able to generate more job opportunities with each percentage point of GDP growth, U.S. consumers face the fastest price increase for each percentage point of GDP growth, and the second highest price increase for each percentage point of employment rate, and U.S. firms pay the highest financing costs per unit of growth among the three countries.

INTRODUCTION

It is well recognized that Allan Greenspan was among the best Chairman in the history of central banks, guiding the U.S. economy through a prolonged period of economic growth and stability, throughout the 1980s and 1990s. However, it is difficult to measure a Federal Reserve Chairman's or a central bank's performance, and to compare central banks' performance, in part because economies exhibit different growth rates, inflation and interest rates at different stages of development, and each economy has its own particular natural, cultural, and political conditions and environments, and the differences may sometimes dominate the role of a central bank.

There are numerous studies comparing the conduct and performance of monetary policies of the Volcker-Greenspan period to those of the pre-Volcker period (Clarida, Gali & Gertler, 2000; Mankiw, 2002; Gamber & Hakes, 2006; Dennis, 2004; Fair, 2007). The researchers find that monetary policies during the Volcker-Greenspan period have been more efficient and more reactive to changes in expected inflation. There are several cross-country empirical studies on relationship between policy efficiency and macroeconomic performance (Cecchetti & Krause, 2001; Cecchetti, Flores-Lagunes & Krause, 2004).

Good conduct of monetary policy or simply reduced supply shocks contribute to good macroeconomic performance. Cecchetti, Flores-Lagunes, and Krause (2004) find that more efficient policy explains 80% of the improvement in macroeconomic performance in 20 out of 21 countries they study. Ahmed, Levin, and Wilson (2004) and Kahn, McConnell, and Perez-Quiros (2002) discuss the sources of reduced output volatility and those of reduced price volatility, both agree that policy is the likely source of stability in inflation. Blanchard and Simon (2001) identify a decline in output volatility since the 1950s and trace to several proximate causes. They find little evidence that the absence of large shocks is the reason of the decline in output volatility.

In this study, we compare the macroeconomic performance in three different countries. Our purpose of this study is to use simple, straightforward calculations to show whether the American people enjoyed better economic conditions in the Greenspan era than did people in Canada and in the United Kingdom, since the Fed's and the other two central banks' policies may have played an important role in the performance of the economy. We do not attempt to trace the causes of the macroeconomic performances in this study since there is already a broad agreement on the importance of monetary policy. We examine and compare relative measures, such as the ratios of inflation to unemployment, inflation to GDP growth, employment and interest rate to GDP growth. We select Canada and the United Kingdom for comparison because these two countries are the most similar to the United States in terms of culture, political system, and stage of economic development. Is the difference in performances of the three countries caused by their different policy goals? Canada and United Kingdom adopted inflation targets in 1991 and 1992, respectively, while the United States does not have formal inflation targets. Dueker and Fischer (2006) find little evidence that inflation-targeting monetary policies outperform given the same circumstances. This is the case when they compare the inflation performances of Canada and the United States. The extensive survey of empirical studies by Dueker and Fischer (2006) provide similar conclusions. Cecchetti and Ehrmann (2002) analyze 23 countries in the pre EMU period and find that inflation targets did not cause difference in the patterns of inflation and output volatilities. A common explanation for this is that the successful non-inflation targeters' practices converge to those of inflation targeters (Bernanke et al., 1999; Mishkin, 2002).

According the Federal Reserve's mission statement, its first duty is

> "Conducting the nation's monetary policy by influencing the monetary and credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates." (See the Federal Reserve Board website for more information regarding the duties of the Fed. http://www.federalreserve.gov/generalinfo/mission/).

This mission gives a starting point for comparisons between the three economies. We first compare some absolute measures including real GDP growth, the unemployment rate, the inflation rate, and the 10-year Treasury bond yield, which is a key measure of long-term interest rates and reflects the level of financing costs in the economy.

Although the Bank of England adopted a policy of inflation targeting in May 1997, it is clear from the Bank's mission statement that inflation is only one element of monetary policy in England. According to the core purposes of the Bank:

> "The first objective of any central bank is to safeguard the value of the currency in terms of what it will purchase at home and in terms of other currencies. Monetary policy is directed to achieving this objective and to providing a framework for non-inflationary economic growth." (See the Bank of England website for more information regarding the duties of the Bank of England. http://www.bankofengland.co.uk/about/index.htm).

The bank of England also makes it clear that "Financial Stability" is an important core concern of the Bank. The objectives of the Bank of England are mirrored by that of the Bank of Canada which had adopted a policy of inflation targeting in 1991.

> "The target also provides a clear measure of the effectiveness of monetary policy. One of the most important benefits of a clear inflation target is its role in anchoring expectations of future inflation. This, in turn, leads to the kind of economic decision making — by individuals, businesses, and governments — that brings about non-inflationary growth in the economy." (See the Bank of Canada website for more information regarding the duties of the Bank of Canada. http://www.bankofcanada.ca/en/index.html).

The fact that both the Bank of England and the Bank of Canada adopted policies of inflation targeting does not take away from the fact that the goals of all three central banks are similar. Although the exact policies and regulations governing the three central banks may differ to some degree, all three banks are primarily concerned with price stability and non-inflationary economic growth.

However, to address the differences that exist between the economies of Canada, the United Kingdom and the Unites States we cannot simply measure Greenspan's or the Fed's performance by examining whether the U.S. GDP growth rate was the highest and unemployment rate and inflation rate was the lowest during his era. Hence, we also examine and compare relative measures, such as the ratios of inflation to unemployment, inflation to GDP growth, employment and interest rate to GDP growth.

We focus on comparing the volatilities of the economic indicators or uncertainties of the economies. If a Fed Chairman/central bank is able to "act against the wind" promptly and adequately he/it should be able to reduce the volatility of the economy. The Federal Reserve System is also concerned about minimizing interest rate variations. These are important for all participants of the economy except a few extreme speculators.

We select the period when Alan Greenspan served as the Fed Chairman 1987-2005 for comparison. We do not compare the U.S. economy's performance of 1987-2005 with that of previous time periods because the domestic and international economic and political environments and development stages are different over time, for example, the US enjoyed high economic growth, low unemployment and low inflation in the 1950s, stagflation in the 1970s; Japan had high growth and inflation in the 1970s and 1980s, followed by Singapore, South Korea, Taiwan and Thailand, which experienced high economic growth in the 1990s. Recently, while developed economies are showing moderate economic growth, China and India have managed to maintain high rates of economic growth.

Data on real gross domestic product growth (GDP), the consumer price index (CPI), and the yield on the ten-year Treasury bond are from *International Financial Statistics* (IFS) of the International Monetary Fund (IMF), the websites of the National Bureau of Economic Research (NBER), the Federal Reserve System, the Bank of Canada and the Bank of England. Data of the unemployment rate for the United States are available from the Bureau of Labor Statistics http://stats.bls.gov/), data on the unemployment rate for the United Kingdom are available from National Statistics Online (http://www.statistics.gov.uk/), and data on the unemployment rate for Canada are available from Statistics Canada (http://www.statcan.ca/start.html).

PERFORMANCE OF THE THREE ECONOMIES

Over the period 1987 – 2005, each of the three countries has experienced at least one recession according to the analyses from National Bureau of Economic Research (NBER) and the Economic Cycle Research Institute (ECRI). (The NBER chronology of business cycles is available via the World Wide Web at http://www.nber.org/cycles.html and the ECRI chronology is available at http://www.businesscycle.com/). NBER determines the timings of the business cycle for the United States and ECRI employs the same methodology for twenty other countries to determine recessions and expansions. The first recession in the United States during Greenspan's tenure at the Fed occurred from July 1990 through March 1991, lasting 8 months. The second recession ran from March 2001 through November 2001, and lasted 8 months. Canada experienced a much longer recession in the early 1990s that began in March 1990, ended in March 1992, and lasted 24 months. The United Kingdom experienced a recession that nearly coincides with Canada, beginning two months later in May 1990, ending in March 1992, and lasting 21 months. Although neither Canada nor the United Kingdom experienced a recession in 2001 as the United States did, it is worth noting that the combined duration of the two United States recessions is still shorter than the duration of the 1990 recessions in both Canada and the United Kingdom, and the total decline of the U.S. GDP during the two recessions is also the lowest. The severity or decline of the Canadian and British

GDPs during their recessions is 3.4 percent and 2.5 percent, respectively, and the total decline of the U.S. GDP during the two recessions is 1.7 percent. The statistics are reported in Table 1.

Table 1. Recessions in the Three Countries, 1987 – 2005			
	Canada	United Kingdom	United States
Recession Length Peak to Trough	Mar. 1990 – Mar. 1992 24 months	May 1990 – March 1992 21 months	July 1990 – March 1991 8 months (1.3%)
Severity or Total Decline in parenthesis	(3.4%)	(2.5%)	Mar. 2001 – Nov. 2001 8 months (0.4%)
Timing of recessions from NBER and ECRI, see footnote 1.			

A comparison of key macroeconomic measures among Canada, the United Kingdom, and the United States between 1987 and 2005 reveals that the United States has been the most stable of the three economies based on all three of the most widely cited measures of economic performance: output growth, inflation, and unemployment. As shown in Table 2, in terms of output growth, for the period 1987-2005, the standard deviation in the United States was 1.32 versus 2.63 for Canada and 1.76 for the United Kingdom. However the average annual growth in output for the United States over this time period was slightly lower, 2.40 percent, as compared to 2.52 percent for Canada and 2.57 percent for the United Kingdom. At the same time the United States experienced the most stability in price level. Based on the consumer price index, the U.S. inflation exhibits a standard deviation of 0.98 as opposed to 1.42 for Canada and 2.02 for the United Kingdom. Although the United States had the lowest standard deviation of inflation between 1987 and 2005, it did not have the lowest average rate of inflation over that period, with an average rate of 3.07 percent, versus 2.59 percent in Canada and 3.57 percent in the United Kingdom.

Table 2. Comparison of Annual Averages and Volatilities 1987 – 2005			
		Real GDP Growth	
Country	Canada	United Kingdom	United States
1987-92 Average	1.09	2.05	1.73
1987-92 Std. Dev.	3.71	3.11	1.63
1993-98 Average	3.07	3.02	2.87
1993-98 Std. Dev.	1.46	0.61	0.88
1999-05 Average	3.40	2.64	2.59
1999-05 Std. Dev.	2.06	0.62	1.29
1987-2005 Average	2.52	2.57	2.40

Table 2. Comparison of Annual Averages and Volatilities 1987 – 2005			
1987-2005 Std. Dev.	2.63	1.76	1.32
		Inflation	
Country	Canada	United Kingdom	United States
1987-92 Average	4.12	5.80	4.12
1987-92 Std. Dev.	1.38	2.10	0.80
1993-98 Average	1.39	2.70	2.50
1993-98 Std. Dev.	0.70	0.70	0.52
1999-05 Average	2.27	2.22	2.59
1999-05 Std. Dev.	0.40	0.64	0.66
1987-2005 Average	2.59	3.57	3.07
1987-2005 Std. Dev.	1.42	2.02	0.98
	Unemployment Rate		
Country	Canada	United Kingdom	United States
1987-92 Average	8.95	8.72	6.15
1987-92 Std. Dev.	1.49	1.51	0.86
1993-98 Average	9.72	8.48	5.57
1993-98 Std. Dev.	1.07	1.57	0.86
1999-05 Average	7.27	5.19	5.04
1999-05 Std. Dev.	0.38	0.50	0.78
1987-2005 Average	8.65	7.46	5.59
1987-2005 Std. Dev.	1.46	2.06	0.91
		T-bond Yield	
Country	Canada	United Kingdom	United States
1987-92 Average	9.56	10.13	8.19
1987-92 Std. Dev.	0.88	0.88	0.66
1993-98 Average	7.06	7.39	6.26
1993-98 Std. Dev.	1.18	0.99	0.63
1999-05 Average	5.09	4.87	4.84

Table 2. Comparison of Annual Averages and Volatilities 1987 – 2005			
1999-05 Std. Dev.	0.64	0.32	0.76
1987-2005 Average	7.12	7.32	6.35
1987-2005 Std. Dev.	2.08	2.34	1.56

Data on Real GDP, T-Bond Rate, and Inflation are taken or converted from International Monetary Fund, *International Financial Statistics* (IFS), January, 2006 edition. Data on unemployment for United States are from US Bureau of Labor Statistics; United Kingdom from National Statistics Online (UK); Canada from Statistics Canada.

This in some sense reflects what Alesina and Summers (1993) have found, i.e., inflation-averse central bank policy may be associated with less or more variability in economic performance. In order to examine whether the Federal Reserve System and the U.S. economy made progress during the chairman's tenure, we divide the period into three sub-periods. The statistics indicate that overall, each of the three countries experienced sharp declines in inflation from the earliest period, 1987-92, when all countries had an annual inflation rate in excess of 4.12 percent through the last period, 1999-2005, when all three countries had an annual inflation rate under 2.59 percent. The decline in inflation rate may be due more to the international economic environment, but the central banks did cooperate better and improve their monetary policies.

Another key indicator of macroeconomic health is the unemployment rate. Although the calculations of unemployment may vary between countries, a comparison based on data available from each country is still feasible, noting that there may be structural differences in the three economies with regards to unemployment insurance and assistance. As with both inflation and output growth, the United States experienced the most stability in terms of unemployment, with a standard deviation for the 1987 – 2005 period of 0.91 compared to 1.46 in Canada and 2.06 in the United Kingdom. Furthermore, for the entire period the United States had the lowest average rate of unemployment, at 5.59 percent versus 8.65 percent in Canada and 7.46 percent in the United Kingdom. It is also of note that unemployment in the United Kingdom dropped the most significantly from the first sub-period to the last, nearly approaching the rate of the Untied States in the 1999 – 2005 period (5.19 percent in the U.K. versus 5.04 percent in the U.S.), indicating that there may have been a decline in some of the structural differences.

The 10-year Treasury bond rate is a key measure of long-term interest rates in the three economies. Over the full period and each of the sub-periods the interest rate in the United States was below those in Canada and the United Kingdom and the most stable, except for the last sub-period of 1999-2005. For the full period the average Treasury bond rate in the United States was 6.35 percent with a standard deviation of 1.56 compared to Canada with an average rate of 7.12 percent and standard deviation of 2.08, and the United Kingdom with an average of 7.32 percent and a standard deviation of 2.34. The fact that the U.S. had the lowest and most stable interest rate may in part be explained by the use of U.S. dollars as a reserve currency and the fact that most of the U.S. dollar reserves are invested in long-term U.S. Treasury bonds under the general assumption that the United States is both politically and economically stable.

In order to examine the cost or efficiency of the Fed's and the economy's performance, we compare four relative measures of the three economies, they are the ratios of inflation rate to real GDP growth, inflation rate to employment rate, unemployment rate to real GDP growth, and Treasury bond yield to real GDP growth.

The ratio of inflation to growth measures the price increase that consumers face for each percentage point of real GDP growth, it is high during a stagflation period (e.g., mid 1970s), and low during high growth and low inflation (e.g., mid and late 1990s). High inflation encourages rent seeking activities, raises risk premiums and creates distortions, which may hurt the economy. Deflation causes high costs and low or negative profit to producers, which also hurts the economy. Therefore, the lower is the ratio the healthier the economy. Negative GDP growth during the recession periods are excluded for the calculation because a negative ratio is irrelevant, and deflation did not occur during the period we examine. The averages and standard deviations are calculated as:

$$\text{Average} = [\Sigma(x_i/y_i)]/n \qquad (1)$$

$$\sigma = \sqrt{\frac{n\sum(\frac{x}{y})^2 - (\sum\frac{x}{y})^2}{n(n-1)}} \qquad (2)$$

where *x* and *y* are values of the macroeconomic indicators, *n* represents number of years. (The ratios in Table 3 are multiplied by 100 for convenience.) The U.S. economy exhibits the highest ratio and largest standard deviation for the whole period (2.28 and 3.37) followed by U.K. (1.79 and 1.96) and Canada (1.19 and 1.36), and for each sub-period, because of the lowest U.S. growth and the medial inflation (See Table 2). This indicates that the U.S. consumers faced faster price increase for each percentage point of GDP growth compared to Canada and United Kingdom, and the Fed's consistent emphases on inflation control is right.

The employment rate is calculated as one minus the unemployment rate. The ratio of inflation to employment indicates the price increase that consumers face for each unit of employment. A lower ratio is preferred. For the whole period, the average ratio for the U.S. was 3.25, below that of U.K. (3.87), but above that for Canada (2.83) while the U. S. experienced the most stability in the ratio. However, both the U.S. ratio and its volatility increased from the lowest in the first sub-period to the highest in the last period.

The ratio of unemployment to GDP growth represents an economy's ability to generate employment opportunities as it grows; a lower ratio indicates stronger ability. Negative GDP growth is excluded in the calculation as negative ratios are irrelevant. The average ratio for the whole period 1987-2005 for the U.S. was 3.54, the lowest or the best among the three, which indicates that the U.S. economy is able to generate more job opportunities with each percentage point of GDP growth. The U.S. economy was the best for the first and second 5-year periods, but the difference declined over time. The U.S. was better than Canada, but significantly worse than the U.K. during the last period. The ratio for the U.S. was also the most stable for the first sub period and the whole period.

Table 3. Comparison of the Relative Measurements 1987 – 2005			
	Inflation/GDP Growth		
Country	Canada	United Kingdom	United States
1987-92 Average	1.54	3.50	3.88
1987-92 Std. Dev.	0.80	3.62	5.46
1993-98 Average	0.58	0.97	0.99
1993-98 Std. Dev.	0.36	0.44	0.47
1999-05 Average	1.44	0.91	1.99
1999-05 Std. Dev.	2.00	0.37	2.89
1987-2005 Average	1.19	1.79	2.28
1987-2005 Std. Dev.	1.36	1.96	3.37
	Inflation/Employment		
Country	Canada	United Kingdom	United States
1987-92 Average	4.51	6.32	4.38
1987-92 Std. Dev.	1.51	2.19	0.82
1993-98 Average	1.53	2.94	2.65
1993-98 Std. Dev.	0.78	0.74	0.57
1999-05 Average	2.45	2.35	2.73
1999-05 Std. Dev.	0.43	0.67	0.68
1987-2005 Average	2.83	3.87	3.25
1987-2005 Std. Dev.	1.56	2.20	1.04
	Unemployment/GDP Growth		

Table 3. Comparison of the Relative Measurements 1987 – 2005			
Country	Canada	United Kingdom	United States
1987-92 Average	5.85	7.46	4.76
1987-92 Std. Dev.	7.11	10.02	5.47
1993-98 Average	3.76	2.89	2.17
1993-98 Std. Dev.	1.73	0.73	0.95
1999-05 Average	4.37	2.04	3.68
1999-05 Std. Dev.	5.67	0.36	4.77
1987-2005 Average	4.66	4.13	3.54
1987-2005 Std. Dev.	4.81	4.90	4.05
	T-bond yield/GDP Growth		
Country	Canada	United Kingdom	United States
1987-92 Average	5.09	7.46	6.88
1987-92 Std. Dev.	4.64	9.12	8.54
1993-98 Average	2.69	2.54	2.39
1993-98 Std. Dev.	1.18	0.71	0.86
1999-05 Average	3.14	1.92	3.70
1999-05 Std. Dev.	4.36	0.39	5.16
1987-2005 Average	3.64	3.97	4.33
1987-2005 Std. Dev.	3.54	4.60	5.49
Data sources are the same as those in Table 2.			

The ratio of the T-bond rate to GDP growth is a relative measure of investors' financing costs for their expansions that contribute to each percentage point of real GDP growth, in this case a lower ratio is considered better. Again, negative GDP growth is excluded for the calculation for the same reason as mentioned above. The U.S. experienced the highest ratio and the lowest stability for the whole period (4.33 and 5.49), followed by U.K. (3.97 and 4.60), and Canada (3.64 and 3.54), partly because of the lowest rate of GDP growth, which indicates that U.S. firms pay the highest financing costs for unit growth compared to Canadian and British firms.

CONCLUSION

There are no clear and consistent criteria for measuring a central bank's and an economy's performance, and economic performance is not entirely related to, or caused by, central bank policies, since economies are often subject to exogenous shocks. However, the U.S. economy exhibited the most stability in terms of real GDP growth, employment, inflation, and interest rate, and the lowest unemployment rate, hence, compared to Canada and United Kingdom, the American people did enjoyed the least uncertainty and most employment during the time period when Alan Greenspan was the Federal Reserve System chairman.

However, the relative measurements reveal that U.S. consumers face the fastest price increase for each percentage point of GDP growth, and the second highest price increase for each percentage point of employment, the U.S. economy is able to generate more job opportunities with each percentage point of real growth, and U.S. firms pay the highest financing costs for each percentage point of growth among the three countries. The results of this study may have implications as to how we measure a Federal Reserve Chairman's and a central bank's performance over time.

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DO YOU THINK I'M SEXTY? MINORS AND SEXTING: TEENAGE FAD OR CHILD PORNOGRAPHY?

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ABSTRACT

Sexting is the term given to the sending of sexually explicit photographs over cell phones. Recent surveys suggest that anywhere from 20% to 39% of teenagers have engaged in sexting. Moreover, depending on which state you live in, sexting can result in civil lawsuits, criminal prosecution, and even required registration as a sex offender. In addition to potentially disastrous legal consequences, sexting has also resulted in ruined reputations and even suicide. This paper analyzes the only currently published federal case on the issue, as well as current and pending legislation being used to address this recent cultural phenomenon.

SEXTING AND SUICIDE

Jesse Logan, like many other teenage girls, sent nudes pictures of herself to her boyfriend over her cell phone. When she and her boyfriend broke up, he sent the pictures to other high school girls. Jesse was harassed, called a slut and a whore, and had objects thrown at her. In May of 2008, Jesse appeared on a Cincinnati television station to tell her story and, as she said, " . . . make sure no one else will have to go through this again." Two months later, Jesse hanged herself. Her parents have since brought a lawsuit blaming the Montgomery Police Department for failing to press charges against the defendants for "disseminating and pandering pornographic matter." The lawsuit also blames Sycamore High School for knowing about the situation but not stopping ". . . the hazing, bullying, taunting and harassment" of their daughter.

While Jesse's story is tragic, the actions of her former boyfriend are not uncommon. In fact, 44% of boys say they have seen sexual images of girls in their school. Approximately 15% of boys admit to disseminating the images when they break up with the girls. While suicide may be the most extreme result of sexting, the lives of those who survive sexting are also being ruined. Throughout the United States, there is a huge variance among state laws regarding how sexting cases are handled. Prosecutors across the country are more than willing to press charges. A few examples:

- ♦ In Fort Wayne, Indiana, a teenage boy is facing felony obscenity charges for allegedly sending a photo of his genitals to female classmates;

- In Texas, a 13 year old was arrested on child pornography charges after receiving a nude photo of a fellow student on his cell phone; and

- In Ohio, a 19 year old cheerleading coach was arrested for taking a topless picture of herself and a 15 year old girl.

The social consequences of sexting can be humiliating for a teen, but the legal consequences can be devastating. For example, in Virginia, any nude photo of an underage person is considered child pornography and is a felony punishable by a maximum of five to ten years in prison.

School districts are on the front line in discovering sexting. Student cell phones are sometimes confiscated for inappropriate use during class. Some schools will simply hold the phone until the end of the day and then return it to the student. Others, however, have seen fit to go through the cell phone, often discovering nude or semi-nude photos of underage students.

In perhaps the most publicized sexting case, involving high school girls from the Tunkhannock School District in northern Pennsylvania, school officials turned the cell phones over to local law enforcement. Two of the girls protested that they had not posed nude. What followed was federal review of the state District Attorney's actions.

PARENTS FIGHT BACK

In October of 2008, officials at a Pennsylvania school district confiscated cell phones from several students. Upon examination, the cell phones were found to contain photographs of "scantily clad, semi-nude and nude teenage girls."

The school district turned the phones over to George Skumanick, District Attorney of Wyoming County, Pennsylvania, reporting that male students were trading the imagines over their cell phones. In November of 2008, the District Attorney publically stated that students possessing inappropriate images of minors could be prosecuted under Pennsylvania law for possessing or distributing child pornography. He further stated that these charges were felonies, could result in long prison terms, would given even juveniles a permanent record, and that if found guilty, the minors would probably be subject to registration as sex offenders under Pennsylvania's Registration of Sexual Offenders Act ("Meghan's Law") for at least ten years. Finally, these minors would have their names and photos displayed on the state's sex offender website.

In February of 2009, the District Attorney sent letters to the parents of approximately twenty students. The letters were sent to the students on whose cell phones the pictures were stored and to the girls shown in the photos. The District Attorney did ***not*** send letters to those who had ***disseminated*** the images. Parents were informed that their child had been "identified in a police investigation involving the possession and/or dissemination of child pornography" and that charges would be dropped if the child successfully completed a six to nine month programmed focused on education and counseling. Those who refused to participate in the program or did not successfully complete it would be prosecuted.

A few days later, the District Attorney held a meeting where he reiterated his threat to prosecute unless the children submitted to probation, paid a $100 program fee and completed the program successfully. One parent inquired as to why his daughter – who was depicted in a photograph wearing a bathing suit – could be charged with child pornography. The District Attorney replied that she was posed "provocatively." He refused, however, to answer a question as to who got to decide what "provocative" meant.

The program at issue was designed as a "re-education program" – divided between girls' and boys' programs. The girls' program was designed to teach girls to "gain an understanding of how their actions were wrong," "gain an understanding of what it means to be a girl in today's society, both advantages and disadvantages," and "identify non-traditional societal and job roles." Homework consisted of an assignment including a paper on "[w]hat you did" and '[w]hy it was wrong."

Plaintiffs MaryJo Miller and her ex-husband met with the District Attorney to view the photograph of their daughter Marissa. The photo was two years old and showed Marissa Miller and her friend, Grace Kelly, from the waist up. Each was wearing a white opaque bra. Marissa was speaking on the phone and Grace was making a peace sign. Both girls were thirteen years old when the photo was taken. The District Attorney alleged that the photo was child pornography because the girls were posed "provocatively." When the Millers insisted that their daughter had a right to a jury trial, the District Attorney informed them that there were no jury trials in juvenile court. If the Millers would not accept his terms, he would prosecute. Jane Doe, another plaintiff in the case, was shown a photo of her daughter Nancy. It was over a year old and showed her with a towel wrapped around her body, just below her breasts, as if she had just emerged from the shower.

The parents of these girls argued that neither of the photographs depicted sexual activity. Moreover, neither showed the girls' genitalia or pubic areas. The District Attorney refused to divulge who owned the phones. Also, prior to plaintiffs filing their complaint, the District Attorney refused repeated requests to provide plaintiffs' counsel with copies of the photographs.

Plaintiffs (the three girls and their parents) filed a complaint pursuant to 42 U.S.C. Section 1983 for violation of constitutional rights:

- Count I – Violation of the First Amendment right to free expression (because the photographs were not in violation of any obscenity law and were therefore protected by the First Amendment);

- Count II – Retaliation in violation of plaintiffs' First Amendment right to be free from compelled expression (regarding the program requiring the girls to write about how their actions were wrong); and

- Count III - Retaliation against the parents for exercising their Fourteenth Amendment substantive due process rights as parents to direct their children's upbringing (by forcing their children to attend classes designed to "gain an understanding of how their actions were wrong," etc.)

The plaintiffs requested a Temporary Restraining Order (TRO) to enjoin the District Attorney and his office from initiating criminal charges against plaintiffs for the two photographs at issue, or for any other photographs of the girls unless the images depicted sexual activity or exhibited the genitals in a lascivious way.

LEGAL ARGUMENTS

The District Attorney agued that the court should abstain because hearing the case would be a collateral attack on state criminal proceedings. Under federal law, a federal court "may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments." The district court disagreed. The U.S. Supreme Court has previously held that 42 U.S.C. Section 1983 (the statute under which plaintiffs brought the action) expressly authorizes such federal action. Moreover, abstention under *Younger* was held inappropriate as there were no ongoing state proceedings (just threatened proceedings) and the danger of irreparable harm was clear and imminent. As such, the request for a TRO could proceed.

The Third Circuit Court of Appeals requires consideration of four factors by a court considering a preliminary injunction: (1) whether the movant has shown a reasonable probability of success on the merits; (2) whether the movant will be irreparably injured by denial of the relief; (3) whether granting preliminary relief will result in even greater harm to the nonmoving party; and (4) whether granting the preliminary relief will be in the public interest.

Regarding whether there was a reasonable probability of success on the merits, the court looked at all three arguments propounded by plaintiffs: (1) that the minor plaintiffs had a right to avoid the courses and the parents had a right to direct their education; (2) prosecution of the girls would be retaliation; and (3) the girls' photos were not obscene, therefore the only reason to prosecute them would be in retaliation for exercising their constitutional right not to participate in the program.

Recognizing that the Supreme Court has long prevented the government from compelling individuals to express certain views, the District Court agreed that both the parents and children had asserted constitutionally protected activity and were reasonably likely to succeed on the merits. As for retaliation, it is an adverse action by the government if "the alleged retaliatory conduct was sufficient 'to deter a person of ordinary firmness' from exercising his First Amendment Rights." The District Court held that the threat of a felony prosecution would deter an ordinary person from exercising her constitutional rights, therefore this claim also met the "reasonable likelihood of success on the merits" standard.

Finally, the court addressed the argument that the photos of the girls were not obscene, therefore the threat to charge the minors with a felony was not a genuine attempt to enforce the law, but rather an attempt to force the minor plaintiffs to participate in an education program. Pennsylvania law prohibits the distribution of imagines depicting a prohibited sexual act, and defines "prohibited sexual act" to mean "sexual intercourse . . . masturbation, sadism, masochism, bestiality, fellatio, cunnilingus, lewd exhibition of the genitals or nudity if such nudity is depicted for the purpose of sexual stimulation or gratification of any person who might view such depiction." Plaintiffs argued that the statute did not apply to the minors, who were the subjects of the photographs. The District Court held that plaintiffs made a reasonable argument that the imagines presented to the court did not qualify as such depictions. Moreover, the argument that the minor plaintiffs were not involved in *disseminating* the photographs was reasonable.

The District Court next looked at whether there would be irreparable harm to the plaintiffs if the TRO was not issued. Plaintiffs argued that "even a temporary violation of First Amendment rights constitutes irreparable harm." They further argued that the threat of criminal prosecution has a chilling effect on plaintiffs expressing themselves by appearing in photographs. The District Attorney countered that there was no irreparable harm because plaintiffs had adequate remedies other than equitable ones. The District Court recognized that if the plaintiffs were pursuing money damages, they would have an adequate remedy at law and no TRO would issue. Plaintiffs, however, were not seeking monetary damages. Instead, the plaintiffs were seeking the extraordinary remedy of equitable relief because they alleged defendant's actions were a violation of their First Amendment rights. The District Court agreed.

The harm to the non-moving party (the District Attorney) also had to be considered. The District Court disposed of this factor easily. The District Attorney had not yet filed charges against the girls, therefore arguably there was no need for immediate prosecution to protect the public from the crimes the girls allegedly committed. In fact, the District Attorney did not even address harm to himself or his office in the opposition papers.

The final factor to be considered by the District Court was whether granting the TRO would be in the public interest. The court agreed with the plaintiffs that the public interest was on the side of protecting constitutional rights. The TRO was then issued with respect to the two photographs at issue.

The American Civil Liberties Union (ACLU) represented the plaintiffs in this case, however it is unclear why they chose not to assert a violation of the girls' privacy rights. The Electronic Frontier Foundation takes the position that if school administrators "confiscate the phone, [it is] reasonable to hold it for the day and return it, but there's a serious question of whether that justifies going through the cell phone." As a result of this case, some school districts are modifying their policies regarding sexting. For example, in Colorado, the Boulder School District changed its policy handbook to state that parents and/or students must give written consent before school officials can examine students' cell phones.

PENDING FEDERAL LEGISLATION

Jesse Logan's parents and Parry Aftab, a New York attorney, are currently seeking a federal law to set penalties for teens who send racy photographs via cell phone. Aftab is the executive director of WiredSafety, an Internet privacy group. Legislators, including one from Jesse's home state of Ohio, are trying to introduce legislation that would make it a misdemeanor for minors to send nude images via cell phones.

New Jersey Senator Bob Menendez and Florida Representative Debbie Wasserman-Schultz are co-sponsoring The Safety Internet Act to ensure that schools teach teens and young adults the consequences of sexting. The bill would give money to nonprofit Internet watchdogs to work with schools in hopes of "integrating Internet safety curricula" into classrooms. Some education is already occurring. In Massachusetts and Rhode Island, law enforcement officers are being trained by Internet safety experts. The officers then address students at school assemblies. The program is funded by grants from the Verizon Foundation.

CURRENT AND PENDING STATE LEGISLATION

In Vermont, a "sexting" amendment was added to the *Adam Walsh Child Protection and Safety Act of 2006.* According to the amendment, the Adam Walsh Child Protection and Safety Act, signed by President George W. Bush in 2006, while well-intended, contains a broad span of provisions that would significantly change state practice related to the registration and management of sex offenders in Vermont in a manner inconsistent with widely accepted evidence-based best practices at a substantial financial cost to the state. As of June 1, 2009, no state was in compliance with the Act. If states are not in compliance by July 27, 2009, they will lose 10% of their federal Byrne/JAG funds. There are currently numerous constitutional challenges to the Act in both state and federal courts, resulting in substantial costs to many states. The registry requirements have expanded significantly in recent years and imposition of the requirements on offenders may violate the constitutional ban on retroactive punishment. Finally, Vermont assigns risk levels to various offenses, whereas the Act would mandate risk determination be based solely on an offender's crime of conviction (instead of on an actuarial risk assessment score).

According to the rationale for the amendment, regulations issued by former U.S. Attorney Alberto Gonzales require states to apply requirements of the act retroactively, meaning that even juveniles not currently required to register as sex offenders would be subject to a registration term as long as 25 years with no opportunity to petition for relief. Moreover, these juveniles would be included on the Internet Sex Offender Registry. Pursuant to the amendment, sent to Vermont's

Governor on May 26, 2009 (and enacted June 1, 2009), actions against minors will now be filed in family court and treated as a juvenile proceeding. Moreover, juveniles will not be subject to the requirements of registering as a sex offender. For an overview of current and pending state legislation, see the table below.

Table 1: Current and Pending State Sexting Legislation

State	Date	Legislation
Indiana	Adopted – April 29, 2009	Senate resolution to study sexting, (S.R. 90) particularly by children
New Jersey	Version – June 15, 2009	Requires school districts to annually (N.J. S.B. 2923) disseminate information to students In grades 6 through 12 and their Parents/Guardians on the dangers of Sexting
New Jersey	Version – June 15, 2009	Prohibits retail stores from selling (N.J. S.B. 2925) cell phones (including equipment And contracts) unless the store provides information brochures About sexting to customers who Purchase such equipment
New Jersey	Version – June 15, 2009	Creates diversionary (educational) (N.J. S.B. 2926) program for juveniles as alternatives to prosecution for sexting
New Jersey	Version – June 11, 2009	Requires school districts to (N.S. A.B. 4068) disseminate information to students and parents/guardians on the dangers of sexting
Vermont	Enacted – June 1, 2009	Minors caught sexting will be (V.T. S.B. 125) charged as juveniles in family court; no sex offender registration for juveniles; and the charges may be expunged when minor turns 18 years of age

CONCLUSION

Seventy-three percent of teenagers say they know sexting can have negative consequences, but they do it anyway.Why? According to psychologist Susan Lipkins, a national authority on teens and young adults, sixty-six percent of the girls who sent sexts did it to be flirtatious. Fifty-two percent of girls send sexts as a sexy present for a guy and forty percent of the girls said the sexts were sent as a joke. Clearly teens do not understand the serious social and legal implications of sexting.

Though not everyone agrees, there is a rising tide of calls by the public, particularly parents, to make sexting a misdemeanor. Moreover, registration as a sex offender is simply too harsh a penalty for underage sexting. There is also the issue of who should be charged with sexting. In some communities, the recipient of the sext, the person in the photo, and those disseminating the photos are charged with child-pornography related offenses. In the *Miller* case, the District Attorney refused to even name those who were disseminating sexts, let alone prosecute them (although he did threaten prosecution to those whose cell phones contained sexts and those who were in the photos found on the cell phones).Finally, if you are an adult and receive a sext from someone who is underage, you are now in possession of child pornography and may face felony charges if caught. If you forward the photo, you may be charged with distributing child pornography.

We need federal legislation to deal with the issue of sexting. Until that happens, the public will be stuck with a potpourri of laws varying from state to state, and will be at the mercy of sometimes harsh and relentless prosecutors. Recommended legislation should, at a minimum, deal with the following issues:

- Make sexting by minors (those under 18 years of age) a misdemeanor;
- No requirement of registration as a sex offender for minors;
- Create separate offenses for those appearing in a sexts versus those disseminating sexts;
- Create clear, federal guidelines as to what constitutes child pornography for the purposes of sexting;
- Establish educational programs and probation for first-time offenders;
- Allow misdemeanor sexting convictions to be expunged when the offender turns 18 years of age; and
- Establish a procedure for amnesty in reporting receipt of sexts (e.g., when a minor or an adult receives an unsolicited sext).

A uniform legal standard is desperately needed for sexting. We need to insert common sense into the law. Until that happens, many promising young lives will be destroyed due to youthful indiscretion.

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A MORAL IMPERATIVE – OVERCOMING BARRIERS TO ESTABLISHING AN MBA INFUSED WITH ETHICS

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ABSTRACT

Business schools have been trying for decades to educate ethical managers, but have often fallen short of expectations. The difficulty for many schools may lie in barriers that prevent the inclusion of ethics into the graduate business program.

This case study describes the development of an MBA program in a small Catholic college which emerged naturally infused with values. We propose that the barriers that often inhibit the creation of such a program can be overcome, if the program emerges from a value-laden culture. Results of this single case study are promising, finding that both faculty and students recognize the emphases placed on ethics two years later.

The question for further research is whether this experience is unique to a single institution, or whether all faith-based institutions have an advantage when trying to integrate ethics into an MBA curriculum. If faith-based institutions truly have the edge in developing ethics-infused graduate business programs, they could have an important competitive advantage in the MBA market.

INTRODUCTION

Business schools have been trying for decades to educate ethical managers. The results of their efforts, however, often fall short of their hopes. MBA students, despite their exposure to business ethics during graduate school, are still often perceived as unethical win-at any-cost corporate climbers. Critics of MBA programs argue that not only do most business schools neglect ethics in their curriculum, but they actually encourage a focus on short-term profits and the compulsion of graduates to go to any lengths to increase shareholder profits (Alsop, 2006; Giacalone and Thompson, 2006). In the post-Enron world, hiring businesses are questioning the values of these graduates, and recognize that their focus on profit above all else can lead to serious damage to corporate reputations (Roy and Roy, 2004). Critics contend that business schools can and must do more in bringing about positive ethical change (Adler, 2002). Business schools have responded to these demands for more ethical graduates by either adding ethics courses to their curriculum or attempting to integrate ethics throughout their curriculum. These often-expensive experiments, however, have proven challenging for institutions that struggle with already-crowded curriculum and faculty who are untrained or unwilling to change their approaches (Piper, 1993).

The purpose of this paper is to describe a success story: the development of an MBA program in a small Catholic college which somehow emerged naturally infused with values. The program's title (Innovation and Entrepreneurship) does not promote or even hint at its value-laden nature. The faculty, when developing the program, were not specifically instructed to focus on ethics in constructing their syllabi. The students were not informed upon entering the program that they were going to be exposed to ethics in all of their courses. Nevertheless, when surveyed, the faculty that developed the program all claimed that each of the courses they developed (including *Accounting* and *Quantitative Analysis*) have significant ethical components and over 70% of the students currently enrolled in the program claimed that there was a significant ethics component in *every* course they have taken in the MBA program. How did this happen? Why did Felician College, a small, Catholic, Franciscan college with an even smaller business division, succeed in developing an ethics-laden program that other much-larger and better funded colleges might aspire toward?

THE IMPORTANCE AND DIFFICULTY OF INCORPORATING ETHICS INTO MBA PROGRAMS

Business is often perceived as a game. The game analogy, though, can lead to some unpleasant ramifications. Games are won or lost. Games have limited and prescribed rules. Certain behaviors are tolerable in playing a game that might, in other social contexts, be unacceptable (Parks, 1993). And, sadly, the goal of the person engaged in the game is often to win at any cost. Nobody likes a loser. The focus is narrow and the stakes are high (Poytner, 1996).

Combine the game-like nature of business with the culture of self-interest and individualism that is inherent in our United States economic system and you have the recipe for unethical behavior. In reality, business school students may be at a greater risk of ethical lapses than other professional school students. Research has found that while business school students cheat at similar levels to students in other professional schools, their attitudes toward cheating are more permissive than the attitudes of their contemporaries (Klein, Levenburg, McKendall, and Mothersell, 2007). It could be hypothesized that the students attracted to business and seeking an MBA are more predisposed to this focus on self-interest, especially in terms of money-making (Parks, 1993). They like the game, and they want to win it. They enter MBA programs to equip themselves with the tools they need to compete.

Traditionally, MBA programs ignored this lethal combination of bright, aggressive students and a competitive, game-like business environment. MBA programs focused on the hard skills that would directly increase graduates' earning potential and students flocked to courses that they believed would make them more attractive to future employers (Alsop, 2007). The lessons of Enron, World-Com, and Arthur Anderson made it impossible for business schools to ignore the absence of ethics in their curricula any longer, though, and today most MBA programs acknowledge the importance of tempering their quantitative models with some focus on "softer skills" and character building. Piper (1993) explained that past overreliance on formal models "minimized the application of judgment and debate about values" (p. 3). Increasingly, academics realized that an MBA provides the framework by which future managers make decisions (Roy and Roy, 2004) and that business programs have a critical role to play in preparing their students to assume leadership roles in ethical and socially responsible businesses (Alsop, 2006). The quantitative thrust of the past needed to be expanded to include the new call for ethical understanding and reasoning abilities (Cohen and Burns, 2006).

As colleges and universities attempted to inject ethics into their MBA programs, though, they soon discovered that doing so was much more difficult than it appeared. During the early 1990s, a study at Harvard Business School identified common barriers that prevent the easy inclusion of ethics into most MBA programs (Gentile, 1993):

1. Difficulty in defining ethics
2. Lack of willingness to try to change students' value systems
3. Faculty's lack of confidence in their own value systems and/or their qualifications to teach ethics
4. The fear of "playing with a loaded gun" when discussing value systems in a classroom

How a small, resource-constrained Catholic college overcame these barriers and emerged with an ethics-laden graduate business program is the focus of this study.

THE FELICIAN COLLEGE EXPERIENCE

In 2004, the business faculty at Felician College were told that prospective applicants had been calling the admissions office inquiring about the availability of an MBA at the college. At that time, the division of business was only several years old (the business programs had existed as a department under Arts and Sciences since the early 1990s) and consisted of a 7-person faculty. The development of a graduate program in business was not a goal of the new division at that time, and seemed almost impossible to achieve. Felician College is a tuition-driven institution, though, and student demand is something that is taken very seriously. If prospective applicants were requesting a Felician College MBA, the tiny business division would have had a very difficult time persuading top administration that they were unable to create one (especially if they wished to preserve the respect of the institution). Therefore, in the summer of 2004 the division of business worked together to develop the theme and curriculum for their new program, which would be an MBA in Innovation and Entrepreneurship.

Felician College is a Catholic institution with a strong religious culture. The President, Vice President for Academic Affairs, and Dean of Students are all habited Sisters, so the Felician heritage of the college is visibly obvious. The Board of Trustees, as well, is heavily dominated by the members of the Felician order, and faculty members are carefully trained to respect and adhere to the religious mission of the college. Liturgies are held at least five times each academic year, crucifixes adorn each classroom, and posters articulating the Franciscan values are displayed throughout campus. Each faculty meeting starts with a 15-minute presentation on famous Franciscans, and each faculty member must attend an annual retreat. The last college strategic plan articulated religious identity as being as crucial as growth to the college's future. Anyone who spends any time on the Felician College campus quickly becomes aware that they are in a strong Catholic setting.

When the business faculty sat down to develop an MBA at the college, they never specifically stated the goal of infusing the program with values. Perhaps they didn't have to: there may be a certain homogeneity among Felician College faculty in terms of ethics. As the President states annually at her State of the College address, if any faculty members do not prescribe to the important Catholic mission of Felician College, they are encouraged to seek employment elsewhere. The faculty members who stay are comfortable with the religious identity of the college, and associate closely with the tenets of Franciscanism. Consequently, the 7-member team that created the MBA were, by default, willing and active participants in the religious culture of the college. They would not have been at Felician College if they had not been.

All courses in the MBA program were written by this full-time faculty team. The courses range from Innovation Management to Managerial Accounting and Managerial Finance. The surprise in the program does not rest in the curriculum, though: It lies in the fact that each of the courses, without prior discussion among the faculty developing them, wound up with a heavy ethics component.

OVERCOMING BARRIERS TO THE INCLUSION OF ETHICS AT FELICIAN

The difficulties articulated by Gentile in 1993 did not hold (or were easily overcome) when the Felician College faculty launched their MBA program. Felician College is mission driven, and that mission unequivocally is rooted in the values and principles of the Catholic Church. The acceptance of this mission by faculty made the inclusion of a strong ethics component into the MBA program both natural and comfortable. Each of the barriers Gentile identified were not formidable in the Felician College case.

At Felician College, the values and ethics of the instructor are presumed to reflect those of the institution. In effect, the faculty member gets to hide behind the values of St. Francis – regardless of whether these are truly the ethics by which he or she actually lives. The starting point is clear, and there is a model by which to frame the discussions. Ethical discussions are neither "vague" nor "nebulous" in this context: they are as clear cut as discussions of any other controversial topic. There is room for debate over interpretation, but no room for reestablishing the ethical groundwork. The faculty member is protected from the vulnerability of "revealing too much" by the college acceptance of a general, agreed-upon value base.

Difficulties in Defining Ethics

A key question when discussing ethics is "Whose ethics?" The recent focus on diversity and multiculturalism has made the identification of common values almost impossible and failure to get around this issue has derailed many attempts to teach ethics in secular institutions (Fukukawa and Shafer, 2007). On top of this is the fear that a discussion of ethics involves indoctrination. Parks (1993) described this fear as "the perception of ethics as a saboteur of the deeply cherished though spurious myth of value-neutral education" (p. 17).

Although many faculty members would prefer not to address issues of ethics in the classroom, it must be acknowledged that, even in their silence (or especially in their silence) they are teaching lessons on values during every class session. According to Piper (1993), management educators have always taught lessons in leadership, ethics, and corporate responsibility, even when they believe that they have avoided the topics. Students quickly pick up the value systems of their instructors, and faculty attempts to remain value-neutral invariably fail. "Omission of discourse is not value-neutral education. There is no such thing. Omission is a powerful, even if unintended, signal that these issues are unimportant" (Piper, 1993, p. 6).

At Felician College, the question of "Whose ethics?" need not be asked. The college subscribes wholeheartedly to the ethics of St. Francis of Assisi. His values, which include respect for all humankind, love and stewardship of nature, and love of God, are the core of the college mission and are posted prominently around campus. The faculty are taught the values and attend an annual retreat to contemplate the application of them in their professional lives. When beginning any ethical discussion at Felician College, faculty are armed with a strong and nonnegotiable starting point – the principles of Francis, as interpreted in modern Catholic Social Teaching.

Lack of Willingness to Change Students' Value Systems

Even if a universal ethics can be agreed upon, faculty in business programs still face reluctance to try to affect students' values. One reason for this resistance is the common belief that by the time students enroll in MBA programs it is too late to change their value systems. Conventional wisdom tends to equate value emergence with character formation, which is associated with early childhood. Parks (1993) called this assumption, which he traced to popular Freudian psychology, highly dangerous (p. 14). In its early experimentation with teaching graduate students business ethics, the Harvard Business School discovered that moral development can and does continue into adulthood, and the impact of value-based education introduced at the graduate level can have a significant impact (Parks, 1993). According to Piper (1993), students in their 20's are in a critical stage of their moral development, and their perceptions about capitalism, leadership, and appropriate resolution of ethical dilemmas can be molded appropriately in ethics-infused graduate programs (p. 5).

The second source of faculty resistance is the belief that ethics really cannot be taught at all. Despite the conclusions of Socrates 2,500 years ago, many faculty members still doubt whether ethics training really works (Cohen and Burns, 2006). In ethics courses, students invariably give the "correct" answers, often mouthing platitudes that they believe their professors want to hear (Gentile, 1993, p. 87). While students might be able to be taught to arrive at the socially responsible or ethically correct response when faced with a case in business school, how likely are they to carry this process with them into their careers?

According to Roy and Roy (2004), the students do develop transferable decision-making skills after exposure to graduate level ethics. Alsop (2006) agreed with this premise: The focus on moral decision-analysis in graduate programs is crucial to the development of ethical managers. The primary hindrance to managers making good, moral decisions is lack of experience in doing so (Poynter and Thomas, 1996) Case studies in graduate school can provide this experience before the students are faced with real-life ethical dilemmas.

The final source of faculty resistance to teaching ethics is more difficult to address. Business faculty, trained and educated in their fields, sometimes view discussions of ethics as "fluff," or distractions from the subject at hand. Lacking analytical models to apply, the faculty consider ethical discussions pointless, or "flat" (Gentile, 1993, p. 87). Students in functional courses (such as finance or strategy) may worsen this perception by acting as though an examination of ethics in class is a welcome break from quantitative analysis. Faculty therefore view ethics as "soft, idealistic, and even nebulous" (Gentile, 1993, p. 92). Why waste valuable classroom time on a topic that offers no clear conclusions and cannot be converted into a useable model? Roy and Roy (2004) perhaps offered the best rebuttal to this faculty resistance: Faculty should teach ethics because employers care. Because employers are looking for future managers well versed in ethics, the faculty member who refuses to introduce ethics into his or her curriculum does the students a disservice.

This barrier is irrelevant to the Felician College faculty. Indeed, part of the mission of the college is to do this very thing: change the value systems of students so that they graduate with "thinking hearts and understanding minds." Toward this end, all undergraduate students must take the Felician College core, which is comprised of four sequential courses infused with mission and leading to a service orientation. Students also are required to take two religious studies courses and two philosophy courses. Faculty are encouraged to get to know the "whole student" in their interactions with them, and to "recognize the face of God in every student who walks through the doors of the college." Changing value systems is what Felician College is all about, and faculty members either buy into this important component of the mission or leave the institution.

Faculty's Lack of Confidence in Their Own Value Systems and/or Their Qualifications to Teach Ethics

Gentile (1993) suggested that faculty resistance to teaching ethics may be rooted in their own insecurities. Faculty teaching in graduate programs are invariably experts in their fields. They have spent their lives polishing their trades, and take pride in their accomplishments. They walk into their classrooms confident that they are the experts in the topics addressed. Until, that is, the topic switches over to ethics. Suddenly the Ph.D. and publications in Finance, Economics, or Operations Research seem less relevant in deeming the instructor an expert, and the feeling of being in unfamiliar territory is an unpleasant one (to say the least).

Even faculty members who believe they are well enough versed in philosophy to teach ethics effectively may doubt their own value systems and resist opening themselves up to students who may find their values somehow lacking. Asking faculty members to teach ethics is asking them to move solidly out of their comfort zones, and share with students their deeply held personal beliefs (Alsop, 2006). The lack of universal ethics in non-faith-based institutions implies that there is no ethical "starting point" beyond the instructor's personal morality. Faculty are subject to the same embarrassment and vulnerabilities as students when discussing ethical issues, and fear that they might lose the respect of their classes if they share too much (Gentile, 2006, p. 88) It is no wonder that many faculty members in these institutions attempt to avoid discussions of ethics altogether.

Faculty at secular colleges feel vulnerable discussing ethics because of the degree of personal exposure they risk in order to do so. If the question "Whose values?" is left unanswered by the institution, the only logical response in the classroom is "those of the instructor." Therefore, a discussion of an ethical dilemma in non-faith-based institutions requires the pronouncement of the values and ethics of the faculty member.

The Fear of "Playing With a Loaded Gun" When Discussing Value Systems in a Classroom

When there is no agree-upon value system to start with, how does a faculty member begin a discussion of an ethical dilemma? Faculty are uncomfortable in situations where they do not have an analytical model to apply (Gentile, 2006, p. 89), and are hesitant to begin a discussion without the application of a set perspective. In the case of ethics, what perspective is that? How does the faculty member begin open, honest communication about ethics without leaving himself or herself open to criticism over personal beliefs? According to Fukukawa, Shafer, and Lee (2007), the discussion of ethics generally encroaches on subjects such as religion, politics, and personal career choices (p. 383). For obvious reasons, many faculty members view the introduction of these topics in class an invitation for heated, and at times unorganized, debate. If they can avoid the "loaded gun" by omitting the discussion of ethics and values in their classes, they are more than happy to do so.

When there is an accepted truth underlying discussions of ethics, the heat of the debate is diffused. Students (and faculty members) who do not share the beliefs of the Catholic church nonetheless recognize the primacy of these beliefs at the college, and engage in thoughtful debate about the applications of these values to real-life dilemmas – not debate about the values themselves. Felician values are explained to all students at orientation, and those students who cannot accept them self-select out of the institution. Those who enroll implicitly agree to respect the ethics of St. Francis as the groundwork for future debate.

RESEARCH METHODOLOGIES AND RESULTS

We based this investigation on a single case study design using the Felician College graduate business program as our main unit of analysis, and the ethical outcomes of individual courses as the subunits of analysis. We base our use of the single case design on the rationale that the Felician case is revelatory in nature in that it offers "an investigator … an opportunity to observe and analyze a phenomenon previously inaccessible to scientific investigation …" (Yin 2003, page 42).

Yin suggests that when determining which research strategy to use, an investigator must consider the amount of control an investigator has over events, the degree of focus on a contemporary versus historical set of events, and the type of research question being asked. Our examination of the emergence of Felician College's ethics-infused graduate business program in 2005, favors the use of a case study design.

Both investigators were involved in the implementation of this program and are characterized in what Yin describes as "participant-observers." Participant-observer status offered investigators an insider role that Merriam (1997) described as a requirement when conducting case study research. Nevertheless, investigators did not have direct, precise, and systematic control of events. Each of the 7-member full-time faculty team created all of the courses in the MBA program independently. Participant-observer status did however, offer full access to a full complement of evidence including program documents, artifacts, interviews with persons involved in the program's launch, and direct observation of events as they unfolded. In addition, one of the investigators no longer works at the institution and can thus offer an additional level of objectivity.

More importantly for determining our methodology however, is the type of research question we ask. Yin notes that research questions have both substance (i.e. What is the case about?) and form (i.e. Is the researcher asking a "who", "what", "where" "how", or "why" question?), and suggests that "What" questions favor survey strategies, while "How" and "Why" questions are explanatory and would lend themselves to the use of case studies. We have guided our research by the following questions:

- *"How can the problems faced by other schools with infusing an MBA curriculum with ethics be overcome?"*

♦ *"Why did an ethic-laden curriculum emerge at Felician College?"*

We propose that ethics can be infused into a graduate business curriculum naturally, if it emerges from a value-laden culture. To link the data to our proposition, we relied upon data from a combination of sources, and triangulated our evidence:

1. Methodologies – Observations, qualitative interviews of graduates and faculty, documentation (e.g. syllabi), and a quantitative survey of students

2. Data – Evidence of an ethics-laden curriculum that was uncovered using one data collection technique was supported by other techniques

3. Use of Multiple Researchers

A survey distributed among the faculty who developed the program and courses uncovered an interesting and amusing statistic. Faculty were asked to respond to two statements: (1) *Which courses did you develop for the MBA program in Innovation and Entrepreneurship?,* and (2) *Of the courses you listed above, list the ones that contain significant ethics components.* In every case, the answers to the two questions were the same. Every faculty member – even those who had developed only *Accounting* or *Finance* courses – believed that every course that he or she created had a significant ethics component. This belief is borne out by reviewing the syllabi for the program. Of the fifteen courses that make up the MBA, nine reference an ethics component in the course objectives, four dedicate at least one full week's discussion to ethics, and one is a stand-alone ethics course. Only four courses in the program do not specifically mention ethics on their syllabi.

Students recognize this emphasis as well. A student survey showed that 90% of the current MBA students agreed or strongly agreed that the college's Felician/Franciscan heritage came through clearly in the program's curriculum and 86% believed that it was obvious the Felician College faculty cares deeply about teaching ethics in the program.

OTHER COLLEGES' ATTEMPTS

Faced with business demand for graduates well versed in ethics, schools have typically chosen one of two routes. Most schools initially tried to introduce ethics into their curriculum through the introduction of a stand-alone ethics course. Duquesne, Carnegie Mellon, Dartmouth, LaSalle, Villanova, and Belmont universities have adopted this model, and all require their MBA students to take courses ranging in title from Managerial Environment to Applied Ethics (Roy and Roy, 2004). In total, 40% of the top-ranked U.S. business schools require a stand-alone corporate ethics course as part of their core MBA curricula (Navarro, 2008). Other institutions, such as

Columbia, have taken the second, more integrated approach to ethics education. Columbia originally launched their ethics initiatives with a stand-alone course (*The Individual, Business, and Society: Tradeoffs, Choices, and Accountability*), but has recently changed this requirement. Instead of students taking a single graded ethics course, Columbia MBA faculty have been charged with weaving ethics into other required standard business courses (Alsop, 2006).

Research suggests that an integrated approach that reinforces ethical standards continuously throughout the curricula, as was implemented at Felician College, may be the better option. In a four-year study on the effects of ethics education on business students' ethical standards, Arlow and Ulrich found that immediately after taking a stand-alone ethics course some students' ethical standards rose initially, but shortly returned to their pre-course levels (1985). This integrated approach, while seen as the preferred option, must emerge from a value-laden organizational culture, though. In order to infuse ethics into a business curriculum, it must be observed at the top and embraced by the entire college community (Cohen and Burns, 2006). The lack of acceptance by the college community is often what causes well-intentioned ethics programs to fail.

CONCLUSIONS

The strong Catholic culture at Felician College created an environment in which the business faculty developed and launched a value-infused MBA program not because they were told to do so, but because doing so came naturally. The very real barriers to the creation of such a program, articulated by Piper, Gentile, and Parks (1993) did not apply in such an environment. Discussion of ethical issues comes naturally to faculty members who are reminded of their shared values at every college gathering, and they comfortably incorporated this discussion into every course in the MBA curriculum. Two years after the launch of the program, both the students and the faculty recognize the dominance of ethics in the curriculum, and both groups believe that the MBA program is enriched because of its inclusion.

The question for further research is whether the Felician College experience is unique to that single institution, or whether all faith-based colleges and universities have an advantage when trying to integrate ethics into an MBA curriculum. The topic is an important one: Research shows that ethics can be taught (Cohen and Burns, 2006; Piper, 1993; Roy and Roy, 2004) and that businesses have come to expect that students will emerge from MBA programs capable of making ethical decisions (Alsop, 2006; Hughes, 2006). In addition, research suggests that students at schools whose missions specifically reference ethical content have a higher ethical orientation than those of schools whose missions lack ethical statements (Davis, Ruhe, Lee, and Rajadhyaksha, 2007). If faith-based colleges and universities truly have the edge in developing ethics-infused graduate business programs, they could have an important competitive advantage in the MBA market.

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THE DISPARITY BETWEEN DISPARATE TREATMENT AND DISPARATE IMPACT: AN ANALYSIS OF THE RICCI CASE

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ABSTRACT

Purpose

The purpose of the article is to provide practitioners and scholars a working knowledge of the US. Supreme Courts recent holding in Ricci v. DeStefano, addressing whether an employer can engage in disparate treatment of one class of employees/applicants in order to remedy the disparate impact of another class.

Design

This article examines reported cases pertaining to Tile VII of the Civil Rights Act. The focus was on cases and literature pertaining to the inherent conflict between disparate treatment and disparate impact legislation. Published cases underwent a comprehensive case review using the Westlaw research system. Relevant cases were shepardized.

Results

The 2009 U.S. Supreme Court holding in Ricci prohibits employers from taking adverse action against employees/candidates that successfully complete the employers criteria, in order to address a claim of disparate impact, unless the employer can establish that there is a strong basis in evidence to warrant the discrimination.

Originality/Value

The article incorporates recent court cases in what has become the most litigated facet of law for employers.

KEY WORDS:: Title VII, Civil Rights Act, Disparate treatment, Disparate impact
CLASSIFICATION: General review

INTRODUCTION

The legal environment is a complicated and expensive component that all business should closely monitor, as changes can change the competitive landscape. In order to sustain a competitive advantage, employers must stay abreast of the numerous changes within the law that has the potential to affect their business. The need to monitor changes within the law is heightened when the business hires employees, as employment law issues have become the most litigated facet of law for small business owners. While the employee at-will doctrine still governs most employees, courts and legislatures have carved out numerous exceptions in order to afford additional safeguards to employees that they otherwise would not enjoy (Galberry, 2000). One of the more publicized examples involves employees seeking protections bestowed upon them through their employee handbook (Galberry, 2000). Courts consistently recognize that employee handbooks can create a reasonable expectation of rights as provided for within the handbook (Galberry, 2000). As a result, many attorneys are now advising their business clientele to adopt "employee instruction manuals" as opposed to employee handbooks in order to circumvent the negative precedence associated with the employee handbook.

A second, and more prevalent, exception to the employee at-will doctrine, and the focus of this article, is Title VII of the Civil Rights Act. The legislative intent associated with Title VII was to prevent discrimination based upon race, gender, religion, or national origin. The purview of Title VII prohibits employers from taking adverse actions against an employee within the employment realm, which includes the hiring, promoting, and termination function. While Title VII is the most comprehensive employee antidiscrimination protection, it has undergone a series of legislative and judicial revisions, expanding the scope of Title VII. One such revision, and the focus of this article, is legislative action prohibiting not only intentional discrimination, but also unintentional practices resulting in a disparate impact, for actions that resulted in discriminatory conduct (Griggs v. Duke Power Company, 1971).

Under the revision, employers must not only ensure their employment activities are facially neutral, but they must also be proactive in preventing and remedying any disparate treatment from facially neutral exams (Civil Rights Act, 1991)). Based upon the Act, employers are confronted with conflicting laws. First, they may not intentionally discriminate based upon race, gender, religion, or national origin (Civil Rights Act, 1961). Secondly, if they discover that their employment criteria results in a disparate impact on one class, the employer needs to remedy the discriminatory practice (Ricci, 2009). In order to correct the disparate impact, the issue often arises as to whether the employer is permitted to revert back to disparate treatment, such as discarding the results from a promotional exam, in order to remedy disparate impact. Until the U.S. Supreme Court's holding in Ricci in 2009, courts were in disagreement, creating uncertainty and little guidance for employers.

This article will start out by discussing the progression of Title VII, which is segmented into the original Act addressing disparate treatment, as well as the 1991 Act prohibiting disparate impact, including the EEOC's use of the four-fifths rule. After briefly addressing the purview of Title VII, the article focuses on the U.S. Supreme Court's contentious 5-4 majority holding in the Ricci case, which addresses whether an employer can intentionally discriminate against one class of individuals based upon a statistical indication that the criteria used within the employment function resulted in a prima facie case of disparate impact discrimination. After discussing the Ricci case, the holding will be analyzed to provide practitioners with a working understanding as to the scope of liability arising from a claim of disparate impact based upon hiring or promotional criteria. The article will conclude by discussing the limitations of the Courts holding, as well as areas that scholars and practitioners should monitor in regard to the judicial construction of Title VII.

TITLE VII

Title VII of the Civil Rights Act is the most comprehensive antidiscrimination legislation designed to protect employees from inequitable treatment based upon impermissible reasons. The protections afforded to employees govern all employers with fifteen or more employees. The legislative intent of Title VII was designed to prohibit employers from treating an employee differently based on race, color, religion, sex, or national origin. The scope of the act is to to achieve two overarching goals: 1) to provide remedies for employees subjected to workplace discrimination, and 2) to encourage employers to prevent discrimination and retaliation from ever occurring. The overall function of Title VII "is to promote hiring on the basis of job qualifications, rather than on the basis of race or color" (Griggs v. Duke Power Co., 1971). Discrimination can be classified as either intentional disparate treatment, or an unintentional disparate impact (Ricci, 2009).

Disparate Treatment

As enacted in 1964, Title VII's principal nondiscrimination provision held employers accountable only for disparate treatment (Civil Rights Act, 1964). The disparate treatment provision makes it unlawful for an employer "to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin" (Civil Rights Act, 1964). This mode of discrimination occurs when an employer treats "[a] particular person less favorably than others because of" a protected trait. (Watson v. Fort Worth Bank & Trust, 1988). In order to prevail on a disparate-treatment case, the plaintiff bears the burden of establishing "that the defendant had a discriminatory intent or motive" for taking the job-related action (Watson, 1988). As passed in 1964, the Civil Rights Act only prohibited intentional discrimination, and did not cover cases involving unintentional practices culminating in a disparate impact. As a result, Congress enacted the Civil Rights Act of 1991.

Civil Rights Act of 1991

As previously stated, the purview of the Civil Rights Act of 1964 was limited to prohibiting cases and policies that were discriminatory on their face. The Act did not include an express prohibition on policies or practices that produced a disparate impact (Peresie, 2009). A disparate impact occurs when the policy is not intended to be discriminatory, but the employers' facially neutral practices are, in fact, discriminatory in operation (Sleiman, 2004). The court first addressed this form of discrimination in *Griggs* v. *Duke Power Co.*, (1971). In the Griggs case, the U.S. Supreme Court expanded the purview of the Civil Rights Act by expressly incorporating disparate impact cases, even absent statutory language prohibiting unintentional employment discriminatory actions.

Twenty years after the *Griggs* holding, the Civil Rights Act of 1991, was enacted (Civil Rights Act, 1991). The Act integrated a provision codifying the proscription on disparate-impact discrimination, as coined within the Griggs case (Sleiman, 2004). Under the disparate impact provision, a plaintiff establishes a prima facie violation by showing that an employer uses "a particular employment practice that causes a disparate impact on the basis of race, color, religion, sex, or national origin." (Civil Rights Act, 1991). Once the plaintiff establishes a prima facie case of disparate treatment, the burden shifts to the employer to justify that the practice is "job related for the position in question and consistent with business necessity" (Peresie, 2009). If the employer satisfies that burden, the plaintiff may still succeed by showing that the employer refuses to adopt an available alternative employment practice that has less disparate impact and serves the employer's legitimate needs. (Peresie, 2009).

The EEOC's Four-Fifths RuleUnder the Civil Rights Act of 1991, plaintiffs must show a statistical disparate impact in order to establish a prima facie case of disparate impact (Peresie, 2009). The Equal Employment Opportunity Commission (EEOC) has adopted the four-fifths rule, a statistical formula, in order to ascertain whether a specific practice warrants additional review to determine whether the practice in question results in a disparate impact. Under the four-fifths rule, a disparity is actionable when one group's pass rate is less than four-fifths (eighty percent) of another group's pass rate (Peresie, 2009). Under this test, a disparity is actionable when the EEOC can be confident at a ninety-five percent interval that the observed disparity is not due to random chance (Peresie, 2009). To apply the ;3182;3182rule, plaintiffs calculate the selection rate for each group and then divide the selection rate of the minority group by the selection rate of the majority group (Peresie, 2009). If the ratio for a particular group is less than eighty percent of the pass rate for others, this difference in pass rates presents evidence of a disparate impact. (Slieman, 2004).

However, this rule does not foreclose the possibility that a disparity less than eighty percent can constitute evidence of disparate impact.

Although EEOC's guidelines are not "controlling," the Supreme Court has consistently acknowledged that they are deeply rooted in "a body of experience and informed judgment to which courts and litigants may properly resort for guidance (Peresie, 2009)." As such, they are entitled to a "measure of respect." (Peresie, 2009). Even with the degree of respect afforded to the EEOC's experience, neither the Supreme Court nor any federal circuit has adopted the four-fifths rule (Peresie, 2009). The U.S. Supreme Court has held that there are "no bright line rules . . . to guide courts in deciding whether plaintiffs' statistics raise an inference of discrimination,[however,] several overarching principles inform the issue." (Peresie, 2009).

With the recognition of both disparate impact and disparate treatment cases, an inherent conflict exists when a business requires promotional or hiring exams, and discovers a statistical disparity between members of protected classes. If the results fall under the purview of the four-fifths rule, the EEOC will classify the exam as a prima facie case of disparate impact. As a result, some employers are tempted to disregard the exam to avoid liability. In doing so, the employer must be cognizant that such an action may violate the disparate treatment of the successful candidates. As a result, the U.S Supreme Court elected to address the issue by hearing the Ricci case.

RICCI v. DESTEFANO

In Ricci v. DeStefano, the U.S. Supreme Court was confronted with the inherent incongruity that arises when an employer is confronted with results indicative of disparate impact, and whether this warrants permitting the employer to disregard the results in order to avoid a lawsuit (2009). More specifically, the Court was required to address whether an employer may engage in the disparate treatment of the successful candidates in order to remedy the alleged disparate impact of another set of candidates. This section will discuss the facts and holding of the Ricci case.

Facts

In November and December 2003, the New Haven Fire Department administered written and oral examinations for promotion to Lieutenant and Captain (Ricci v. Destafano, 2009). All promotions were based upon the candidate's performance on written examinations and oral interview, as required under the city charter. The purpose of the promotional criteria was to establish a merit system for the promotion and hiring process. The merit system required the City to fill vacancies in the classified civil-service ranks with the most qualified individuals, as determined by the candidate's performance on the exam. At the conclusion of the exam, the New Haven Civil Service Board (CSB) certified a ranked list of applicants who passed the exam. Under the charter's "rule of three," the hiring authority was restricted to filling each vacancy by selecting one candidate from the top three applicants.

The exams were developed and administered by Industrial/ Organizational Solutions, Inc. (IOS), which was retained by the City. In developing the exam, the IOS engaged in a comprehensive job analysis to identify the tasks, knowledge, skills, and abilities that are essential for the lieutenant and captain positions, respectively. The comprehensive analysis involved the IOS interviewing incumbent captains, lieutenants, and their respective supervisors as to what skills were necessary to fulfill the responsibilities as contained within the job description. In addition, members of the IOS rode with and observed on-duty officers. Based upon the results, the IOS composed a job-analysis questionnaire and administered them to most of the incumbent battalion chiefs, captains, and lieutenants within the Department, to supplement their research. Moreover, the IOS oversampled minority firefighters to ensure the examinations would not favor the white candidates.

In 2003, Seventy-seven candidates completed the lieutenant examination which was racially comprised of 43 whites, 19 blacks, and 15 Hispanics. Of those, 34 candidates passed. The racial distribution of the successful candidates consisted of 25 whites, 6 blacks and 3 Hispanics. Of the successful candidates, the top ten performers were all white. At the time of the exam, there were only eight vacant lieutenant positions. As a result, all the candidates eligible to receive a promotion under the "rule of three" were white.

As for the captain exam, forty-one candidates completed the test. The racial composition included 25 whites, 8 blacks, and 8 Hispanics. Of those, 22 candidates successfully passed the exam, which was comprised of 16 whites, 3 blacks, and 3 Hispanics. At the time of the exam, there were seven vacant captain positions. Under the "rule of three" nine candidates that were eligible for an immediate promotion. The racial makeup consisted of 7 whites and 2 Hispanics.

Based upon the results of the exams, City officials expressed concern that the tests unintentionally discriminated against minority candidates. Soon after the tests, a public debate was held to determine whether a disparate impact had occurred. Some firefighters argued the tests scores should be disregarded, while other contended that the exams were fair and that to disregard the results would result in the disparate treatment of the successful candidates. After several public hearings, the City refused to certify the results of the exam, and elected to disregard the exam based upon the belief that disparate impact had occurred. This decision was based solely on one set of statistics indicating that the overall performance of white candidates was at a higher level than minority candidates. As a result some white and Hispanic firefighters who would have been promoted based on the results filed suit against the City and some of its officials.

Holding

The purpose of Title VII is to promote hiring on the basis of job qualifications, rather than on the basis of race or color" (Griggs, 1971). A conflict arises, however, when attempting to balance the Equal Protection Clause, and the Civil Rights Act which allows for limited actions permitting race to be considered in order to remedy past discrimination (Ricci, 2009). Under Title VII, before an employer can engage in intentional discrimination for the asserted purpose of avoiding or remedying an unintentional, disparate impact, the employer must have a strong basis in evidence to believe it will be subject to disparate-impact liability if it fails to take the race-conscious, discriminatory action (Ricci, 2009). As a result, the two provisions are not always harmonious. In order to balance the competing issues, the Court has coined a test to be applied to alleged disparate treatment cases. After a plaintiff raises the issue of discrimination, the employer must establish that the practice was job related. If the employer is able to satisfy the burden, the employee must then establish that the employer had a legitimate alternative that would have been less discriminatory (Ricci, 2009).

In its holding, the Court labored with the appropriate standard which should be used when addressing disparate impact cases. The court warns that too low a standard would result in a de facto quota system, whereby statistics alone would be permitted to control employment decisions (Ricci, 2009). The Court acknowledged that quota systems have long been prohibited (Ricci, 2009). Moreover, such a system would put unnecessary pressure on employers to adopt inappropriate prophylactic measures" (Watson, 1988). In contrast, the Court recognized that too high of a standard would permit the entrepreneur to engage in racial discrimination at the slightest intimation of disparate impact, permitting employers to disregard valid promotional tests (Ricci, 2009). In order to balance the needs of the employer and employee, the U.S. Supreme Court adopted the strong basis in evidence standard to resolve any conflict between the disparate-treatment and disparate-impact provisions of Title VII (Ricci, 2009). While the Court adopted the rule, it provided little guidance and what qualifies as a "strong basis in evidence". The Supreme Court, however, did conclude that a threshold showing of a significant statistical disparity, and nothing more—is grossly insufficient to permit intentional discriminatory treatment of another class (Connecticut v. Teal, 1982).

Under the strong basis in evidence standard, an employer can engage in intentional discrimination, for the asserted purpose of avoiding or remedying an unintentional, disparate impact, if the employer has a strong basis in evidence to believe it will be subject to disparate-impact liability if it fails to take the race-conscious, discriminatory action (Ricci, 2009). In addition, the Court held that employers are entitled to incorporate affirmative efforts to ensure that all groups have a fair opportunity to apply for promotions and to participate in the process by which promotions will be made (Ricci, 2009). This permits employers to elect how to design that test or practice in order to provide an equitable opportunity for all individuals, regardless of their race. Once the test is adopted, however, and employers have made clear their selection criteria, they may not then invalidate the test results, thus upsetting an employee's legitimate expectation not to be judged on the basis of race, absent a strong basis in evidence to believe that they would be liable under the theory of disparate impact (Ricci, 2009). The Court held that to permit the employer to disregard the results without a strong basis in evidence of disparate impact would amount to the sort of racial preference that Congress has expressly disclaimed, and is antithetical to the notion of a workplace where individuals are guaranteed equal opportunity regardless of race (Ricci, 2009).

APPLICATION

The debate over the theory of disparate impact has persisted since the enactment of the Civil Rights Act of 1991 (Sleiman, 2004). Tension arise as Title VII paradoxically embodies two contending conceptions of equality: the colorblind vision, which claims that employers should not contemplate the applicants race, color, national origin or sex, but rather individual merit and qualifications in employment and promotion practices, and the remedial vision, which assert that the law must acknowledge race, color, national origin and sex in order to remedy past injustices and ferret out inequality within the employment function. (Sleiman, 2004). The balancing of these two interests are precisely the issues confronting the U.S. Supreme Court in Ricci.

While struggling with the competing theories, as evidences by the contentious 5-4 holding, the above ruling does provide some guidance in helping small business owners navigate the landmines associated with disparate impact and disparate treatment cases. First, the employer must remain cognizant when crafting a hiring and promotion criteria to ensure that the plan does not have a discriminatory impact on one of the protected classes. In providing guidance, it becomes clear that the concept of disparate impact is best addressed at the onset of the hiring practices or promotion exams, as the courts delve into the development and administration of the employment criteria (Ricci, 2009). This includes proactively researching and designing exams that take into consideration the likely effect on protected classes, and then incorporates measures to ensure all candidates have an equal opportunity to pass the job related requirement (Ricci, 2009).

Secondly, it becomes evident that once the criteria has been established, courts are hesitant to disregard the results of the exam, as the successful candidates have often sacrificed a substantial amount of time and invested valuable resources in preparing to meet the selected criteria. According to the Supreme Court, the mere fear of legal repercussions, absent being rooted within a strong basis of evidence, does not warrant the employer to disregard the results of an otherwise legal criterion (Ricci, 2009). As a result, a poorly researched or planned test may be costly to employers, as they will face legal pressures from all contending parties.

A third area of practical guidance for the practitioner is that the employer must actively investigate the alleged disparity before invalidating the results of the criteria. While lawsuits can be inordinately expensive, some risk adverse practitioners may believe it is best to just disregard the results. This action, however, will not prevent a legal action from occurring (Ricci, 2009). Instead, the practitioner must diligently investigate the allegations of associated with a claim of disparate impact. This investigation should include a statistical analysis, investigate whether the criteria is business related, whether there are any less restrictive means available, as well as reviewing the process that went into developing the employment criteria. Only after such actions have been exhausted will an employer be able to take appropriate recourse in addressing the allegations.

CONCLUSION

The Ricci case is a landmark case that has changed the way practitioners should view Title VII. The traditional method, which was used by both the District Court and Court of Appeals, focused primarily on remedying disparate impact as opposed to focusing on the disparate treatment of the successful candidates. Under the Ricci case, employers must still focus on the possibility of an unintended disparate impact, but may only invalidate results if there is a strong basis in evidence to support that claim. Moreover, the Ricci case specifically incorporates the process of creating and administering the exam to ascertain whether the results were biased, or based upon the candidate's qualifications. The holding also emphasizes the proactive measures during the implementation stage as opposed to corrective measures that occur after the employment criteria have been composed and adopted by th4 employer.

While the above case focused on race, it is important to evoke the holding extends to members of all protected classes. To illustrate, in *Lanning v. S.E. Pa. Transp. Auth*., the employer required that all employees be able to pass a fitness test as a condition of employment (1999). More specifically, all perspective employees were required to be able to run 1.5 miles in under twelve minutes. Five women were unable to meet this condition, and subsequently sued, and prevailed, under the theory of disparate impact (Lanning, 1999). As a result, disparate impact can be applied to a wide variety of practices, such as ability and intelligence tests, education requirements, work history requirements, arrest records, credit history, and height, weight, and strength requirements" (Sleiman, 2004).

As illustrated within the contested 5-4 majority holding, the issue of disparate treatment and disparate impact remains a very sensitive matter. So much so that Justice Ginsberg, in the dissent, predicts that the majority holding does not have staying power (Ricci, 2009). Future research should be directed at analyzing lower court holdings pertaining to the Ricci issue. The purpose for the analysis is twofold. First, the Supreme Court left the interpretation of "strong basis in evidence" to the lower courts to define. It is imperative that practitioners have an understanding of what type of evidence will be needed before discarding the results of promotional exams or other hiring criteria. This can only be accomplished after lower courts develop a consistent set of precedence. Secondly, the current holding changes the traditional understanding of Title VII, as evidenced by the procedural history of the Ricci case whereby the District Court and Court of Appeals ruled in favor of the plaintiff before being overturned by the U.S. Supreme Court. With the sensitivity of the Ricci holding, and change to the traditional notion of Title VII, research should be directed at focusing on whether lower courts rely upon the precedence derived from the Ricci holding, or liberally construe the holding in order to distinguish future cases from the facts in Ricci.

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FACTORS OF INFLUENCE ON LEGISLATIVE DECISION MAKING: A DESCRIPTIVE STUDY-UPDATED AUGUST 2009

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ABSTRACT

The transformation of public will into policy is characterized by many complex variables, including the factors of influence upon voting decisions. In recent years empirical research on this topic has been limited. The purpose of this descriptive study was to provide knowledge and insight about the factors of influence that shape legislative decision-making as perceived by lawmakers. Based upon a previous qualitative study, indentifying 18 key factors of influence,105 surveys were mailed to legislators in a northwestern state, asking them to rank the relative effect each had on decision-making. Results show fiscal impact having the most influence, followed by trust and constituents. Media and legislative staff received the lowest mean.

INTRODUCTION

Pressure to produce better and more efficient schools has been felt by education policymakers across all levels. By statute, providing a system of public education rests with state legislatures, and lawmakers have become more assertive in directing policy to improve schools. McDonnell (2001) confirms the increasing role governors and legislators have taken in directing state education policy over the past several years. She asserts the role of education specialists including chief state school officers has declined. The extent of legislative involvement in education policymaking is confirmed by Fowler (2009) who writes, "State government has become increasingly important in the last 25 years and will probably continue to do so" (p. xii).

Despite the ongoing interest by state lawmakers to produce education policy, few professional educators have a clear understanding of how public will is transformed into public policy (Fowler, 2009). Moreover, why politicians make decisions on whether to vote for or against a particular bill is ambiguous. Building upon a previous qualitative study (Canfield-Davis, 1996) conducted with 25 legislators, the purpose of this descriptive study was to examine the numerical ranking of the factors of influence that shape legislative decision-making.

Using a behavioral research model (Wahlke and Eulau, 1959) Canfield-Davis (1996) discovered 18 key factors of influence that shape legislative decision making. Fiscal impact, trust, constituents, timing of when a bill is introduced, committee chairs, legislative leadership, sources of information, sponsor, regionalism, governor, interest groups, lobbyists, sources of voting advice, re-election, state agency bureaucrats/civil servants, religion, legislative staff, and media were among the 18 key factors found. The present study provides a numerical ranking in order from high to low of these 18 factors.

PREVIOUS RESEARCH PERTAINING TO LEGISLATIVE DECISION-MAKING

Policy decisions in state legislatures may be influenced by any number of sources known to shape human behavior (Patterson, 1983). Wirt, Morey, and Brakeman (1970) identified the three variables affecting voting behavior as: (a) personal characteristics or affiliations including political party, age, gender, socioeconomic background, seniority and committee membership; (b) the home district of the legislator; and (c) the type of constituency represented in terms of urban-rural, agricultural-industrial, ethnic-religious, and affluent versus poor. Patterson identified six sources of influence including: (a) party and party leaders, (b) committees, (c) staff, (d) lobbyists, (e) the governor, and (f) a legislator's constituents.

To pinpoint the factors of influence upon legislative decision-making, researchers have observed the norms governing legislators' behavior, the roles they assume, and the goals and objectives that motivate them (Clausen, 1994). Analyzing the possible influences upon lawmakers' voting decisions is complex. Patterson (1983) noted multiple confounding influences are present in legislative decision-making. Interest groups, governors, party affiliation, and legislative committees were among some.

Despite these challenges of complexity, studies focusing upon influence variables pertaining to state legislative decision-making have been conducted. In a study of the effectiveness of state-level education lobbying strategies in Minnesota, Mazzoni, Sullivan, and Sullivan (1983) asked legislators to identify what factors influenced their education policy decisions. Legislators give weight to personal feelings, constituent desires, recommendations of colleagues, staff recommendations, interest groups views, and recommendations of friends when making decisions about school issues.

Keese (1990) devised three cluster rankings to categorize the sources of influence perceived by Tennessee legislators as effective and reliable. She found fellow legislators and education lobbyists to be the most effective and reliable sources of influence for decision-making. Local school administrators, special interest groups, family and friends, business and industry lobbyists, teachers, state agencies, and constituents fell into the medium range of effectiveness for decision-making. The least important sources of influence on legislative decisions were party, parents, national and regional organizations, legislative staff, college or university representatives, and the governor. Flagel (1990) looked at various individual and group factors influencing voting behavior on school finance reform policy decisions in Texas. In terms of individual factors, Flagel determined running for re-election had the strongest influence on voting decisions. Tenure and previous voting record had a moderate influence, and gender and age did not affect decisions. Group factors with a strong influence on legislative voting behavior included party affiliation and wealth of the legislator's home district.

Roberson, Durtan, and Barnham (1992) studied selected influences on the voting decisions of the Virginia General Assembly. They found legislators ranked their personal views as having the strongest influence on their voting behavior followed by constituents, interest groups and colleagues in the legislature next, and staff last. According to a study of the decision-making process conducted by Winton-Glisson (2006) Oklahoma state legislators are, "greatly influenced by local school administrators, teachers, and other school personnel…extremely influenced by lobbyists…and heavily influenced by fellow legislators or other governmental officials" (p. 118). In an earlier analysis of New York state legislative decision making Hogan (2003) identified constituents as a major factor affecting how legislators voted on an aid bill for higher education.

In addition to the present study, several others (Hirschi, 1969; Turner, 1976) examined sources of influence upon Idaho legislators. Huckshorn (1965) wanted to know what factors as perceived by Idaho state legislators affected their voting decisions. Based upon interviews conducted with 96 of the 103 members of the legislature, Huckshorn concluded that decisions are influenced by contacts with fellow legislators, interest groups, constituents, the governor, and political parties. Respondents suggested that decisions were heavily influenced by fellow members with demonstrated expertise in a particular area of knowledge. However, no experts were identified in the field of education.

Hirschi (1969) investigated selected variables associated with personal characteristics and affiliations to determine if a relationship with voting behavior existed. He concluded legislators most likely to support education-related legislation would: (a) be older and have more legislative experience; (b) be actively involved in school-related activities; (c) represent a large population of school-aged youngsters from rural districts; (d) express religious affiliation, except those belonging to the Catholic faith; (e) be employed as a professional, semiprofessional, or a salesman; and (f) serve on a major legislative committee, but not in a leadership position.

Turner (1976) identified 20 interest groups perceived by Idaho legislators as sources of influence on decisions regarding selected education bills. She found legislators most frequently contacted their colleagues in the legislature for information about education legislation. Lawmakers also sought advice and information from school administrators, the State Board of Education, and individual citizens. Although professional educational associations ranked first as reliable sources of information, lawmakers did not frequently contact them. Legislators ranked school trustees second and administrators third as reliable information sources.

Exploration of the influence variables on legislative decision-making is convoluted. Some of the factors that have been shown to influence voting behavior include age, gender, socioeconomic background, religion, legislative seniority, committee membership, party affiliation, staff interest groups, lobbyists, legislators' constituents, and personal views and values. This study builds upon previous research conducted on legislative decision-making, and attempts to determine the degree to which 18 key factors of influence swayed voting decisions.

METHODOLOGY

During the 2009 legislative session, 105 surveys were mailed to the total population of legislators in a northwestern state. The surveys were accompanied by a cover letter introducing the researchers, outlining the purpose of the study, and ensuring confidentiality of responses. Also included was a description of 18 variables and an identical stamped envelope to return the completed survey. Anonymity was further ensured by leaving the surveys unmarked Due to the size of this particular legislature, individual legislators are not assigned legislative aides. Therefore, it was assumed by the researchers, legislators personally completed the surveys.

Legislators consisted of 76 % Republicans and 24% Democrats; 25% female and 75% male. Of these, 58 (55%) respondents completed the survey. The participants were comprised of 11 (19%) democrats, and 46 (79.3%) republicans, and one (1.7%) participant did not indicate party affiliation. The participants included 45 (77.6%) males and 13 (22.4%) females. The mean length of service in the legislature was 6.84 years (SD = 6.73, range = 0-42) for the 56 (96.55%) participants who indicated the years of service in the legislature.

The instrument, located in Appendix A, contained a total of 18 factors of influence listed in alphabetical order. These factors were generated based upon findings obtained from an earlier case study on the legislative process and factors of influence upon voting decisions conducted in the same state (Canfield-Davis, 1996). The survey resembled a Likert-type inventory where participants indicated the degree to which each variable influenced their voting behavior. In scoring the ordinal data collected from the surveys, consecutive integers were assigned to seven response options, with a score of 1 equating to no influence and a score of 7 as high influence. The total number of responses for each factor was calculated, and then a mean score was obtained for each. The minimum possible score on this instrument is 18 and maximum score is 126. Data gathered by the three other questions (i.e., party affiliation, gender, and the length of service in the legislature) were provided in the participant demographic section. In this study, the overall alpha reliability coefficient for the instrument was 0.81, which well exceeds Nunnally's (1978) minimum criteria of at least 0.70 to demonstrate internal consistency. Based on reliability standards set by Springer, Abell, and Nugent (2002), the reliability for this scale is "very good".

Collected data were organized in SPSS 13 statistical software for analysis. Descriptive statistics were utilized to summarize, organize, and simplify the data (Gravetter, & Wallnau, 1996).

RESULTS

Results of the data analysis examining relative influence of the 18 factors determining legislative outcome is provided in Table1. Factors are listed in rank order of highest influence to least influence.

Table 1: Summary of Results: Factors of Influence Rankings

Rank	Variable	Minimum	Maximum	Mean	SD
1	Fiscal Impact	2.0	7.00	5.83	0.99
2	Trust	3.00	7.00	5.71	1.14
3	Constituents	2.00	7.00	5.51	1.24
4	Timing	2.00	7.00	4.60	1.66
5	Committee Chairs	1.00	7.00	4.59	1.34
6	Legislative Leadership	1.00	7.00	4.55	1.51
7	Sources of Information	2.00	7.00	4.47	1.29
8	Sponsor	1.00	6.00	4.21	1.31
9	Regionalism	1.00	7.00	3.93	1.55
10	Governor	1.00	7.00	3.86	1.36
11	Interest Groups	1.00	6.00	3.72	1.10
12	Lobbyists	2.00	6.00	3.64	0.91
13	Sources of Voting Advice	1.00	7.00	3.55	1.33
14	Re-election	1.00	7.00	3.16	1.65
15	State Agency Bureaucrats/Civil Servants	1.00	5.00	3.10	1.24
16	Religion	1.00	7.00	3.00	1.66
17	Legislative Staff	1.00	6.00	2.67	1.47
18	Media	1.00	5.00	2.24	1.05

DISCUSSION

Findings of this study show fiscal impact carried the most weight upon legislative policy decisions, and media as having the least influence. Further discussion of each variable follows.

Fiscal impact refers to the amount of money required to implement the proposed legislation, and the monetary impact on legislators' constituents. With headlines like, *Massive U.S. debt forecast* (Montgomery, 2009) it is little wonder lawmakers ranked fiscal impact as being the factor of influence most affecting whether legislators vote yes or no on a bill (5.83).

Trust provides the foundation upon which many other factors of influence depend. Legislators develop a network of individuals whom they trust both inside and outside the legislature. Individuals who are trusted, respected, and considered to be credible are depended upon by legislators for information and voting advice. In this study, participants ranked trust as the second factor of influence with a mean of 5.71.

Legislators represent citizens or constituents who reside in their home districts. Constituents received a mean of 5.51, placing it in the top three factors of influence on decision-making. Selberg (2004) expressed surprise at how low constituency ranked in her study of voting behavior on education funding bills in Arizona, despite prior research placing it higher. According to Ray (1982), less professional legislatures may rely on the wishes of their constituents for voting cues. The legislators surveyed for this research were members of a citizen legislature, meaning lawmakers have careers in their home districts. They are not considered professional, full time politicians and therefore, may be strongly influenced by their constituents.

Timing refers to the length of time legislators have to consider the pros and cons of proposed legislation. The mean score of the participants' response on this influence factor was 4.60. Long-term exposure to legislation increases the probability of its passage (Canfield-Davis & Jain 2009). Lawmakers in this study explained the time of a bill's formal introduction could be predictor of passage or failure, although contradictory opinions were given. Some legislators believed legislation introduced early in the session risk undergoing too many changes and revisions, causing the bill to ultimately fail.

A chairman, or co-chairmen preside over all legislative committees. This study shows committee chairmen wield a fairly high level of influence with a 4.59 mean. This finding is supported by Weaver and Geske (1997) who found current chairs and co-chairs as being highly influential in the Louisiana state legislature. Selberg (2004) confirmed chairpersons as exerting influence on legislative decision-making decisions.

For the purpose of this study, legislative leaders included the Speaker of the House, the Senate Pro Tem, and the minority leaders in both the House and Senate. A mean of 4.55 was obtained on this influence factor. Studies conducted by Milstein and Jennings (1973), Patterson (1983), Mitchell (1981), Kingdon (1997), Selberg (2004) are consistent with results of this study, indicating party leaders influence decision-making to some degree.

Legislators seek and receive information from sources beyond those who give expert testimony during committee meetings, information meetings, floor debate, and other gatherings. Information may also include written material provided from a variety of individuals and organizations. Sources of Information received a mean score of 4.47. Although this study did not focus on specific information sources, Weaver and Geske (1997) considered five sources of information to be influential in decision making: 1) the legislature; 2) legislative staff; 3) state government agencies; 4) interest groups; and 5) constituency. After identifying eight sources of information Riffe (1988) concluded that although some sources provide useful information, most are of little value when it comes to making a decision.

Bill sponsors are legislators who promote and carry bills through the legislative process. Those who are perceived to be credible, and who have the respect of their colleagues sway legislative voting decisions. This study suggests sponsors have some degree of influence with a 4.21 mean.

On some issues, it is not uncommon for lawmakers to align regionally in their voting patterns. In this study regionalism fell in the middle of the 18 factors of influence with a 3.93 mean. Referring to the state in which this data was collected, Stapilus (1994) points out:

> But [this state] is made up of many little worlds, a surprising number for our population, split off from each other by Chinese walls. What may be common knowledge, or a topic of intense, in one area, may be little-noted in others, and even within those worlds, much is cloudy and uncertain. (p. 1)

This parochialism may guide decisions on issues that do not have statewide impact. As a factor of influence in the present study the governor obtained a 3.86 mean score, showing participants in this study had mixed reactions regarding the level of influence rendered. In the state where the data was collected, the governor was a member of the majority party. This finding supports the research conducted by Ray (1982) who found the governor's office had minimal influence despite the fact the governor belonged to the majority party. When asked what one governor did to influence legislator's voting behavior, the response was:

> Basically, I know the personalities of most of the legislators to where I know where they're going to be on given issues. And that just comes with the experience of being here a long time, and knowing the people who come and go…And then to influence, I know basically on both sides of the House [legislature] where the votes are going to be…then I turn [my legislative liaison] loose and I visit with some of my friends on both sides of the aisle and ask them how many votes they can get and what I have to do. (Canfield-Davis, 1996, p. 87).

The governor's influence on whether bills pass or fail is further illustrated by Johnson (1993-1994) who described options governors have in either approving or disapproving legislation.

As reported in Fowler (2009) an interest group is "an association of individuals or organizations…that, on the basis of one or more shared concerns, attempts to influence public policy in its favor" (Thomas & Hrebenar, 2004, p. 102). Examples might include teachers unions, business associations, power companies, conservation leagues, the AFL-CIO, and religious or ethnic based interest groups. Interest groups in this study ranked below the midpoint, garnering a 3.72 mean. This may be contrary to a national trend which shows interest groups and their activities have grown in recent years, especially at the state level (Fowler, 2009). In a study of interest groups and education policy in Spain, Bonal (2000) described how the State's immediate responses to educational conflicts weakened the ability of interest groups to effectively participate or influence the decision-making process. The present ranking of interest groups in this study aligns most closely with that of Kingdon's (1997) research indicating they were neither the least or most influential on a member of Congress' vote.

Lobbyists are individuals who represent outside organizations and who provide information on proposed legislation. They are among the most astute, experienced, and knowledgeable actors in legislative policymaking (Hall & Deardorff, 2006). Ainsworth (1993) analyzed how legislators structured their interactions with lobbyists to minimize their influence. Among other findings, he concluded one of the more important roles of a lobbyist is to communicate issue relevance. In the state where the data were collected more than 400 individuals, representing multiple organizations are registered as lobbyists. With a 3.64 mean score, they rank slightly below Interest Groups.

Legislators seek voting advice from a variety of individuals largely dependent upon the issue. For example on education related issues, in addition to committee members and fellow lawmakers, legislators sought voting advice from school superintendents, teachers, lobbyists, and school board members. These researchers also found legislators depend upon each other for voting advice. A mean score of 3.55, places this factor of influence lower than a majority of other determinants on voting behavior.

Re-election is a factor of influence for legislators who want to be re-elected, or reside in a "swing" district. The mean score of 3.16 may be attributed to the fact the majority of legislators in the state where data were obtained represent one political party, and feel confident they will return to the legislature. In the words of one former state Senator, D. Davis "No one wants to admit they cast a vote based upon their desire to be reelected" (D. Davis, personal communication, March 20, 2009). Bishin (2000) cites research conducted by Kukinski (1978) showing senators in the United States Congress who are running to be reelected are more responsive to their constituency. Despite these findings, re-election ranked lower than other factors of influence.

Examples of state agency bureaucrats include the Secretary of State, Attorney General, State Superintendent of Public Instruction, and Director of Department of Corrections. The mean score of 3.10 illustrates individuals in these positions have little influence in legislative decision making. There is irony in this phenomenon, because all of the elected bureaucrats in the state where the data was collected were members of the same dominant political party. In addition the appointed bureaucrats were selected by the Governor, who is also a member of the dominant party.

Religion refers to one's philosophical beliefs and value systems, and in this study it received a mean score of 3.00. This number corresponds with Cann's (2009) results from an empirical test indicating personal religious identification, at least among Mormons has little influence on legislative voting. Greenawalt (1994) concurred noting that most political leaders avoid religious discourse when considering policy issues, even if their spiritual convictions may intertwine with those issues. Religious affiliation, in this study, does not appear to influence the decision-making of legislators to a high degree.

With the exception of Media, Legislative Staff received the lowest ranking as a factor of influence (mean 1.47). These individuals include members of the Legislative Services Office, and other support staff. One reason for the low ranking in this study could be attributed to the limited number of staff available in this particular legislature. However, this is consistent with Kingdon (1997) who writes, "In short, if staff are important in voting decisions, their influence is either extremely subtle or is restricted? (p. 204).

Media, including television, radio, and newspapers, received the lowest ranking for shaping legislative decisions with a mean score of 1.05. A study of Virginia by Penn (2000) rendered a split ranking. Of those surveyed, 32% said the press was not an influence on decision-making, and another 39% reported media influence was low. These percentages are reflected in the present study. Nevertheless, Rose (2004) argues, "Like it or not, the media is part of the legislative process. The bottom line is that reporters and legislators need each other" (¶. 4).

IMPLICATIONS FOR EDUCATORS

Each legislative session evolves into a complex, diverse, and dynamically changing process. Few, if any, generalizations transcend across all actors and time. The importance of each of these factors of influence can shift during the session. Therefore, what was deemed important at the beginning of the session may be upstaged by changing events and changing priorities mid-session, and regain major importance at the end. If practitioners are familiar with why politicians vote for or against proposed bills, then they may have greater influence on the policies enacted, and the content therein.

Some factors of influence may be masking other indicators not readily apparent. For example, the Governor may appear to be large factor of influence. However, the most important influence variable might actually be re-election, if the governor has some power or ability to shape the future for a particular legislator. In other words, these factors are multilayered with some influencing or controlling others. Unless one is familiar with the process and the present session, these nuances may go undetected, and limit practitioners from enhancing policy outcomes.

The legislative process is fluid. Developing ways of staying informed with the changing events is essential in effectively influencing policies one wants to shepherd through the process. Physical presence every day may not be possible, but monitoring news, events, and initiating regular contacts with those involved in the process may lead to more effective development and implantation of legislative policies.

RECOMMENDATIONS FOR FURTHER RESEARCH

First, the factors of influence in this study are numerically ranked, and the inter-relationship among and between these variables is complex. Further analysis of the inter-relationship between these variables may result in better understanding the summative relationship value of individual influence factors. Second, a national and international study should be undertaken to determine whether the ranking of these factors of influence are typical or unique. The findings in this study are limited to one state legislature. Other factors of influence may be significant, but absent in this study. For example, in this investigation legislators serve on a part-time basis. Therefore, some members spend time on other matters during the legislative session, causing them to miss meetings. The passage or failure of legislation is affected by legislators who fail to attend meetings. Research on additional factors of influence not addressed in this study will shed further light on legislative outcomes. Finally, each influence factor carries a degree of power. A study of the relative power of each factor of influence would render further insight into legislators' decision-making.

CONCLUSION

This descriptive study contributes to the body of knowledge about the factors of influence that guide the transformation of public will into public policy. State-level education policy-making will continue, and all those concerned with public schools can expand their impact upon the development of coherent education policies by having a better understanding of how and why decisions to pass or fail bills are made. This knowledge can help close the gap between state legislative policy-makers and education policy implementers, resulting in more effective outcomes for public schools and more positive benefits for the nation's school-aged youngsters.

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APPENDIX A: SURVEY OF STATE LEGISLATORS

Party: Democrat _____
Republican _____
Other _____
Gender: Male _____ Female _____
Length of Service in the Legislature: _______ years
To what degree do you believe is the relative influence of the following factors in determining a bill's passage or failure? Please circle one number in each row.

	No Influence		Some Influence			High Influence	
Committee Chairs	1	2	3	4	5	6	7
Constituents	1	2	3	4	5	6	7
Fiscal Impact	1	2	3	4	5	6	7
Governor	1	2	3	4	5	6	7
Interest Groups	1	2	3	4	5	6	7
Legislative Leadership	1	2	3	4	5	6	7
Legislative Staff	1	2	3	4	5	6	7
Lobbyists	1	2	3	4	5	6	7
Media	1	2	3	4	5	6	7
Re-election	1	2	3	4	5	6	7
Regionalism	1	2	3	4	5	6	7
Religion	1	2	3	4	5	6	7
State Agency Bureaucrats/Civil Servants	1	2	3	4	5	6	7
Sources of Information	1	2	3	4	5	6	7
Sources of voting advice	1	2	3	4	5	6	7
Sponsor	1	2	3	4	5	6	7
Timing	1	2	3	4	5	6	7
Trust	1	2	3	4	5	6	7

MANAGERIAL AND LEGAL PERSPECTIVES ON THE GREEN BUILDING MOVEMENT

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ABSTRACT

This article discusses the green building movement from managerial and legal perspectives. Green building is first defined and managerial perspectives on why companies build green are examined. Legal liabilities posed by green building are also raised with focus on the failure to achieve LEED™ certification, the impact of governmental mandates, and professional liability and warranty claims. Finally, recommendations for minimizing legal liability in green building are proposed.

INTRODUCTION

Once relegated to the realm of environmentalists, concern over the environment is now mainstream as public attitudes have shifted in favor of a green agenda. (Garber, 2009). Accompanying that movement is the rapid growth of the green building industry. In recent years, private developers, governmental entities, individual homeowners, and educational institutions have been moving towards the green building phenomena in growing numbers (Bardaglio & Putnam, 2009).

A generation ago, the interests of business and the environment appeared mutually exclusive; today that is no longer the case. This article discusses the green building movement from managerial and legal perspectives. Green building is first defined and managerial perspectives on why companies build green are examined. Legal liabilities posed by green building are also raised with focus on the failure to achieve LEED™ certification, the impact of governmental regulations and professional liability and warranty claims. Finally, recommendations for minimizing legal liability in green building are proposed.

WHAT IS GREEN BUILDING?

To a certain extent, aspects of green building have been around for millennia. Prior to the days of electricity and central heating and cooling, builders relied on a variety of sustainable practices such as transoms, awnings, large windows, etc. Many of these practices were discontinued and considered old-fashioned with advances in technology such as electricity, modern HVAC systems and the availability of cheap fossil fuels in the late 19th and 20th centuries.

Today, green building is a term that can encompass a vast array of environmentally conscious building techniques. At one end of the continuum, green building could entail something as mundane as replacing old windows with energy efficient ones. At the other end of the continuum, green building could involve sustainable design and construction techniques in every aspect of the building. According to the U.S. Environmental Protection Agency (2009):

> Green building is the practice of creating structures and using processes that are environmentally responsible and resource-efficient throughout a building's life-cycle from siting to design, construction, operation, maintenance, renovation and deconstruction. This practice expands and complements the classical building design sustainable or high performance building. Green buildings are designed to reduce the overall impact of the built environment on human health and the natural environment by:
>
> - Efficiently using energy, water, and other resources
> - Protecting occupant health and improving employee productivity
> - Reducing waste, pollution and environmental degradation

Table 1: Green Building Considerations

Aspects of Built Environment	Consumption	Environmental Effects	Ultimate Effects
Siting	Energy	Waste	Harm to Human Health
Design	Water	Air pollution	Environment Degradation
Construction	Materials	Water pollution	Loss of Resources
Operation	Natural Resources	Indoor pollution	
Maintenance		Heat islands	
Renovation		Storm water runoff	
Deconstruction		Noise	

Source: United States Environmental Protection Agency (2009). Green building: Basic information. Available at http://www.epa.gov/greenbuilding/pubs/about.htm

In 2000 the U. S. Green Building Council launched a voluntary building certification program called Leadership in Energy and Environmental Design (LEED™) which acknowledged performance in five key areas:

- human and environmental health
- sustainable site development
- water savings
- energy efficiency
- material selection and indoor environmental quality

The LEED™ system awards points according to a strict set of criteria which consider such factors as indoor environmental quality, materials and resources, and water efficiency. Based on the number of credits earned on a 69-point scale, owners and builders can apply for LEED™ certification at one of four levels: Certified (26-32 points), Silver (33-38 points), Gold (39-51 points), or Platinum (52-69 points).

With increased environmental awareness and natural resource depletion, the modern day version of green building is now very much in vogue. The following section discusses why companies choose to build green.

MANAGERIAL PERSPECTIVES ON WHY COMPANIES BUILD GREEN

Companies, large and small, across America are choosing to build green in ever increasing numbers. Their motivations vary. Some companies build green primarily for social responsibility concerns of their own or their clients. Others embrace green building primarily for economic reasons such as decreased operating costs, the ability to charge higher rents or sales prices, or to gain a competitive advantage in the market place. Still others build green because of regulatory mandates or incentives. A number of these factors are outlined below.

Environmental and Social Responsibility Concerns

Clearly, increased environmental awareness and concern over global warming are important motivating factors for companies building green (Pinkse & Kolk, 2009). The size and scale of modern business is unprecedented in the history of the human race. Never before has business had such an overwhelming impact on every facet of life on Earth (Carson, 1962). Nowhere is this more self evident than in the natural order. Through both normal business operations and ecological disasters such as the Exxon Valdez spill, business can now cause pervasive and lasting environmental damage. A more mundane example of the effects of business on health and the environment is the recent controversy over Chinese-made drywall (Corkery, 2009) resulting in several lawsuits.

Vice President Al Gore's Oscar-winning documentary "An Inconvenient Truth" followed by his receipt of the Nobel Prize, heightened public consciousness of business's role in global warming among other things. As good corporate citizens, businesses have an obligation to their stakeholders to do everything possible to exercise environmental stewardship.

Needless to say, the marketing and public relations benefits of a demonstrated concern for the environment are incalculable (Dernbach, 1998). Green buildings also reinforce a company's brand image (Yudelson, 2008, p. 60). Companies such as Subaru, SC Johnson or Starbucks can enhance their brand image by being associated with green buildings and products. By being perceived as good environmental stewards, companies promote good public relations and allay criticisms from stakeholder groups (Boutlier, 2009).

Reduced Operating Costs

In addition to environmental factors, operating costs are an impetus for green building. As energy costs continue to rise with increased worldwide demand for limited fossil fuels, energy conservation is a key concern for businesses and consumers alike. Gas prices reached almost $5 a gallon in some parts of the country during summer 2008. Electricity prices are rising steadily in many parts of the country, especially during peak periods. Areas facing water shortages such as the southeast and southwest have seen water prices increase dramatically. Likewise, natural gas has experienced dramatic price hikes in the past several years. The cost of waste disposal has also increased.

Building green and using energy-saving technologies reduces operating costs and can result in long-term savings that more than recoup the upfront green premium. As energy costs continue to increase, the return on capital investments for energy and water conservation makes good business sense. Energy efficient cost savings may come about through standard green construction features such as solar heating, natural lighting, reduced water consumption and energy use. Insurance premiums may also be lower because green buildings are built to last and tend to hold their value better with lower operating costs (Carlson, 2009, p. 6).

Revenue Enhancement

Businesses may build green because they believe it will increase revenues. Green buildings with lower operating costs and better indoor environmental quality are more attractive to a growing group of corporate, public, and individual buyers (Yudelson, 2009, p. 61). As noted previously, stakeholders often want to see a demonstrated concern for the environment by a business. Failure to provide green services or products may result in the loss of business to competitors who do.

Many tenants and consumers are willing to pay a premium for green features in the form of higher rents or sales prices. This is particularly so if the building is LEED™ certified by the U. S. Green Building Council (USGBC) with a concomitant increase by certification level.

Governmental Mandates and/or Incentives

Businesses are increasingly compelled to consider green building techniques as the regulatory framework rapidly embraces green initiatives. More and more, state and local governments are issuing green-focused laws or regulations. Some mandate green building in public facilities or stipulate energy efficiency targets that must be met. Governmental entities are also providing tax incentives to build green. Oregon, New York, Massachusetts, and Nevada are just some of the states that provide tax credits or tax abatements for private development projects achieving a certain level of green building certification.

The federal government has also been a major player in providing incentives to businesses for building green. The federal Energy Policy Act of 2005 offers both tax incentives and tax deductions for various green building features and loan guarantees for alternative energy production. President Barack Obama's stimulus plan likewise provides tax incentives for going green. President Obama's economic stimulus plan places a high priority on alternative energy production, energy efficiency, and environmental management allocating $70 billion towards green initiatives (Wolgemuth, 2009). On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act which provides some $7 billion for environmental initiatives including green infrastructure, wastewater treatment, energy efficiency, brown field cleanup, superfund hazardous waste cleanup and diesel emissions reductions (U. S. Environmental Protection Agency, 2009). On June 26, 2009, the House of Representatives passed the American Clean Energy and Security Act which proposes to cut greenhouse gases by 80% by 2050 by capping emissions and selling the right to emit gases such as carbon dioxide. At the time of this writing, the bill is currently pending in the Senate.

As noted above, companies build green for a plethora of reasons. Once that decision is made however, companies need to be cognizant of the potential legal liabilities they face with that decision. The following sections discuss key areas of potential legal liability.

LEGAL LIABILITY FOR FAILING TO OBTAIN LEED™ CERTIFICATION

At this point in time, the legal concerns surrounding green building are just beginning to emerge. Relatively little case law exists at this moment. "Those involved with green building not only face liability emerging from contractual obligations but also must consider and comply with case law and emerging federal, state, and local mandates" (Conner, 2008, p. 10). Contractual liability is a particular concern for the parties involved.

While there are some developers who undoubtedly build green solely for environmental reasons, the majority do so for financial reasons. On a mundane level, those economic advantages may come about through energy savings through standard green construction features such as solar heating, natural lighting, reduced water consumption and energy use. These green features are important since they serve as a marketing tool and the bases to charge higher rents or sales prices. More likely, developers build green in anticipation of being able to charge higher rents to occupants who are willing to pay more to work and live in a LEED™ certified green building. They expect good public relations and tax breaks to ensure economic viability of the project. An army of builders, contractors, design professionals, and even law firms market their services expressly in terms of their ability to assist in getting these financial incentives and LEED™ certification as they jump on the green bandwagon.

In order to promote economic viability in green building, the project typically has to be LEED™ certified. There can be a substantial time lag between the time construction is completed and when the decision on LEED™ certification is made. What happens when the architect, contractor, builder, or other green specialist fails to deliver the LEED™ certification or delivers certification at a level lower than the developer anticipated?

Failure to obtain LEED™ certification may preclude the developer from charging higher rents, getting tax incentives, and could ultimately undermine the economic viability of the project. When this occurs, developers may turn to litigation, suing on such bases as breach of contract for failure to meet completion deadlines or negligence for failure to meet the green building specifications spelled out in the LEED™ rating system. As the emphasis on LEED™ certification increases, the number of green-related lawsuits is starting to rise. LEEDigation is a term coined by Chris Cheatham (2009) to describe this situation. "LEEDigation could involve disputes arising from green building certification. LEEDigation could arise if a project fails to obtain government incentives or satisfy mandates for green building construction. LEEDigation could simply result from improperly designed or constructed green building strategies." An example of LEEDigation is the Shaw Development case discussed below. This case is one of the first green building cases filed against a developer (Del Percio, 2008).

Southern Builders v. Shaw Development

In 2006, general contractor Southern Builders completed construction on a $7.5 million luxury condominium project in Crisfield, Maryland, called the Captain's Galley Condominiums. Shaw Development was the developer for the project. The condominiums were built with green features, which supposedly would have led to LEED™ Silver certification. "The LEED™ rating was critical to the project, because the project had been accepted into a Maryland Energy Administration program that provided an eight percent green building tax credit. But obtaining that credit required both achieving at least LEED™ Silver rating as well as completing the project prior to the expiration date established when the project was admitted to the program" (Ness, 2009). Southern Builders was required to deliver its Certificate of Occupancy within 336 calendar days from the date of the agreement. The project was not finished until nearly 9 months after the required completion date.

After completing the project, Southern Builders filed a $54,000 mechanic's lien against Shaw Development in late 2006. On February 16, 2007, Shaw Development filed a counter complaint against Southern Builders Inc. in the Circuit Court of Somerset County, Maryland for $1.3 million. Shaw alleged claims of negligence and breach of contract. The developer claimed that Southern failed to construct the condominiums in accordance with the LEED™ rating system and failed to complete the project on time. Shaw alleged that both of these factors were responsible for the development losing the Maryland tax credit. Specifically, in its complaint Shaw noted "Southern Builder's failure to obtain the contractually required LEED™ Certification is costing Shaw Development a $635,000 tax credit." Shaw sought additional damages for non-conforming work and loan defaults with its construction lender.

Shaw provided no details in its filings on precisely how Southern Builders was responsible for the lost tax credits. It would appear that Southern failed to complete the project in a timely fashion such that Shaw could obtain a Certificate of Occupancy by the expiration date specified in the Initial Credit Certificate application to the Maryland Energy Administration.

The case was ultimately settled out of court, but the story does not end there. The development consisted of 17 units and a restaurant. Unfortunately for the developer, the condominiums were completed just at the time the housing market was beginning to decline. In 2008, the restaurant closed after a financial dispute with Shaw and only six of the condominium units had been sold (Harrington, 2008). In December 2008, a foreclosure auction was to take place for the remaining units. Shortly before the sale, Shaw filed for Chapter 11 bankruptcy, canceling the auction and allowing time for the business to restructure (Redmiles, 2009). The condominiums are currently being offered at 50% less than their original asking price.

Since the case was settled out of court, there is very little written material on the Shaw case. However, one can clearly see the liability issues that arise when the developer loses substantial tax incentives because the builder fails to achieve LEED™ certification and misses the completion date. This undoubtedly is an area of concern for developers, architects, and builders. The documents in the available pleadings in the Shaw case gave no indication of any risk transfer whatsoever with respect to securing tax credits. It would appear that the standard American Institute of Architects (AIA) industry contract was used in this instance which would have included completion deadlines and the risk of timely completion. Green building components most likely would have been part of the specifications incorporated into the agreement between Shaw and Southern Builders. Therefore, Shaw clearly had the upper hand in terms of establishing contractor liability in his countersuit. The Shaw case is a clear shot across the bow for green contracts. Standard industry contracts will not protect a contractor in assigning risk liability.

Another area of legal concern in green building emerging on the horizon is the impact of governmental regulations on green building. The next section addresses that issue in a dispute with City of Albuquerque.

LEGAL LIABILITY AND GOVERNMENTAL MANDATES

Increasingly, federal, state, and local governments are passing regulations mandating energy efficiency standards and other green building requirements. Companies face the potential of running afoul of these regulations when building green as noted in the following case.

AHRI et.al. v. City of Albuquerque

The city of Albuquerque passed several municipal ordinances that imposed minimum energy efficiency standards for commercial and residential buildings (AHRI v. City of Albuquerque, 2008). Among other things, the codes sought to increase energy efficiency in multifamily homes and commercial buildings some 30% by requiring more insulation in single-family houses, outlawing electric water heaters, and imposing high efficiency standards for heating and cooling equipment. Attempts by contractors and distributors to negotiate with the city to revise the codes and lower requirements failed. On July 3, 2008, a consortium of HVAC contractors and distributors and the industry trade group the Air-conditioning, Heating, and Refrigeration Institute (AHRI) filed suit in the Federal District Court of New Mexico challenging parts of the codes from taking effect. The plaintiffs argued that the federal Energy Policy and Conservation Act of 1975 set standards for HVAC equipment that preempted the Albuquerque building codes provisions on energy efficiency. The plaintiffs contended that sections of the Albuquerque codes had higher standards than the federal law.

On October 3, 2008, the United States District Court for the District of New Mexico granted a preliminary injunction barring enforcement of Albuquerque's challenged building codes. Judge Martha Vazquez noted that many, if not all, of the prescriptive standards in the codes exceed the federal standards. "As the Court has found that Plaintiffs are likely to succeed on their challenge to each compliance alternative provided by the Code, it is not clear that there are any provisions of the Code that survive the injunction." In conclusion, the judge noted:

> The City's goals in enacting Albuquerque's Energy Conservation Code and the Albuquerque High Performance Buildings Ordinance is laudable. Unfortunately, the drafters of the Code were unaware of the long-standing federal statutes governing the energy efficiency of certain HVAC and water heating products and expressly preempting state regulation of these products when the Code was drafted and, as a result, the Code, as enacted, infringes on an area preempted by federal law. The extent to which the Code and the Ordinance are preempted will be determined after development of a full record (AHRI v. City of Albuquerque, 2008).

The case is pending further litigation at the time of this writing. The following section discusses professional liability and warranty claims which are a growing area of legal liability in green building.

LEGAL LIABILITY AND PROFESSIONAL LIABILITY AND WARRANTY CLAIMS

The growth in the green building industry is being accompanied by an equally rapid growth in the numbers of green specialists in various established professions such as design, architecture, and law. Many professionals see the potential economic benefit of offering green services for their clients. The USGBC is facilitating this trend. It has created a separate entity called the Green Building Certification Institute (2009) which administers credentialing programs for professionals in green building practices. Additionally, the USGBC certifies authorized training programs across the country (i.e., Everblue Training Institute) to assist individuals wanting to pass the LEED™ AP Exam and become LEED™ certified professionals. Notably, law firms are increasingly seeking certification for their attorneys (Switzky, 2008).

One result of this rush to credentialing may be an increase in professional liability claims. "In general, the architect or engineer may be sued by the owner or the contractor for negligence or for breach regarding the failure to perform contractual obligations. The architect or engineer may face lawsuits by contractors who claim to be third-party beneficiaries of the agreement between the owner and the architect or engineer" (Conner, 2008, p. 13).

Since green building standards are new and evolving, design professionals often play the role of adviser as well as designer. Connor (2008, p. 14) also notes that:

> The advisory role may lead to documentation that describes an anticipated level of LEED certification as a performance specification. For design professionals this is an area of concern, because these provisions may give rise to a warranty regarding performance that not only exposes design professionals to greater potential liability but also to the risk that the liability may not be covered by their professional liability insurance. Moreover, the issues of warranty and guaranty may lead to exposure for design professionals as a result of the language adopted in the certification documents submitted to the USGBC as part of the LEED certification process (2008, p. 14).

> In one case, an architect was sued by a LEED™ Silver building owner when a tenant demanded a rent rebate. The developer had promised that the green features would result in healthier air quality. The tenant claimed that instead poor air quality had caused increased sick days, lower production, and eye strain (Dahl, 2008).

The paucity of green litigation is likely a short-lived phenomenon. As green building increases, green litigation can only increase in concert. Precautionary steps to limit successful litigation are discussed below.

RECOMMENDATIONS FOR MINIMIZING LEGAL LIABILITY IN GREEN BUILDING

As a rapidly developing industry, green building faces notable legal risks. Parties involved in building, marketing and selling green buildings need to know how to minimize their legal liability. Recommendations based on the limited green litigation handled to date are discussed below.

Never Guarantee Green Building Benefits or Certification

"Builders, architects, sales and marketing representatives and sellers should never make statements that imply an outcome, commitment or guarantee regarding future performance of the building" (Guevarra, 2008). Extreme caution should be exercised in all communication and correspondence related to a project, e.g. contracts, oral representations, correspondence, promotional materials, etc. not to give the impression of a guarantee or warranty. This is particularly true in terms of achieving LEED™ certification. The USGBC is an independent third party which will award or deny accreditation based on its own requirements. Instead, documents and representations should be made on the basis of "endeavoring" or "attempting" to achieve certain benefits. Even if LEED™ certification appears to be a certainty, it is dangerous to make a claim that your green building features will produce specific benefits. For example, claims that air quality will be better and create a healthier and more productive work environment are fraught with potential legal liability.

Don't Use Standard Industry Contracts

In green building contracts, parties must never sign standard industry contracts that are not specifically geared for green projects. Each green building project is unique and the contract must reflect the unique specifications on that project. There is no one-size-fits-all green provision that can be slipped into a contract. In recognition of this fact, the "AIA released its B214 2004 Standard Form of Architect's Services: LEED Certification, which provides the architect's scope of services for a green building project. B214 establishes the duties and responsibilities of the architect when an owner seeks certification from the USGBC" (Conner, 2008, p. 14).

Two of the most critical contractual considerations in green building projects are completion deadlines and specific green building specifications. Contractors must be fully aware of the substantial legal liability they face when failing to meet deadlines and specifications. Serious consideration must therefore be given to providing sufficient leeway in construction deadlines to allow for contingencies and inevitable delays. This is particularly critical when there is a time deadline associated with obtaining a tax credit from a governmental entity.

Clearly Allocate Risk in the Contract

Risk allocation provisions must be incorporated into a green building contract, which expressly allocate the potential costs of not obtaining LEED™ certification among the key parties such as the contractor, developer and architect (Ness, 2009). Since certification allocates points to various specific areas such as design or construction, specific responsibility should be assigned to the particular parties who will bear the risk if LEED™ certification is not attained or attained at a level lower than anticipated. Developers may wish to consider adding a liquidated damages provisions. "An owner constructing a building to a specific certification in order to obtain government approvals or support may find that the damages incurred due to lack of certification are much higher than a traditional liquidated damages amount based on the contractor's profit" (Conner, 2008, p. 11).

Contractors Must be Careful in Selecting Sub-Contractors

Contractors engaged in green building face substantial potential legal liability if the building is not certified. Needless to say, they and their staff need to be well versed in green building practices and LEED™ certification. Contractors should agree only to direct damages provisions (e.g. completion of work) and never agree to consequential damages provisions in a contract with an agency or owner (Conner, 2008, p. 12). Consequential or special damages are indirect damages. They arise not as a direct result of an act, but rather the consequences of an act. They could include loss of profit or revenue if, for example, certification was not received, and such damages were reasonably foreseeable when the contract was drawn up by the parties. Signing such a provision would leave the contractor open to substantial potential liability and could well jeopardize their ability to get insurance.

Extreme caution must also be exercised in selecting sub-contractors who have sufficient background in green building and knowledge of LEED™ certification. Contractors may even wish to explore the possibility of assigning some of the risk potential for achieving green certification with their subcontractors.

Clearly Understand Federal, State, and Local Ordinances and their Interaction

State and local governments are increasingly passing green building requirements (Smithson & Senior, 2009). While the intentions in passing these requirements are often laudable, there are legal challenges nonetheless that can arise with them (Van Fleet, 2008). As noted previously in the AHRI case, care must be taken by governmental entities to not run afoul of federal preemption standards. Yet another concern that arises is when zoning ordinances and design control laws serve as legal barriers to sustainable design. For example, local laws do not always differentiate between gray water and black water (toilet water). "Despite gray water comprising 50-80% of domestic wastewater, and despite its reusability after relatively inexpensive treatment, localities often make the recycling of gray water very difficult" (Bronin, 2008).

CONCLUSION

The next decade will see substantial growth in green building. In all likelihood, green litigation will also grow as the green building movement continues to expand. This article addressed managerial perspectives on why companies build green as well as some of the potential legal pitfalls they may face when building green. Preliminary recommendations for limiting legal liability in green building were also proposed.

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THE FALL OF THE PER SE VERTICAL PRICE FIXING RULE

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ABSTRACT

In mid-2007, the U.S. Supreme Court overturned a 1911 precedent prohibiting manufacturers from setting prices at the retail level. That earlier decision put resale price maintenance (vertical price fixing) into the category of "per se" violations of the Sherman Act. Per se violations cannot be justified by findings of benefits to competition. The 2007 Leegin decision moved such cases into the other category under the Sherman Act: the rule of reason. Under this category, proof of a violation is often very difficult because of the type of evidence required. Such cases rarely succeed, with the effect that manufacturers can now set retail prices. In this case, Leegin, manufacturing a popular line of women's accessories, disputed the right of a Dallas area retailer Kay's Kottage to discount Leegin's products. Leegin was enforcing a minimum price policy on many, if not all, of its retailers. When Kay's Kottage refused to stop the discounting, Leegin cut off its supply, depriving the store of substantial sales. This article analyzes the opinions of the lower courts and the Supreme Court. Finally, it argues that the decision is mistaken because it breaks long standing precedent, ignores legislative intent, and leads to higher prices for certain types of products.

INTRODUCTION

Recent years have seen the decline of the per se rule in the interpretation of Section 1 of the Sherman Act dealing with restraints of trade (1890). Now vertical price fixing has been moved by the Supreme Court out of this category. Vertical price fixing (or resale price maintenance) occurs when a manufacturer sets a price for a retailer. An example might be a high-quality jeans manufacturer not allowing discounting at the retail level.

Section 1 of the Sherman Antitrust Act deals with combined activities of two or more parties that may hurt competition and these are called "restraints of trade." Since early in this century, the Supreme Court has divided restraints of trade into two categories, the per se rule, and the rule of reason.

The "per se" rule is used where the restraint is found to be almost always anticompetitive (hurting competition in the market), and thus the Court finds it to be an automatic violation. No defenses or justifications are allowed once the facts indicate the violation. There is no need to show evidence that the practice is anticompetitive. It is assumed. It is thus a fairly easy case for the government or the plaintiff if the facts are there. The Supreme Court has designated a limited number of practices as fitting into this category and up until 2007, vertical price fixing was one of them. Thus the Supreme Court has recently taken another step in restricting the scope of per se antitrust illegality by reversing the per se rule for minimum vertical price fixing in a case decided in June 2007: *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*

The first application of the automatic illegality rule appeared in *United States v. Trenton Potteries Co.* case in 1927. The term "per se" itself was first used in 1940 in *United States v. Socony-Vacuum Oil Co.* These cases did not allow justifications or defenses. In the course of the twentieth century, Supreme Court opinions basically defined six kinds of per se violations:

- ♦ cartels (a cartel is a group of “competing” businesses that coordinate their activities to reduce competition—for example, OPEC is a cartel but beyond the reach of our laws);
- ♦ horizontal price fixing (competitors agreeing to set prices, typically driving prices higher);
- ♦ vertical price fixing (sometimes called “resale price maintenance”);
- ♦ horizontal production quotas—competitors setting limits on production which again drives prices higher;
- ♦ horizontal market divisions (competitors agreeing to split up who they will deal with—one example is bid rigging); and
- ♦ group boycotts (competitors refusing to deal with certain buyers or suppliers). Also, tying contracts were often considered illegal per se, though that has largely changed (Independent Ink, Inc. v. Illinois Tool Works Inc 2006).

If a restraint of trade does not fit into the category of per se violations, then it must be proved as a violation of Section 1 of the Sherman Act under the “rule of reason.” This means that the government or plaintiff must bring economic experts to show that that the anticompetitive effects outweigh the competitive effects. The defendant may counter with its own expert witnesses. The net effect is that rule of reason cases are notoriously expensive and difficult to win. Courts have become very skeptical about the merits of rule of reason cases. They are not automatically legal, but sometime close to it. Thus under Section 1 of the Sherman Act, either restraints of trade are either per se illegal (automatic) *or* they fall under rule of reason, and the stakes are high as to how the restraint is categorized.

Vertical price fixing or resale price maintenance (hereinafter "RPM") typically consists of an agreement between a manufacturer and a retailer to set a fixed price for the good when it is resold. Suggested list prices given by a manufacturer were always allowed since they were not mandatory. This rule that RPM is illegal has been in effect (with the exception of the "Fair Trade" era which is discussed below) since a 1911 case *Dr. Miles Medical Co. v. John D. Park and Sons*.

THE FACTS AND THE LOWER COURT PROCEEDINGS IN THE *LEEGIN* CASE

The defendant and appellant in this case is Leegin Creative Leather Products. The company designs and makes women's leather products and accessories under the "Brighton" brand. The company prides itself in selling through 6,000 "family-owned specialty stores" (Brighton – About Us 2009). According to a Brighton spokesperson, "We have a business that is based on more than pretty products. It's built to last. We have sales associates who are passionate about our products, and we have consumers who appreciate our high quality and love to collect Brighton. It's a sort of love story." Leegin's President Jerry Kohl said, "We want the consumers to get a different experience than they get in Sam's Club or in Wal-Mart. And you can't get that kind of experience or support or customer service from a store like Wal-Mart" (Leegin Creative Leather Products, Inc. v. PSKS, Inc 2007 at 883).

The plaintiff in the case was PSKS, Inc., which operated a store in Lewistown, Texas (a suburb north of Dallas) named "Kay's Kloset." In 1997 Leegin refused to sell to discount sellers and in the following year it created a program (the "Heart Store Program") for some of its stores in which the stores actively agreed not to discount Brighton products. Kay's Kloset initially was part of that program, and sales of Leegin's Brighton product constituted almost half of the store's profits. Kay's Kloset's status in the Heart Store Program was terminated because a Leegin (Brighton) employee found the store unattractive. However, Kay's Closet continued to sell Brighton products, and in December 2002 Leegin discovered that Kay's Kloset was discounting the entire Brighton line by 20%. After a request that it stop discounting was refused, Kay's was discontinued as a Brighton store (Leegin Creative Leather Products, Inc. v. PSKS, Inc 2007 at 884).

With a substantial loss of revenue and profit, PSKS (Kay's) sued Leegin claiming that Leegin was engaged in vertical price fixing (or RPM). When Leegin attempted to introduce evidence of the pro-competitive effects, the Federal District Court of Eastern Texas excluded the testimony, citing the per se rule (Leegin Creative Leather Products, Inc. v. PSKS, Inc 2007 at 884). Leegin also responded that it was involved in unilateral action; here "unilateral" indicates that no second party was involved in a pricing agreement, and all

Sherman Act Section 1 violations must involve two parties (Leegin Creative Leather Products, Inc. v. PSKS, Inc 2007 at 884, citing United States v. Colgate & Co. 1919). However, the jury found otherwise and awarded PSKS damages in the amount of $1.2 million. Under the Sherman Act, when private parties win, their damages are automatically tripled (or "trebled"). Thus that amount was trebled and with attorney's fees the judgment was $3,975.000.80 (Leegin Creative Leather Products, Inc. v. PSKS, Inc 2007 at 884).

Leegin appealed to the Fifth Circuit. A three judge panel affirmed in a fairly short opinion. In the appeal, Leegin did not challenge that it had engaged in price fixing; it did challenge the per se rule and the damages. It argued that the rule of reason should apply (PSKS, Inc. v. Leegin Creative Leather Products, Inc 2006 at 466). Leegin claimed that the Supreme Court had not consistently used the per se rule for RPM (PSKS, Inc. v. Leegin Creative Leather Products, Inc 2006 at 466).

However, the Fifth Circuit found that none of the cases cited by Leegin involved minimum vertical price fixing and thus were not inconsistent. For example, *State Oil Co. v. Khan* (PSKS, Inc. v. Leegin Creative Leather Products, Inc 2006 at 466, citing State Oil Co. v. Khan 1997) involved *maximum* vertical price fixing (where the retailer is setting a maximum price for a retailer, not dealing with minimums or discounts). Another case *Business Electronics Corp. v. Sharp* (PSKS, Inc. v. Leegin Creative Leather Products, Inc 2006 at 466, citing Business Electronics Corp. v. Sharp 1988) involved a case of a business pushing prices higher, but it did not set a fixed or minimum price. A third case involved a vertical non-price restriction (PSKS, Inc. v. Leegin Creative Leather Products, Inc 2006 at 466, citing Continental T.V. v. GTE Sylvania). Therefore, the Fifth Circuit decided that the Supreme Court had been consistent in its condemnation of minimum vertical price fixing since 1911's *Dr. Miles* case (PSKS, Inc. v. Leegin Creative Leather Products, Inc 2006 at 466, citing Dr. Miles Medical Co. v. John D. Park and Sons 1911).

Leegin claimed that its action involved no competitive harm and thus was entitled to an exception to the per se rule (PSKS, Inc. v. Leegin Creative Leather Products, Inc 2006 at 467). Leegin also challenged the exclusion of an economic expert who would have testified that its actions were pro-competitive. But the Fifth Circuit ruled that the per se rule presumed the existence of harm and ruled out extensive economic investigation (PSKS, Inc. v. Leegin Creative Leather Products, Inc 2006 at 467, citing Viazis v. Am. Ass'n of Orthodontists 2002 and N. Pac. Ry. Co. v. United States 1958). Leegin also made the argument that there was no antitrust injury, and thus the plaintiff had no standing. But the court said that antitrust injury for standing purposes related to the plaintiff and not to "overall competition" and that PSKS did suffer antitrust injury in losing its "best-selling and most profitable line" (PSKS, Inc. v. Leegin Creative Leather Products, Inc 2006 at 468). The court also rejected Leegin's argument for reducing damages (PSKS, Inc. v. Leegin

Creative Leather Products, Inc 2006 at 468-71). Thus the decision of the trial court was affirmed (PSKS, Inc. v. Leegin Creative Leather Products, Inc 2006 at 470).

STATUTORY EVOLUTION OF RESALE PRICE MAINTENANCE

As stated earlier, since 1911 RPM has been illegal under the *Dr. Miles* interpretation of the Sherman Act's § 1. But RPM doctrine became more convoluted during the New Deal era of the 1930s. When both supply and demand are fairly steady, market prices cause good resource allocation. But the Great Crash brought a collapse of consumer confidence and a consequent collapse in demand, and the ongoing excessive strong supply of goods became the dominant influence, driving prices down. Falling prices caused demand to decline still further.

During normal times, it is unlikely that buyers will obtain a lower price for the goods by postponing their purchases. But during a depression "people expect falling prices, due to depression and deflation, and will therefore hold more money and spend less on goods, awaiting the price fall" (Rothbard 2000). Due to plentiful supply and low demand, they expect to obtain the goods at a lower price if they postpone the purchase. So demand stays low, and supply is likely to remain strong as producers seek to keep their firms going by obtaining some revenue even by temporarily selling at a loss. Producing firms can become insolvent and this reduces wages of the people whose purchases are needed in order to restart demand. Buyers who postpone their purchases succeed in obtaining lower prices, which cuts still further into the collapse of aggregate demand.

With demand collapsing, competition among suppliers could not help the markets move toward satisfactory equilibrium. As historian David M. Kennedy said,

> New Deal regulatory initiatives were precipitated from decades of anxiety about overcapacity and cut-throat competition, the very issues that had so disrupted the first great national industry, the railroads, in the nineteenth century and led to the creation of the country's first regulatory commission, the Interstate Commerce Commission (ICC), in 1887. Against that background, the Depression appeared to signal the final, inevitable collapse of an economy that had been beset for at least fifty years by overproduction and an excess of competition (Kennedy 1999, at 372-73).

Within the Roosevelt Administration, competition among suppliers was viewed as problematic. Raymond Moley, a member of Franklin Roosevelt's brain trust, criticized competition for producing "sweatshops, child labor, rackets, ruinous price cutting. . ." (Brand 2002 at 170). The Roosevelt Administration's first response was to convince

Congress to enact the National Recovery Act in 1933 , under which firms in an industry could in effect set up a cartel to reduce its supply of goods (Fite & Reese 1965 at 603). (A cartel is a group of "competing" businesses that coordinate their activities to reduce competition.) Likewise the supply of agricultural commodities was reduced by the Agriculture Adjustment Act passed in 1933, which provided benefit payment to farmers if they restricted their cultivation to an allotted amount of acres (Fite & Reese, 609).

However, when the U. S. Supreme Court held the National Recovery Act was unconstitutional, revival of demand looked all the more important. In Senate debate, Congressional leaders such as Senator Millard E. Tydings considered the survival of small businesses to be essential for maintaining the earnings, spending power, and stability of America's population (Peritz 1996 at 154, citing 81 Cong. Rec. 7495). In the Congressional Record, Representative Miller said "The grocer, the hardware dealer . . . were to be found shoulder to shoulder with the doctor, the lawyer, the clergyman . . . These men constituted the woof and fabric of our national life" (Peritz 1996 at 155, citing 81 Cong. Rec. A873-74). But the small firms in industries such as groceries, apparel, and drugs, found it hard to compete with chain store systems which reduced costs with economies of scale, by integrating the wholesale and resale functions (Shughart 1990 at 66). Small firms, and their owners and employees, could not survive if they had to lower their selling prices to match the retail prices offered by the chain stores. To deprive the chains of their ability to undercut the prices of their local competitors, Congress became more disposed to override the *Dr. Miles* precedent, by letting each state decide whether to allow RPM. In this context, RPM could be viewed, not as primarily a detriment to consumers, but more positively as a way of stabilizing prices, so that demand would not collapse and so that money would stay in circulation, providing necessary liquidity. It is understandable then that during the 1930s Congress would be deposed to protect RPM.

Congress took note that the National Association of Retail Druggists had drafted a model RPM statute, and twenty states had adopted "fair trade statutes" based on it.(Shughart, 67). Leaving RPM regulation to the states had its difficulties. There were problems applying RPM to transactions across state lines. For each state, its fair-trade statute could only authorize RPM for goods that were "manufactured, wholesaled and retailed completely within the state boundaries, a privilege of trivial economic importance" (Hollander, 1966).

So the stage was set for the U.S. Congress to pass the Miller-Tydings Amendment of the Sherman Act in 1937, to reinforce the states' fair trade statutes. The Sherman Act was amended to lift its prohibition on vertical price control, even on goods that moved from one state to another, when and if the state in which the merchandise was finally retailed had authorized RPM. The Miller-Tydings Act facilitated operation of the states' fair trade statutes; without it, it would have been "necessary for a manufacturer to be incorporated in each state in which he wished to issue fair-trade contracts" (Views 1952 at 602), Reportedly the Miller-Tydings Act did not have an easy passage:

> the administration's economists were united in opposing this legislation. . . . Yet the Miller-Tydings Bill became the law of the land through a legislative maneuver; it was attached as a rider to a bill that the administration supported, one dealing with taxation in the District of Columbia (Barber 1996 at 104).

The state fair trade statutes typically contained a "non-signers clause". This clause provided that "the manufacturer need conclude a price agreement with only one retailer to bind all other dealers within the same state" (Hollander 1966 at 69). Without that clause, "fair-trade contracts in any state would be meaningless, because the firms who precipitate price wars are the very ones who would not sign the fair-trade contract" (Views 1952 at 602). But in its 1951 decision in *Schwegmann Brothers v. Calvert Corp*., the U.S. Supreme Court viewed the non-signers clause as outside the scope of the Miller-Tyding Act (at 389-90). So Congress solved that problem by passing the McGuire Act in 1952 to supply language that specifically authorized the non-signers clauses (Hollander 1966 at 70). But a few states did not enact fair trade laws, and federal Circuit Courts held thereafter "that mail-order firms located in non-fair trade territory cannot be bound by the minimum prices set for the fair trade districts into which they sell" (Hollander 1966 at 69, citing General Electric Co., v. Masters Mail Order Co. of Washington 1957).

Despite such difficulties in applying the fair trade laws, altogether forty-six states adopted them as modifications of their antitrust statutes (Ford 1975), and they continued to hold sway during the 1950s and 1960s (Hollander 1966 at 72; Skitol 1999 at 245). It appears the fair trade laws did not burden consumers enough to cause their repeal during those decades. Neil M. Ford said: "For the most part the impact of fair-trade laws in the United States was relatively light. At any one time no more than 5% to 10% of retail sales were covered by fair-trade legislation" (Ford, 2006). With other nations rebuilding their economies after World War II, the American economy was supreme. Any harm that American consumers might have felt from RPM was assuaged for many by the power of labor unions to obtain wage increases (Brinkley 2003). However, by the 1970s it was seen that a spiral of wage and price increases was causing a persistently high rate of inflation (Krugman 2008). Simultaneous double digit inflation and double digit unemployment was causing economic stagnation (Debate 1975). Senator Edward Brooke and Representative Barbara Jordan introduced the Consumer Goods Pricing Act of 1975, which repealed the Miller-Tydings Act and the McGuire Act. Senator Brooke commented that as of February 1975, fifteen states had already repealed their own fair trade statutes. He also noted that both

Canada and Great Britain had used fair trade extensively, but Canada had repealed it in 1957 and Great Britain in 1965 (Debate 1975). In signing the Act, President Ford commended its "bipartisan recognition that price competition is important to American consumers…" (Ford 1975).

THE SUPREME COURT'S 2007 *LEEGIN* DECISION

Leegin appealed to the U.S. Supreme Court which agreed to hear the case. The Supreme Court reversed the case on a 5 to 4 vote. Justice Anthony Kennedy (often the swing vote in close cases) wrote the decision. He was joined by Justices Roberts, Scalia, Thomas, and Alioto. The four dissenters were Justices Breyer, Stevens, Souter, and Ginsburg (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 881).

The majority started its reasoning by rightly saying that the courts could never literally apply §1 of the Sherman Act (because its terms outlaw all restraints of trade – and all contracts create duties that restrain trade). Therefore the rule of reason became the "accepted standard" for violations of that section. According to the court, "In its design and function the rule distinguishes between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer's best interest" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 886). The majority then discussed the per se rule that eliminates the "need to study the reasonableness of an individual restraint" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 886). The rule should only be used in regard to restraints "that would always or almost always tend to restrict competition and decrease output" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 886, citing Business Electronics Corp. v. Sharp Electronics Corp, 1988). The rule should not be used in situations where the "economic impact of certain practices is not immediately obvious" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 887, citing State Oil Co. v. Khan 1997).

The majority found that *Dr. Miles* had relied on a common law rule against restraints on alienation (e.g., resales) that dated back to a treatise published in 1628 (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 888, citing Dr. Miles Medical Co. v. John D. Park and Sons 1911). *Dr. Miles* also equated vertical price fixing with horizontal price fixing.

The majority relied on a number of advisory briefs to the court and economic studies which suggested that minimum resale price maintenance can be procompetitive (helps competition) in a number of situations (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 889, citing Brief for Economists as Amicus Curiae). The brief for the United States Department of Justice agreed (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 889). The Court also referred to the works of Robert Bork and Hubert Hovenkamp that consider the procompetitive aspects of the practice (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 889).

According to the majority, RPM "can stimulate interbrand competition . . . by reducing intrabrand competition" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 890). RPM can encourage "retailers to invest in tangible or intangible services or promotion efforts that aid the manufacturer's position as against rival manufacturers." The consumers can choose among "low-price, low service brands; high-price, high-service brands; and brands that fall in between" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 890). The Court relied significantly on the free-rider argument that without RPM some consumers will make use of high service dealers with showrooms, demonstrations, and highly knowledgeable employees and then turn to a discount seller with none of the above and buy at a cheaper price (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 891).

In addition, the Court believed that in some instances RPM can facilitate new entry for firms that can induce retailers to make the kind of capital and labor investments required to sell the product or service (such as knowledgeable sales personnel and adequate inventories). It also may be difficult and/or inefficient for manufacturers to force retailers to supply these services (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 891).

Still the majority recognized that even under the rule of reason, there can be situations where minimum RPM can be anticompetitive. This would seem to differentiate this rule of reason category from others (such as vertical market divisions and maximum vertical price fixing) where the practices are largely de facto legal under the rule of reason.

The Court said that RPM may facilitate a manufacturer cartel by making it easier to police a participant "undercutting the cartel's fixed prices" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 892). A "cartel" is a group of competitors coordinating its activities on such things as prices, supply, etc. It might also discourage "manufacturers from cutting prices to retailers with the concomitant benefit of cheaper prices to consumers" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 892).

Another problem, cited by the Court, is that RPM may facilitate cartels by retailers. This may prevent "retailers with better distribution systems and lower cost structures ... from charging lower prices..." (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 893). Of course, such cartel-like behavior by either the manufacturers or the retailers would be the equivalent of horizontal price fixing and thus should be outlawed. The Court gave several examples where this was happening (and indeed the facts of *Dr. Miles* indicated that it was going on in that case) (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 893).

The Court also discussed the possibility of a dominant manufacturer or retailer using RPM in an anticompetitive way. A manufacturer may use it to keep retailers from carrying products of competitors. A retailer may use it to prevent innovations in distribution that may lead to lower costs (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 893-94).

The majority opinion rejected arguments that the per se rule should be kept because of "administrative convenience"–the lower cost of providing guidance and the lesser burden to litigants. The Court should not accept that argument if the practice often is procompetitive (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 894-95). The respondent also made the argument that RPM will lead to higher prices. But the court concluded that higher prices sometimes may enhance "consumer welfare" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 895). Furthermore, generally manufacturers have no incentive to give retailer huge margins as it may lead to fewer sales (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 896). But presumably in situations involving free riding, the manufacturer may be able to increase its total sales revenue by using RPM. Retail prices might be lower under RPM than those where a manufacturer imposes vertical territorial restrictions on retailers (under the rule of reason) (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 896) or where the court unilaterally refuses to deal with discounting dealers. It has always been legal under the Sherman Act to act without agreement of others (thus said to be "unilateral); this was made clear in the *Colgate* case (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 901, citing United States v. Colgate & Co. 1919). The majority may view RPM, with its enhanced margin for the dealer, as one type of distributional cost for the manufacturer, similar to a discretionary decision to increase the amount of advertising for the product (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 896).

Still the majority returned to an earlier theme: "Resale price maintenance, it is true, does have economic dangers" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 897). The majority suggested that the courts develop litigation structures, rules for offering proof, and "even presumptions" to help sort out the good RPM from the bad. The Court gave some suggestions as to when RPM may well be dangerous: (1) the impetus comes from the retailers; (2) many of the manufacturers adopt the practice; (3) a retailer or manufacturer has dominant market power (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 897-98).

The Court recognized that it had two other substantial problems in reaching its conclusion: (1) the overturning of long standing precedent–nearly a hundred years old and (2) Congressional intent as reflected in the Consumer Goods Pricing Act of 1975, that repealed the states' ability to have "Fair Trade" laws that permitted RPM within that state (by repealing the Miller-Tydings Act and the McGuire Act) (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 899, 905)

In regard to the precedent-breaking aspect of the decision, the court gives two general reasons why the old rule should be overturned. First, the courts have viewed the vague wording of § 1 as an invitation to create a common law set of rules–a common law that could change with the evolving understanding of the economics of the situation. Following the strict wording of the statute might have invalidated all contracts since contracts are in essence restraints of trade, and clearly Congress did not intend to do that (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 899, citing Northwest Airlines Inc. Transport Workers Union 1981). Also, the court cited a string of cases where it has gradually chipped away the per se rule as it applied to vertical restraints: *Continental TV* relating to non-price vertical restraints) (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 901, citing Continental T.V. v. GTE Sylvania 1977); *Monsanto* and *Business Electronics* (relating to the level of proof) (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 901-02, citing Monsanto Co. v. Spray-Rite Service Corp. 1984 and Business Electronics Corp. v. Sharp Electronics Corp. 1988); and *Khan* (repealing the per se rule for maximum vertical price fixing) (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 902, citing State Oil Co. v. Khan 1997). The court also cited *United States v. Colgate* (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 902, citing Colgate, 1919) (though that is a straight forward interpretation of §1 since a unilateral refusal to deal does not involve a contract, combination, or conspiracy).

The effective repeal of the state "Fair Trade Laws" by the 1975 Consumer Goods Pricing Act posed another problem for the majority (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 905). Those two repealed laws, Miller-Tydings and the McGuire Acts, allowed states at that time to legalize RPM; most of them did so. The repeal of those two laws brought RPM squarely back under the cross-hairs of *Dr. Miles* and a string of consistent rulings that deemed the practice to be per se illegal. However, since the Consumer Goods Pricing Act did not specifically say that RPM was illegal but left it under *Dr. Miles* and its progeny, the majority found that the Congress had left the Court with the ability to do its common law interpretation of the statute According to the majority, the purpose of Miller-Tydings was to allow states to protect small retailers from big discount sellers (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 905, citing California Retail Liquor Dealers Ass'n. 1980).

The majority acknowledged that estimates of RPM during the height of "Fair Trade" were between 4 and 10 percent of retail sales though that the percent was thought to have dropped off considerably by the time of the Consumer Goods Pricing Act (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 905, citing Scherer and Ross 1990).

Perhaps ironically, at the end of the majority decision, it is mentioned that the president of Leegin also "has an ownership interest in retail stores that sell Brighton." The plaintiff claimed that this made it a "horizontal cartel of competing retailers." If that had been proven, the Supreme Court may have had to rule for PSKS. But since this was not alleged in the lower courts, the Court would not consider the matter (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 907-08).

Thus, the majority closed the books on *Dr. Miles* and reversed and remanded the decision of the Court of Appeals (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 908).

The four member dissent was written by Justice Breyer. He started the dissent by saying that Congress has repeatedly rejected the majority's justification to deviate from the per se rule (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 908). Breyer said that if no long-standing precedent had been involved, the arguments would be or could be different. Breyer's dissent is organized by looking at the arguments for the anticompetitive aspects of RPM, the procompetitive aspects, and the administration of the law (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 908-09).

In regard to dealers, RPM can prevent lower prices, discourage dealers from responding to "changes in demand," substitute wasteful services at times instead of lowering prices, and stifle new methods of more efficient retailing (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 910-11). As to producers, RPM may help firms in concentrated markets to collude and give them an easier way to police their collusion (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 911).

At the time of the passage of the Consumer Goods Pricing Act, an Assistant Attorney General from the Justice Department said that a comparison of prices in the 36 states with fair trade laws as compared to the 14 that did not have it showed that prices were 19% to 27% higher in states with those statutes then without them (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 912, citing Hearings of Senate Bill 408). Breyer used the writings also cited by the majority—such as Areeda and Hovenkamp, who said that RPM tends to produce higher prices (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 912, citing Areeda and Hovenkamp, 2004, at Volume 8, P1640b, 40); Breyer also cited William S. Comanor and Frederic M. Scherer who said, "It is uniformly acknowledged that [resale price maintenance] and other vertical restraints lead to higher consumer prices" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 912-13, citing Amicus Brief for Comanor and Scherer).

Breyer conceded that RPM may be beneficial in some kinds of cases. It might facilitate new entry. It may help curb free riding. Breyer asked, "But before concluding that courts should apply a rule of reason, I would ask such questions as, how often are harms or benefits likely to occur? How easy is it to separate the beneficial sheep from the antitrust goats?" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 914).

For the dissenters, it is clear that RPM can and does cause harm and it is also clear that banning RPM may in some instances cause harm. It is clear that free riding exists. To Breyer, some free riding exists in the economy regardless of the rules. He also said that it is easy to imagine situations where free riding exists, and then he asked, "But does it happen often?" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 916) His answer after reading the economic studies is "an uncertain 'sometimes'," noting that according to the brief of Comanor and Scherer, there exists, "skepticism in the economic literature about how often [free riding] actually occurs" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 916, citing Brief for Comanor and Scherer).

In regard to how easily courts can identify situations where the benefits are greater than the harm, Breyer's answer is "Not very easily" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 916). It is difficult to determine in many cases who is initiating the RPM–the retailer or manufacturer. It is difficult to identify the seriousness of free riding. It is difficult and expensive to identify the market and the extent of market power (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 917). Breyer cited Hovenkamp who said that litigating a rule of reason case is "one of the most costly procedures in antitrust practice" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 917, citing Hovenkamp, 2005).

Breyer said that if he was forced now to make a decision on the legality of the practice, he might agree that the "per se rule should be modified" for a few cases. But he said that the question is different than starting a rule "from scratch." "We here must decide whether to change a clear and simple price-related antitrust rule that courts have applied for nearly a century." (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 917-18)

Justice Breyer complained how easily the majority overturned nearly a hundred years of well-used precedent: "I am not aware of any case in which this Court has overturned so well-established a statutory precedent" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 918). Furthermore, the passage of the Consumer Goods Pricing Act of 1975 was clearly intended to forbid RPM. At that time the Assistant Attorney General testified that the passage of the Consumer Goods Pricing Act would mean that such "minimum resale price maintenance [would be] per se unlawful" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 919, citing Clearwaters, 1975). The Supreme Court in *Sylvania* recognized the importance of this 1975 statute: "Congress recently has expressed its approval of a per se analysis of vertical price restrictions by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair trade price at the option of the individual States" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 919, citing Continental T.V., 1977).

While Breyer admitted that Congress did not forbid the Court from "reconsidering the per se rule," he felt that such a change would only be justified with substantial new evidence" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 919-20). Breyer found that the economic studies are weak at best and some are out of date. The newer studies showed that *sometimes* RPM can bring benefits. But Breyer said the "proponents of a per se rule have always conceded as much. What is remarkable about the majority's arguments is that *nothing* in this respect is new" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 921). If the manufacturer wants extra services, that still can be required of the retailers or the retailers can charge for those services (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 921). Breyer is also concerned about the increased concentration in retailing (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 921-22) (presumably implying that retailers might have greater power in soliciting for RPM from manufacturers–which would amount to horizontal price fixing).

Justice Breyer then attacked the overturning of precedent, based on the five criteria for overruling precedent set forth by Justice Scalia in a concurring opinion in *Federal Election Commission v. Wisconsin Right to Life, Inc.* (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 923, citing Federal Election Commission 2007). First, Scalia said that the principle of *stare decisis* (following precedent) is more rigid in statutory cases as compared to constitutional cases. Second, overturning precedent is more easily done when the case that is overturned was decided a short time earlier, but note again that *Dr. Miles* was nearly a hundred years old. Third, the precedent should be overturned if it has created an "'unworkable' legal regime." But Breyer felt that the per se rule has been eminently workable, particularly since it allowed manufacturers a back door out by refusing to deal with discount sellers under the *Colgate* rule. Fourth, a decision that "unsettles" the law could be overturned. Here, Breyer believed that the majority was doing the unsettling with its decision. Fifth, cases involving property or contract rights should normally not be overruled because of the considerable reliance on the rules by the economic parties. Here again, the majority has disrupted reliance. Also, Breyer cited several briefs of discount sellers and other consumer groups arguing that RPM stifles "low price innovators" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 923-25).

The minority opinion of Breyer also chastised the majority for claiming that RPM during its prime (during the time of the Fair Trade Laws) only affected "a tiny fraction" of manufacturers. But Breyer said at the time of the repeal of the Fair Trade Laws, it constituted "ten percent of consumer goods." Translated to today's prices, that might mean an increase of $750 to $1000 for a family of four (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 926). Breyer considered pricing to be the economy's "central nervous system" (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 926-27, citing National Soc. of Professional Engineers 1978).

GENERAL ANALYSIS OF §1 OF THE SHERMAN ACT

The outcome of the *Leegin* case was perhaps somewhat predictable given the movement of the Supreme Court in recent years regarding antitrust cases. There has been a steady movement against the per se rule and in favor of the rule of reason. However, whereas in the previous antitrust cases, the majority was able to pick up some "liberal" judges, in this case it was a five to four decision based on the typical conservative-liberal split. Perhaps that is because the case is somewhat more controversial than some earlier cases. And it also goes straight to the heart of what the antitrust laws are ultimately about: who really are the "consumers" that we are supposed to be concerned about?

When the Supreme Court says that the Sherman Act §1 is basically a law that gives the court the right to treat the area as common law–thus allowing the Court to decide as it sees fit, does it amount to being able to write on a blank slate? Not completely. But the conservative position has been to use §1 to do one thing and only one–that is, as Robert Bork puts it in his groundbreaking book *The Antitrust Paradox*, to maximize consumer welfare (Bork 1978 at 61). Bork believes that the legislative history supports his interpretation of the Sherman Act in regard to the maximization of consumer welfare (Bork 1978 at 61). In the same paragraph, Bork says that legislative history of §1 of the Sherman Act intended to make illegal "two classes of 'arrangements, contracts, agreements, trusts, or combinations:' (1) those 'made with a view, or which tend, to prevent full and free competition'; and (2) those 'designed, or which tend, to advance the cost to the consumer.'" (Bork 1978 at 62)

What does Bork mean by "consumer welfare"? He said the "whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare" (Bork 1978 at 91).

> Allocative efficiency, as used here, refers to the placement of resources in the economy, the question of whether resources are employed in tasks where consumers value their output most. Productive efficiency refers to the effective use of resources by particular firms (Bork 1978 at 91 note).

When discussing monopolistic activities, Bork said that "higher price is not the root of the problem, nor is lower output" (Bork 1978 at 100-01). Antitrust should have no equity concerns, nor concerns with income distribution (Bork 1978 at 111, 220). He says that a "shift in income distribution does not lessen total wealth" (Bork 1978 at 111).

Thus the idea of higher prices with the sellers becoming richer and the buyers becoming poorer is not necessarily a problem if the total "consumer" welfare is not hurt. Thus, it is apparent that Bork's use of the term "consumer" does not match what most people would consider a "consumer." For Bork, consumers are both buyers and sellers; consumers are both business sellers, business buyers, and people buying for personal use. To apply Bork's thinking to our particular case, RPM should not automatically be illegal just because it produces higher prices to buyers (who may be individuals purchasing for personal use).

Bork goes beyond the *Leegin* case by saying that all vertical restraints "should be completely lawful" (Bork 1978 at 288). Bork does admit that the possibility of dealer or manufacturer cartels as being the instigator of RPM, but he says that those should just be viewed and treated as horizontal restraints which hurt consumer welfare (Bork 1978 at 292-93).

But Bork's idea that allocative and productive efficiency was something considered by Congress when it passed the Sherman Act in 1890 is rather unlikely, at best In fact, the idea of allocative efficiency was just being invented in a footnote of a massive tome by the famous economist Alfred Marshall in the same year 1890 (at Book V, Ch. 15, sec. 7, note).

Furthermore, according to the *Congressional Record*, Senator Sherman (the main author of the bill) himself was concerned about income distribution:

> The popular mind is agitated with problems that may disturb social order, and among them all none is more threatening than the inequality of condition, of wealth, and opportunity that has grown within a single generation out of the concentration of capital into vast combinations to control production and trade and to break down competition (Debate, 1890 at 2460).

Senator Hoar (who apparently was also involved in drafting the legislation) said the following:

> When, on the other hand, we are dealing with one of the other classes, the combination aimed at chiefly by this bill, we are dealing with a transaction the only purpose of which is to extort from the community, monopolize, segregate and apply to individual use, for the purposes of individual greed, wealth which ought properly and lawfully and for the public interest to be generally diffused over the whole community (Debate, 1890 at 2728).

Obviously the Sherman Act was concerned less with pure wealth redistribution, but more with wealth inequalities *resulting from unfair trade practices*. Sherman viewed the law as an economic bill of rights:

> [I]t is the right of every man to work, labor, and produce in any lawful vocation and to transfer his production on equal terms and conditions and under like circumstances. This is industrial liberty and lies at the foundation of all rights and privileges (Debate, 1890 at 2457).

Fairness played a prominent role in the thinking of the legislators. Senator Sherman objected to arrangements that

> combine with a purpose to prevent competition, so that if a humble man starts a business in opposition to them, solitary and alone, in Ohio or anywhere else, they will crowd him down and they will sell their product at a loss or give it away in order to prevent competition, interrupt, and impair the freedom and fairness of commerce... (Debate, 1890 at 2569).

The problem with Professor Bork's and the majority's analysis is that the Sherman Act, as established by Congress, was not a blank slate on which could be written the latest and most fashionable economic theory. Congress had in mind specific types of problems. Of course, unfortunately, they are not well-spelled out in the language of §1. But they are much clearer when one reads the legislative debate.

Specific Analysis Relating to RPM

First, while this commentary will generally side with the dissenters, some of the stronger points of the majority should be examined.

a. Even the dissenters admit that there may be some possible cases where economic efficiency may indicate that RPM should be allowed. Such examples mentioned by the dissenters include free riding and new entrants into a market (presumably with a new type of good). Free riding occurs when customers may go to a high-service retailer to see and "test" the good and then go to a low-service retailer to buy the item at a cheaper price (Van Baal & Dach, 2005, at 75, 81-81). Manufacturers may want to prevent this since the high-service retailers (with higher costs) may not be able to stay in business, if their sales are taken away by the low-service retailers. And, in some cases high service may be necessary to get the customer ready to buy the item. Similarly, a company with a completely new type of product may need a new high-service retailer to get customers interested in the product.

Now Justice Breyer admits that this can happen and may be inefficient. However, he is uncertain whether it happens *enough* to move away from the per se rule. At one point, he says that he might be willing to carve out an exception to the per se rule for companies with new types of products or services. (Note that exception to a per se rule might seem to be contradictory, but in fact there is an exception to the strongest per se rule—the one regarding horizontal price fixing (e.g., the *Broadcast Music Inc. v. CBS* case) (1979).

But the type of economy that exists now would seem to make this free riding less prevalent. Increasingly, consumers are getting their information about technical guidance, issues, and problems through other people (such as friends and fellow employees with technical knowledge), the use of third party magazines and the Internet. Many manufacturers bypass the retailer with their own support, FAQs, and forums. Third party forums abound relating to almost any technical problem of any significance. In short, the Internet economy has changed the way we learn about products.

Another economic problem about free riding is rarely recognized. It might be called the "reverse rider" effect. It is the result of companies that use RPM to maintain their high service retailers. While many customers potentially might benefit from the high service retailers and thus are rightly paying a higher price for that item that needs high service, there also may be many potential buyers that are "low maintenance consumers" (An example might be that of a new kind of computer; Apple's IIe was typically sold by stores that did not discount so that the stores presumably could assist customers). But some customers may know how to use the item already; or, they may be able to figure things out themselves; or, they may be able to get help from third parties and/or from the Internet. These particular customers will be paying too much because they do not need the "costly" services provided by retailers (Yamey 1966 at 13). This too is economically inefficient.

So one question about free riding is this: for a particular item does the efficiency from using RPM to mitigate the free riding problem offset the problem of the "reverse rider" effect? The answer to this problem is that the "low maintenance" customers may naturally migrate to a different company's product that is cheaper and does not provide the costly service. In some cases that may be a way out, but *only if* there are good substitutes for the initial product. If the product is highly differentiated (there are no good substitutes), the low maintenance customer is just stuck with the choices of either not buying or paying the high price. Obviously, the manufacturer needs to pay attention to the problem, but in any event, low maintenance customers will feel cheated at facing the higher cost item that they want. This is an inefficiency that needs more attention from economists.

b. Another point made by the majority is that they appear to view minimum vertical price fixing under the rule of reason somewhat differently than other rule of reason cases such maximum vertical price fixing, vertical market divisions, etc; these practices technically fall under the rule of reason but for all practical purposes are per se legal.

It is well known among antitrust lawyers that §1 rule of reason cases are notoriously hard to win either at the trial or appellate level. Partially, that is because of the prevailing economic "wisdom" relating to antitrust and partially it may be due to a plethora of economist experts who can found to testify to a party's needs. Still the majority tries to hold out hope that minimum RPM cases could be won by the government or private plaintiffs. The majority seems to be encouraging the trial courts to "sniff out" the reasons for the RPM practices and to be especially vigilant for cases of retailer or manufacturer cartels. Thus what the majority is espousing is a tough or extremely vigilant rule of reason standard. But will the lower courts take their counsel?

c. A further point may be made for the majority (though they may not have made it themselves). As noted above, the nature of the economy has changed greatly; for most products, consumers are very cost conscious and have the ability to check prices on the Internet. Also we have seen the growth of huge retailers that thrive in a discounting environment both in "bricks and mortar" stores and on the Internet. It will be difficult for most manufacturers (particularly for largely undifferentiated products) to ignore these discounting retailers and buyers who are savvy enough to look closely for the lowest price.

Still there undoubtedly will be some types of products or services that are sufficiently differentiated that they do not have substantial interbrand competition. This is apparent from the facts of the *Leegin* case, where the manufacturer makes and sell "distinctive" handbags, accessories, and apparel. These products may not have a patent. The manufacturers may over the short and medium run be able use RPM to their and the retailers advantage. And this will mean higher prices for consumers.

d. A further point is implicit in the facts of *Leegin*. Some manufacturers use higher prices as a way of showing the "high quality" of their product; they can differentiate their product by using higher prices as a surrogate for the care, concern, features, and quality of their products. And obviously some customers are convinced by this argument. Is this indeed a valid argument in favor of many types of RPM? It appears to be one of the main elements when the FTC cracked down on Levi-Strauss in the 1970s, when that manufacturer disallowed competitive pricing at the retail level in order to exhibit the "quality of their product." Is this type of RPM (even if it involves an increase in "consumer welfare" as defined by Professor Bork) a good idea or a bad one?

When a good is differentiated partly by the prestige the marketing channel supplies, this might be called a "demand-pull" RPM situation; it is not solely an imposition by the manufacturer or the retailers. As Thorstein Veblen's theory of conspicuous consumption indicates, the consumers are willing to pay a price premium as a way of signaling that they belong in a select category of people who can afford to buy that product (Veblen 1899). In a society where prices are not set by central planners, it is inevitable that there will be a prestige element in some prices, and it may be that a per se illegality rule that allowed no exceptions would place law at too much tension with human nature.

Second, what was the intent of the Congress that passed the Sherman Act? Certainly Professor Bork was right in saying that lowering prices for buyers was one the main objectives. And by "buyers" we mean individual and business buyers. Congress certain recognized that very low (predatory) pricing could lead to less competition, monopolization, and higher prices later. And so there are exceptions to the low price objective. "Allocative" or "productive" efficiency was certainly nowhere near their radar screen at this time. They certainly were open to allowing the courts to set the specific rules but it is dubious that promoting higher prices as happens under RPM was one of their objectives.

It may be thought that Congress was mainly thinking of horizontal price fixing and its corollary practices (cartels, horizontal production quotas, horizontal market divisions). Did it consider at all vertical price fixing (RPM)? It may be surprising that there was some discussion of it in the 1890 legislative debate. For example, Representative Culbertson talks of certain contracts:

> The object of this peculiar contract is to force every dealer in the country who deals in that product to purchase from them, and if he does not, or if he does not conform to the price they choose to fix upon the commodity, they will make him pay more than if he was a regular customer, and more than another man who enters into the contract or private agreement with the manufacturers. This is restraint of free and liberal trade, as I take it, and tends to destroy competition. The customers of the manufacturer are not allowed to sell at a lower rate than that fixed by the manufacturer... (Debate, 1890 at 4089)

Congressman Morse, however, is worried that the bill will stop such practices and is worried that ability of retailers to sell at any cost will lead to "ruinous competition"–a phrase often heard from those who try to justify horizontal competition and RPM:

> Deny manufacturers this right to control the selling price of their goods and compel them to enter into ruinous competition and the effect is a constantly deteriorating quality of goods to meet such ruinous conditions; deny manufacturers this right, it means adulterated food, adulterated spice, it means short weight and short count to meet the constant demand for cheaper goods that will still afford a profit... (Debate, 1890 at 5954)

Despite Congressman Morse's concern, the bill was passed without the changes that he wanted.

In this context, Professor Bork's interpretation of the Sherman Act strikingly contradicts its legislative history. He favors per se legality for RPM even while acknowledging that one of the Act's two main purposes was to stop practices that "advance the cost to the consumer". Since almost everyone agrees that minimum RPM does increases prices to buyers, is this a problem for Professor Bork and the majority position in this case? Apparently, as noted above, they intend for the word "consumer" to include not only ordinary individual buyers but also sellers. Still it is a little misleading for Professor Bork to call what he wants to maximize "consumer welfare," since businesses are normally not referred to as consumers.

Third, what can be said about the precedent-breaking aspect of the case? Probably little can be added to what both the majority and the dissenters stated. Yes, *Dr. Miles* is almost 100 years old (excepting the years of Free Trade Laws in particular states). But the majority is right that those who watch antitrust law over the last twenty years could see this coming though they would have rightly seen that it was going to be a close vote.

What is more objectionable is the majority ignoring the clear aims of the Sherman Act and of the Consumer Price Protection Act of 1975. As is argued earlier and as admitted by Professor Bork, one of the main reasons for the Sherman Act was to keep prices low. And it is all but disingenuous to argue that the Consumer Price Protection Act was to wipe the slate clean for the Supreme Court to make any new law they saw fit regarding RPM. It is true that technically that is what Congress did by simply repealing the Miller-Tydings and McGuire Acts. But clearly it was much simpler for Congress to make RPM illegal by repealing those two laws rather than by creating additional statutory language. Congress knew at the time precisely what they would effect by repealing those laws. RPM would become per se illegal. "Per se" is more of a term of the courts, not one usually put into statutes. Prices, which they were told were higher in Fair Trade states, would likely return to competitive rates. Republican President Ford issued a release when signing the repeal (in H.R. 6971):

> As a result, these laws prevent the American people from receiving the benefit of lower prices on cameras, watches, sporting goods, small appliances, auto supplies, and many other brand name products....When this new legislation takes effect..., retailers will again be able to set prices on a more competitive basis, thereby enabling consumers in all 50 States to shop for the best products at the lowest possible prices. . . . As I have been saying since taking office, the best way we can protect the consumer is to identify and eliminate costs, inefficient, and obsolete laws and regulations. Thus, I take particular pleasure in signing this bill for the benefit of the American consumer (Ford, 1975).

The discussions by both the House and Senate in 1975 confirm the intent of the bill. Representative Barbara Jordan moved "to . . . pass the bill (H.R. 6971) to amend the Sherman Antitrust Act to provide lower prices for consumers" (Debate 1975 at 23,658). She later said that "at one stroke, it eliminates vertical price fixing in large segments of the economy." (Note, already some states had repealed their Fair Trade laws and so they already were back under the per se rule against RPM). She said the result of Fair Trade (and RPM) was "artificially high prices to the consumers." She then recognized the direct result of repealing the two laws: after the repeal, RPM, "without the exemption granted by those acts, would be per se violations of the antitrust law" (Debate 1975 at 23,659) and thus not within the rule of reason. She also said that vertical price fixing facilitated horizontal price fixing (Debate 1975 at 23,659). Representative Hutchinson said that "upon enactment of the bill it would be a violation of the Federal Antitrust Act for a manufacturer to set a minimum retail price for any item he makes; that would be price fixing." He also cited studies that showed that for certain goods, prices in fair trade states were 19 to 27 percent higher than in states without such laws (Debate 1975 at 23,659). Representative Van Deerlin said, "What a misnomer, 'fair trade.' No doubt it referred to the benefits of manufacturers and retailers." He estimated that eliminating the "price fixing" would save consumers (depending on the study) $1.5 to $6.5 billion annually (Debate 1975 at 23,661). No one spoke against the bill at that time. On July 21, 1975, the bill passed the House by vote of 380 to 11 (with 43 not voting).

In the Senate, there was virtually no opposition to the bill. In fact, the bill must have passed by voice vote as the specific yeas and nays were not recorded. Senator Brooke announced to the Senate that the bill had been approved unanimously by House and Senate subcommittees, passed overwhelmingly by the House, and endorsed by President Ford (Debate 1975 at 38,049). Again the Senate recognized the consequences of repealing Miller-Tydings and the McGuire Acts. Brooke said, "Without these Federal statutes, these interstate price-fixing conspiracies would be in violation of the most basic of our antitrust laws–the Sherman Antitrust Act. . . ." (Debate 1975 at 38,049-38,050). Senator Brooke recognized studies showing that businesses in fair trade states had lower volume of retail sales compared to those in non-fair trade states (Debate 1975 at 38,050). Senator Brooke mentioned that manufacturers were illegally using the practice to spread RPM illegally into non-fair trade states (Debate 1975 at 38,051). Brooke cited studies again showing that prices were higher in fair trade states (19-27% and as much as 37% on some items). Several studies showed that the laws were costing consumers between $3 billion and $6.5 billion (Debate 1975 at 38,050). Senator Hruska of Nebraska said that fair trade laws have "the effect of eliminating price competition and raising costs to the consumer on numerous commodities." Repealing the law would encourage competition "resulting in a lowering of consumer prices."

If Congressional intent means anything, there can be no doubt what the purpose was for the Consumer Goods Pricing Act. It had nothing to do with wiping the slate clean for the Supreme Court to use new criteria to interpret the Sherman Act. Given the vagueness of the Sherman Act §1, the Consumer Goods Pricing Act is a clear demonstration that Congress intended to affirm the courts' long history of the per se treatment of RPM.

As to the majority's interpretation of *Dr. Miles*, the *Leegin* Court said that the intent behind the decision was to maintain the common law rule against restraints on alienation (resales). In fact, the Supreme Court in *Dr. Miles* looked at the practice under two theories

(1) common law and (2) "the act of Congress of July 2, 1890" (the Sherman Act) (Dr. Miles Medical Co. v. John D. Park and Sons 1911 at 400). It is true that the court in *Dr. Miles* found the practice to be in violation of rules regarding restraints upon alienation. Still the *Dr. Miles* court said that the common law had to be viewed, not under rules centuries old, but in light of the situation of the day : "the public interest is still the first consideration" (Dr. Miles Medical Co. v. John D. Park and Sons 1911 at 406).

The *Leegin* majority believed that the Sherman Act should be interpreted through a common-law like approach. Of course, generally in recent years it has been held that there is no federal common law. However, the Court believed that it has the right to construe the law as it sees fit under statutes where Congress laid down just a broad standard (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007 at 905, citing Texas Industries, Inc. 1981). The *Dr. Miles* Court did not say that the Sherman Act resulted in a common law method of determining legality. The *Dr. Miles* Court did deal with the practice under the Sherman Act. The Court dealt with the language of §1 and said that "agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void. They are not saved by the advantages which the participants expect to derive from the enhanced price to the consumer" (Dr. Miles Medical Co. v. John D. Park and Sons 1911 at 409). This latter sentence goes directly against Professor Bork's broadly expanded idea of "consumer" welfare. Near the end of the opinion, the *Dr. Miles* Court concluded, "The complainant having sold its product at prices satisfactory to itself, the public is entitled to whatever advantage may be derived from competition in the subsequent traffic" (Dr. Miles Medical Co. v. John D. Park and Sons 1911 at 409).

DEVELOPMENTS SUBSEQUENT TO THE *LEEGIN* DECISION

The Supreme Court majority notes at the end of their opinion that the President of Leegin owned a number of retail stores selling Leegin's products. Since this was not argued in the lower courts, it was ignored. According to the brief for Kay's Kloset, the defendant Leegin owned over seventy of its own retailers (Brief of Respondent 2007 at 3). Now, that number may be small as compared with the number of retailers (approximately five thousand). It not only sells through small retailers; it also sells at the giant retailer Nordstrom; it may have formerly sold directly over the Internet, but it does not now. Currently in the Dallas area, Leegin owns 7 out of the 39 retail stores selling its products (Brighton – Store Locator).

However, because those Leegin-owned retailers compete with the plaintiff in the Dallas market, Leegin's setting of prices at the retail level would seem to amount to both vertical and horizontal price fixing (horizontal because retailers are involved in having the retailer-manufacturer set prices). The majority in *Leegin* certainly is not arguing (at least now) to overturn the horizontal per se price fixing rule. And in fact, the dissenters and opponents of RPM have argued that vertical price fixing is often driven by horizontal price fixing interests–which surely should be a matter of concern for those interested in the competitive aspects of our economy.

Has Leegin won this case? After the case was remanded by the Supreme Court, the owners have refiled the case in the federal court for the eastern district of Texas. Their case might have been bolstered with evidence that Leegin owns retail stores and some in the Dallas area and continues to require RPM at independent stores. This means that the case involves not only vertical price fixing with retailer involvement but also horizontal price fixing. Two central questions are: should this count as per se horizontal price fixing, and should it count as illegal vertical price fixing instigated by retailers, a practice warned of as being anticompetitive by the majority under the rule or reason? But the trial court in 2009 again ruled that this evidence could not be introduced since it was not introduced at the original trial (PSKS, Inc. v. Leegin Creative Leather Products, Inc., 2009 U.S. Dis. LEXIS 28505, at 15, E.D. Tex., 2009).

A manufacturer's selling at the retail level and also to independent retailers is known as dual distribution. When the manufacturer sets the retail price, it would appear to be both vertical and horizontal price fixing. Clearly the manufacturer benefits from the higher prices at the retail level and does not have to compete on price with its independent retailers. In one 1956 Supreme Court case *United States v. McKesson*, McKesson was a drug manufacturer that also acted as a wholesaler of its products. McKesson also sold them to independent wholesalers and then set the price for the wholesalers. The Supreme Court found this to be a per se violation of the Sherman Act. This of course was during the fair trade era, but the court found that the two fair trade laws did not apply to horizontal restraints on price (United States v. McKesson & Robbins, Inc.1956 at 315).

It does appear that more recently some lower courts and commentators are thinking that vertical restraints under dual distribution should be rule of reason cases despite the appearance that in dual distribution there is both a horizontal effect and agreement (Banks 1995 at 6-5 §6.01). Of course that doesn't necessarily make them legal.

Leegin may argue that Leegin is the one instigating the vertical price fixing, trying to take it out from the *Leegin* majority's wariness of retailer-instigated RPM. But even if Leegin instigated it alone, Leegin's dual role as a retailer would seem to back it into the horizontal price fixing area (which of course is even worse). But again, with a lack of such evidence at the first trial, PSKS's attempt to retry the case was dismissed (PSKS, Inc. v. Leegin Creative Leather Products, Inc., 2009 U.S. Dis. LEXIS 28505, at 15, E.D. Tex., 2009).

Another class action suit against Leegin was scheduled for a jury trial scheduled on July 14, 2008 in Kansas under Kansas antitrust law (*Lindsay Hall v. Leegin Creative* in Sedgwick Co, Kansas). However, the trial judge granted a summary judgment for the defendants; the plaintiffs plan an appeal (Wilson, 2008, July 15). Minimum resale prices are also a central issue in Babyage.com, Inc., v.Babies "R" US, Inc., and so far it has survived a motion to dismiss (2008). This is part of a class action law suit against five other manufacturers, as is indicated in the Wall Street Journal (Pererira 2009, July 16). In October 2009, the Federal Trade Commission announced that it would investigate whether the company was stifling discounts (Pereira 2009, October 17-18).

States have their own antitrust laws. While usually state law tracks federal antitrust statutory and case law, the states are not bound to do so. About half the states' statutes are the same or virtually the same as the Sherman Act, and those courts will likely follow the *Leegin* decision. In other states, the statutory language may be different and thus the outcome may be less certain. A number of states (such as Hawaii (2006), Connecticut (2007), and Kansas (2006)) have laws that appear to prohibit all forms of price fixing (Lindsay 2007, Fall). In California, the Cartwright Act (1990) prohibits combinations that increase or fix the price to the public or consumer, and the California Supreme Court has ruled that minimum RPM is per se illegal under this law, although it tends to give deference to federal law (Mailand v. Burcle 1978); still the language of the California statute would seem to make it difficult to find RPM legal (Cartwright Statute § 16720(b), §16720(d), §16720(e)(3) 1990). New York (2007) has a statute that makes RPM agreements unenforceable though not technically illegal. New Jersey (2007) has a similar law though it also says that its laws should be construed to be in harmony with federal laws "insofar as practicable."

Other activity is occurring. The Nine West Group, one of the country's largest supplier of women's shoes, sought to reverse a 2000 FTC consent decree forbidding Nine West from engaging in vertical price fixing. This was based on the *Leegin* case. In May 2008, the FTC modified but did not completely rescind its order. The modified order allows Nine West to use RPM, because Nine West did not appear to have substantial market share and claimed that the impetus for the RPM was from the company itself and not from its retailers. However, the FTC required that Nine West report within one, three, and five years from the order on the company's "use of RPM and its effect on its prices and output." The agency wants Nine West to demonstrate that the practice is pro-competitive. The agency agreed that the company may not be able to provide such evidence immediately since it had been prohibited to engage in RPM (Federal Trade Commission 2008).

An interesting Third Circuit opinion was issued in June 2008 that deals with the post-*Leegin* landscape: *Toledo Mack Sales & Service, Inc. v. Mack Trucks*. Toledo Mack was a local retailer of Mack Trucks. After Toledo Mack was discontinued by Mack, it sued

Mack for a violation of §1 of the Sherman Act and several other claims. The District Court of the Eastern District of Pennsylvania issued a summary judgment for the defendant on both antitrust claims. The Third Circuit remanded the Sherman Act claim. It found substantial evidence of a conspiracy among Mack dealers to restrain competition and evidence that Mack, the manufacturer, was actively involved in trying to restrain Toledo from discounting. It also found substantial evidence that other dealers were instigating the practice. The manufacturer was involved also in not giving assistance to Toledo (that it was giving to other dealers) because of Toledo's aggressive marketing and discounting.

The Third Circuit recognized that after *Leegin*, a vertical restraint would need to be judged under the rule of reason (even though it was being used to support a horizontal restraint among dealers that could be per se illegal). The Third Circuit noted that the *Leegin* decision specifically instructed the lower courts to deal more harshly under the rule of reason standard with cases where the vertical restraint was instigated by retailers. Specifically, the *Leegin* majority said that under the rule of reason "courts would have to be diligent in eliminating their anticompetitive uses" and also said, "The source of restraint may also be an important consideration. If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restrain facilitates a retailer cartel…"

Congress may also take action. On July 31, 2007, Senator Herb Kohl presided at a hearing before the Subcommittee on Antitrust, Competition Policy and Consumer Rights, of the U.S. Senate's Judiciary Committee (The Leegin Decision: The End of the Consumer Discounts 2007). Senator Kohl had formerly worked at his family's Kohl's Department Stores, which experienced loss of product lines when it "sold at prices lower than what the manufacturer and [its] rival retailers wanted" (The Leegin Decision: The End of the Consumer Discounts 2007, at Opening Statement).

The witnesses explained the complexities of RPM in practice (The Leegin Decision: The End of the Consumer Discounts 2007, List of Witnesses). Janet McDavid, a former Chair of the American Bar Association's Antitrust Section, testified that manufacturers, in order to safely use the *Colgate* doctrine, will often distort their interactions with their retailers and will avoid counseling the retailers on pricing policy, to avoid creating any evidence of an agreement with the retailer about price levels. That way, the manufacturer can use the *Colgate* exception to terminate a retailer who charges low prices. But this is managerial dysfunction, with retailers being directed to communicate with the manufacturer's house counsel rather than its marketing department (The Leegin Decision: The End of the Consumer Discounts 2007, at Statement of Janet McDavid).

The *Leegin*'s decision indicated that, within the rule of reason, the federal courts can be attentive to problematic RPM situations:

> Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones (Leegin Creative Leather Products, Inc. v. PSKS, Inc. 2007, at 898-99).

Testifying before the Senate's Subcommittee, FTC Commissioner Pamela Harbour argued for such decision structures within a restored general per se illegality for RPM

> I am willing to concede that it makes sense to have a modified per se rule, and to allow a respondent to rebut the presumption of illegality. But the respondent should bear the burden of proof, and should be required to introduce sufficient factual evidence to demonstrate why a particular restraint is necessary in a specific market. For example, a restraint might be needed to cure an identifiable market failure that could not be cured by less restrictive means - provided, of course, that the net benefit to consumers would outweigh the presumptive harm (The Leegin Decision: The End of the Consumer Discounts 2007, at Statement of Pamela Harbour).

and Robert Pitofsky also said at the hearing:

> We have exceptions for new entrants in other areas of per se illegality. Why not here? . . . we could do what we did with horizontal price fixing and have what is called a ``BMI preliminary." The defendant has to explain to the court in a quick look why it deserves rule of reason and not per se treatment, and only after that will the court give rule-of-reason treatment (The Leegin Decision: The End of the Consumer Discounts 2007, at Statement of Robert Pitofsky).

On October 30, 2007, Senators Kohl, Biden and Clinton introduced a Discount Pricing Consumer Protection Act aimed at requiring the courts to restore per se illegality for RPM. If consumers would find all sellers quoting the same prices on differentiated goods of importance to them, pressure could build on a new Administration to press for investigation of egregious examples. If the courts would not apply the rule of reason to such cases in a way that protects consumers, then support for a bill like the Discount Pricing Consumer Protection Act could grow. With the Congressional leadership having changed in 2009, the prospects for a bill like this appear to be growing.

In December 2008, a front page article in the Wall Street Journal reported that a group of discount sellers including eBay and Costco called on Congress to overturn *Leegin.*

The article reported that new businesses had sprouted up (such as NetEnforcers) to help some of the top manufacturers (Sony, JVC, Kenwood, Black and Decker, etc.) scour "hundreds of thousands of Web sites" looking for discounting of manufacturers' products. This allows the manufacturers to police retailers into not discounting below certain levels (Joseph Pereria 2008, Dec. 14.) Another report prior to Christmas 2008 indicated why there was no discounting for certain popular toys: manufacturers setting minimum prices (Pereria 2008, Dec. 24, at D1)

CONCLUSION

The *Leegin* majority may be right that there are some occasions where RPM produces a more efficient result. The dissenters question whether there are enough of those cases to overturn a long standing per se rule and mention that there could be exceptions. (As sacrosanct as the per se rule involving horizontal price fixing per se rule is, there are exceptions for that—for example the *BMI/ASCAP* case) (Broadcast Music Inc v. CBS 1979).

This article has maintained that the purpose of the Sherman Act was not necessarily to maximize allocative and productive efficiency–ideas that economists would later make popular. Nor was the Sherman Act, as vague as it admittedly was, a blank slate. Clearly Congress had in mind certain goals–goals which can be ascertained by reading their debate in the Congressional Record. Still, even if one accepts the "blank slate-common law–use the latest economic theory of efficiency" argument, it is difficult to get around the straightforward Congressional intent of the Consumer Goods Pricing Act of 1975: resale price maintenance was to be outlawed and put back in the category of per se violations.

It is ironic that despite the 1975 bipartisan bill that promoted price competition (and the New Deal's past that questioned its importance), the conservative majority in *Leegin* established a rule of reason which will allow more instances of RPM, to the diminishment of consumer benefit from price competition; on this outcome, Judge Bork, the *Leegin* majority and Justice Brandeis would see eye-to-eye.

Perhaps, the one saving element to the decision is that consumers might find that most companies in today's economies will be loathe to use RPM. Given the nature of competition and the use of the Internet, price will still be "King"–at least for the most part. Still producers of differentiated products, ones for which there are few competitors, (such as those of Leegin's Brighton line) may still use RPM; customers, for better or worse, will be stuck with higher prices if they want to buy those products. Thus the majority in *Leegin* has accomplished three things: it enabled higher prices for certain goods; it overturned a nearly one-hundred-year-old precedent that was actively relied upon by litigants and by Congress; and it ignored the clear congressional intent of the 1975 Consumer Goods Pricing Act. Those who oppose judicial activism may well find it in the *Leegin* decision.

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CONSUMER CREDIT: THE NEXT SHOE TO DROP OR A BULLET DODGED?

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ABSTRACT

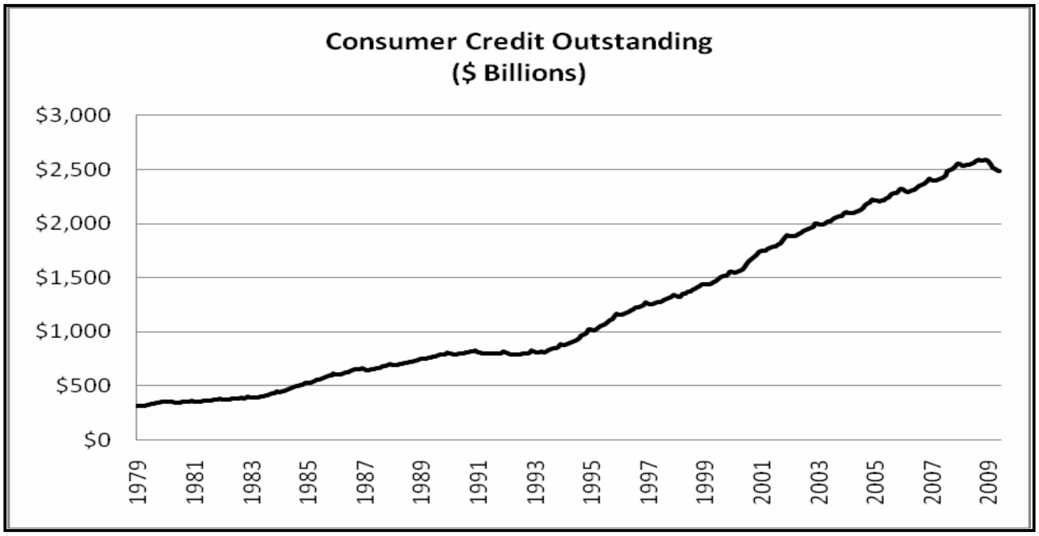
This research examines consumer credit outstanding and considers the benefits and risks to the various market participants in light of the financial crisis. The implications of recent regulatory changes regarding consumer credit are also considered. We conclude that there is a substantial risk to financial markets resulting from the amount of outstanding consumer credit in this economy. In addition to the widely recognized risk associated with consumer loans backed by real estate (home equity loans and lines of credit), credit card debt could experience significant defaults.

INTRODUCTION

The amount of consumer credit outstanding has increased substantially over the last 30 years as American consumers have increased their use of credit. According to the Federal Reserve Board, consumer credit outstanding increased more than eight-fold from $310 billion in January 1979 to $2,592 billion in December 2008.

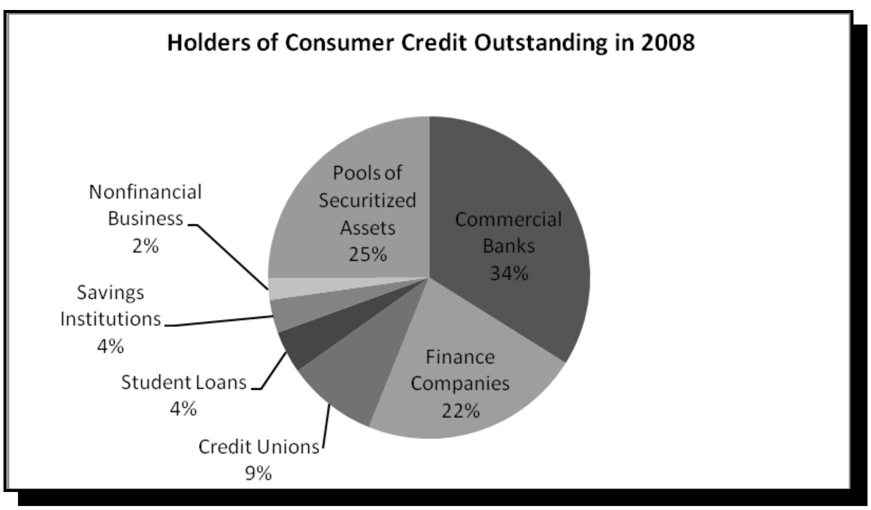
Figure 2 shows that consumer credit is held by several different types of financial institutions and businesses, as well as sold to investors in securitized issuances. Commercial banks are the largest holders of consumer credit, with $878.6 billion or 34% of consumer credit outstanding at the end of 2008. The second largest amount of consumer credit outstanding is held as pools of securitized assets, with $650.0 billion or 25% of consumer credit outstanding held by investors. Finance companies follow with $575.8 billion or 22% of consumer credit outstanding. The remaining 19% of consumer credit outstanding is held by credit unions (9%), student loans (4%), savings institutions (4%), and nonfinancial businesses (2%). This research examines consumer credit outstanding and considers the benefits and risks to the various market participants in light of the financial crisis, as well as the implications of recent changes in policy and regulation regarding consumer credit and financial institutions.

Figure 1



Source: Board of Governors of the Federal Reserve System

Figure 2.



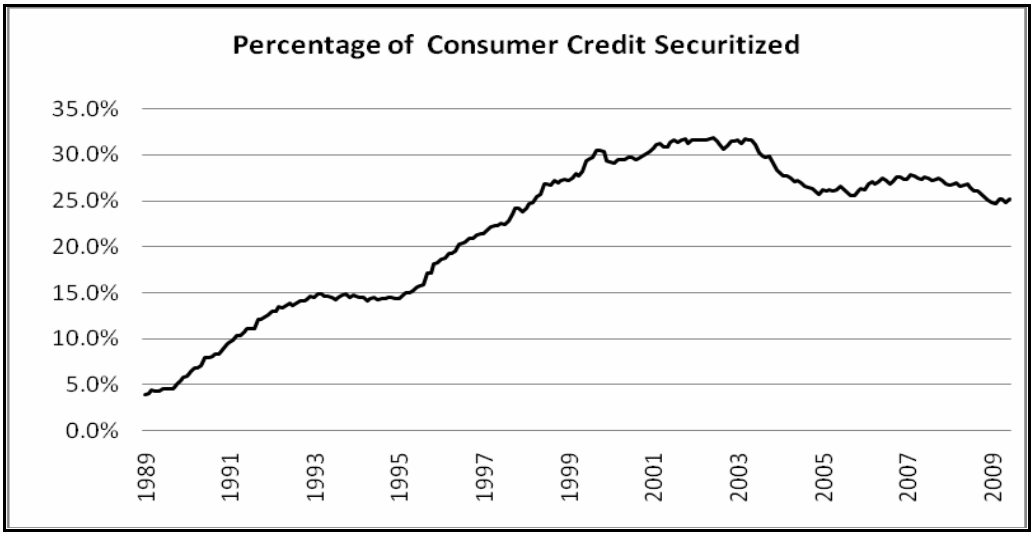
Source: Board of Governors of the Federal Reserve System

SECURITIZATION OF CONSUMER CREDIT

The large increase in consumer credit outstanding has been facilitated by the securitization of consumer credit. In 1985, auto loans were the first type of consumer credit to be securitized when Solomon Brothers sold $60 million of securities backed by auto loans that were originated by Marine Midland Bank (Greenbaum and Thakor, 2007 pg. 360). The securities were known as Certificates of Automobile Receivables (CARs). The following year, Solomon Brothers continued innovating by purchasing $50 million in credit card receivables from Banc One and selling Certificates for Amortizing Revolving Debts (CARDs) that were backed by the credit card receivables. Securitization of consumer credit has proliferated over the subsequent years. Securitization of consumer credit has benefited both lenders and borrowers. When consumer loans and other types of consumer credit are removed from the asset side of the balance sheet through securitization, financial institutions are relieved of the burden of maintaining sufficient capital relative to the assets thus removed. As a result of the liquidity provided to financial institutions through securitization, credit has been more readily available to American consumers. Securitization has also provided additional investment options for the investment community. The percentage of consumer credit that is securitized grew rapidly over the years until the late 1990s and reached its peak in June 2002 with 31.8% of total consumer credit outstanding securitized. The growth in the securitization of consumer credit coincides with the explosion of mortgage securitization noted by Wegman (2008). Since then, the percentage of consumer credit that is securitized has fallen to 25.2% in June 2009. The financial securities that are created through securitization are generally referred to as asset backed securities (ABS).

The types of consumer credit that are most commonly securitized are home equity loans and lines of credit, credit card receivables, auto loans, and student loans. Figure 4 shows the growth in the various types of securitized consumer credit over time. In 2004, the amount of securitized home equity loans (HELs) and home equity lines of credit (HELOCs) outstanding surpassed that of securitized credit card receivables, as consumers borrowed against the rising values of their homes. HELs and HELOCs now constitute the largest portion of securitized consumer debt, with $395.5 billion outstanding at the end of 2008. Both HELs and HELOCs offer the advantage to borrowers that interest on the loan is generally tax deductible. HELs are term loans that are amortized over the life of the loan. In contrast, HELOCs are a type of open-account credit that allows consumers to borrow at will, make payments, and continue to borrow additional amounts up to their credit limits. HELOCs are similar to credit cards and are typically classified as revolving credit, although some are partially amortizing.

Figure 3



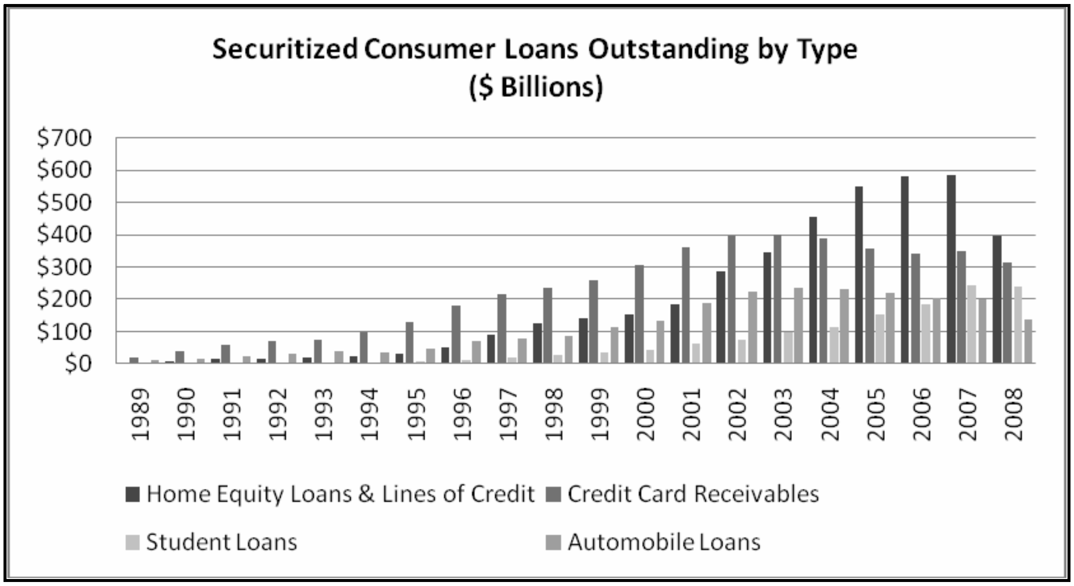
Source: Board of Governors of the Federal Reserve System

Credit card receivables are the second largest category of securitized consumer debt, with $314.1 billion outstanding at the end of 2008. Credit cards are a type of open account credit that allows consumers to borrow at will, make payments, and continue to borrow additional amounts up to their credit limits. Credit card debt is classified as revolving rather than amortizing because the payments do not include a regularly scheduled reduction of principal and consequently no set term.

Student loans are now the third largest category of securitized consumer debt, with $239.5 billion outstanding at the end of 2008. Most student loans are government guaranteed, so investors in student loan asset backed securities (ABS) are generally assured of receiving payment. However, the segment of uninsured student loans is growing. Student loans have scheduled payments that systematically reduce principal, so they are classified as amortizing or nonrevolving credit.

Auto loans fell to fourth place behind student loans in 2007 in terms of outstanding ABS. At the end of 2008, $137.7 billion of auto loans ABS were outstanding. Auto loans are amortizing term loans, and classified as nonrevolving credit. The auto loans that are securitized are primarily prime loans, made to borrowers with strong credit histories (An Investor's Guide to Asset-Backed Securities, page 5).

Figure 4



Source: Securities Industry and Financial Markets Association

RISKS TO THE US ECONOMY

The large amount of consumer credit outstanding represents a potential risk to the US economy, particularly in light of the uncertain economic forecast and the drop in housing values. At the end of 2008, consumer debt represented 17.9% of GDP, down slightly from its peak of 18.4% in 2003 (Federal Reserve Board). With the rise in unemployment, delinquency and default among consumers is an increasing concern. National unemployment stood at 9.7% in August 2009, a 26-year high. In addition, the average duration of unemployment in August 2009 was 25.1 weeks, compared to 17.6 weeks in August 2008 (Bureau of Labor Statistics). The number of people unemployed for 27 weeks or more rose to 5,061,000 in August 2009 (Bureau of Labor Statistics). Estimates indicate that half a million people will exhaust their unemployment benefits in September 2009 and 1.5 million more individuals will exhaust their benefits by the end of 2009 (Owens, 2009). As American households are pressured financially though job loss, pay cuts, and forced furlough days (Belkin, 2009), the borrower's ability to meet payment obligations is an open question.

Figure 5 shows the US Civilian Unemployment Rate from January 1989 to July 2009, with recessions shaded in gray. For both the 1990-91 and the 2001 recessions, unemployment continued to rise for more than a year after the recessions ended. The 1990-91 recession lasted from July 1990 through March 1991, with unemployment peaking 15 months later in June 1992 at a rate of 7.9%. Similarly, the recession in 2001 lasted from March through November, and unemployment reached its high of 6.3% in June 2003, 19 months after the recession ended. This pattern of a significant lag in unemployment did not exist for the nine recessions that occurred from 1945 to 1982, when unemployment peaked an average of three months after the end of the recessions. Whether the more recent pattern continues is a question of great interest due to the implications for both social welfare and national economic wellbeing.

Figure 5

Sources: Bureau of Labor Statistics and National Bureau of Economic Research

As bank failures mount, lenders have worked aggressively to shore up their balance sheets. Gupta and Riese (2009) note that banks have pared almost $1 trillion from credit lines to limit their risk. Mark Zandi, chief economist of Moody's Economy.com, analyzed 7.5 million credit files provided by Equifax Inc. (Simon and Ford, 2009). He reports some signs of improvement, but also reasons for concern. His analysis shows the number of mortgage and consumer debt payments that were 30 and 60 days past due is falling, suggesting the number of delinquencies could fall within the next year. However, the number of delinquencies and defaults is expected to continue to rise, as consumers who are 30, 60, or 90 days past due work through the system. In June 2009, the delinquency and default rate stood at 10.0%, up from 8.01% in December 2008. Because of the deterioration in the credit markets, the Federal Reserve Bank of New York developed a more robust web site to provide factual information on consumer credit conditions (Girardin, 2009). The web site provides maps of the U.S. with delinquency information on auto loans, credit cards, student loans, and mortgages, as well as some information on bankruptcy.

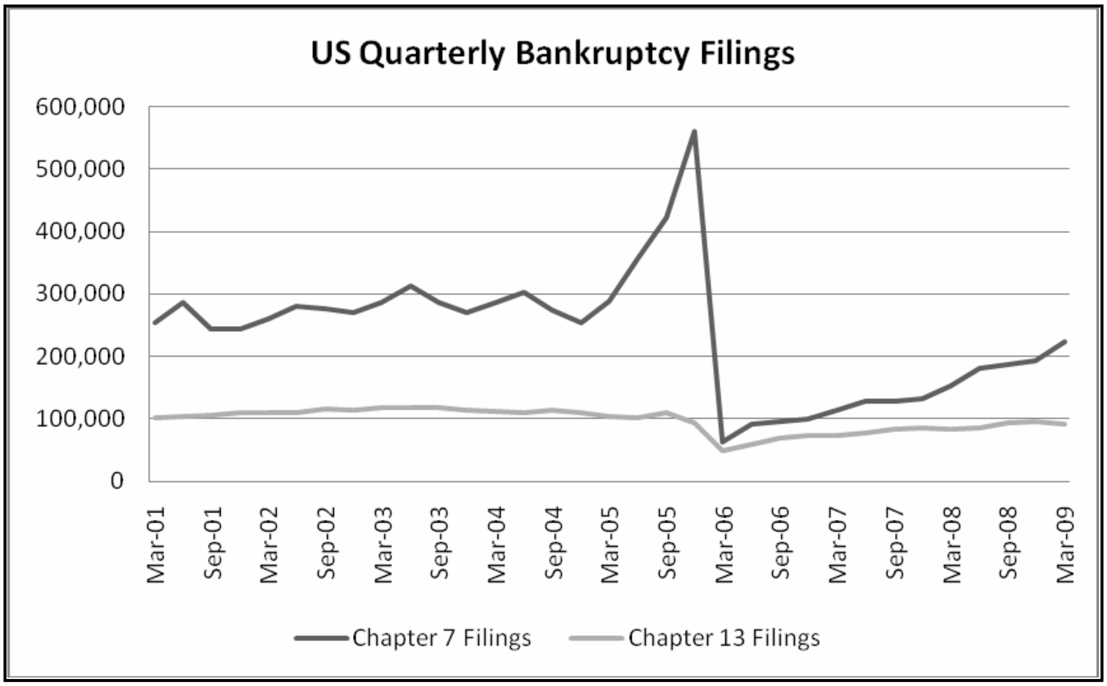
Research shows a strong correlation between several measures of consumer credit outstanding (including total, revolving, and nonrevolving credit) and consumer bankruptcy filings (Tabb, 2006). The relation between the various debt measures and bankruptcy filings is examined using concurrent year data, and with one and two year lags applied to the bankruptcy filings. Evidence shows positive, statistically significant correlations for all three cases, and particularly strong correlations with the 2-year lagged bankruptcy filings. Thus a time lag exists as consumers in the aggregate borrow large amounts, become delinquent, default and file bankruptcy. Other research shows that consumers with credit card debt are more likely to file for bankruptcy than consumers without credit card debt. In addition, higher levels of credit card debt are correlated with higher bankruptcy filings in the following year (Levitin, 2008).

Personal bankruptcy filings increased in July 2009 to 126,434, the highest monthly level since the Bankruptcy Abuse and Consumer Protection Act of 2005 took effect on October 20, 2005 (Trejos, 2009). One purpose of the Act was to reduce the total number of personal bankruptcy filings. Another purpose was to shift debtors from filing under Chapter 7 of the Bankruptcy Code to Chapter 13 (Evans and Lewis, 2008).

The “means test” in the Act precludes debtors with income above the median for their states from filing under Chapter 7 of the Bankruptcy Code. Chapter 7 allows the debtor to obtain a discharge of most types of debt incurred prior to filing without the obligation of associated future debt payments, as long the debtor relinquishes all non-exempt assets owned at the time of filing. Under a Chapter 13 filing, the debt is restructured and the debtor must repay at least a portion of the debt owed at the time of filing. The debtor is not required to relinquish any non-exempt assets, but a portion of the debt owed is often charged off by the lender under Chapter 13.

The “great recession” that developed out of the subprime debt crisis has placed additional pressure on household finances as a result of layoffs, pay cuts, forced furlough days and unemployment. Evans and Lewis (2008) analyze state level bankruptcy data between the fourth quarter of 1995 and the fourth quarter of 2006. As part of their analysis, they study the effects of economic factors on the number of bankruptcies. Their results show that a 1% increase in the rate of unemployment leads to an average increase of 320 bankruptcies per quarter per state. Evidence also shows that a drop of $1,000 in per capita income increases the average number of bankruptcies per quarter per state by 133. In addition, consumers whose income stream is interrupted by unemployment are frequently unable to service their debt and thus seek bankruptcy protection (Levitin, 2008). The question then becomes what does an increasing unemployment rate portend for the holders of consumer credit?

Figure 6



Source: U.S. Courts Bankruptcy Statistics

The drop in housing values adds to consumers' problems. Those who lose their jobs may be unable to find work without moving to a different area. However, people are frequently unable to sell their homes for a large enough value to cover their mortgages. Lang (2009) reports that 8.8 million people in the U.S. are upside down in their mortgages. Thus short sales and charge-offs on HELs and HELOCs are commonplace in today's challenging economic environment.

EFFECT OF THE BANKRUPTCY ABUSE AND CONSUMER PROTECTION ACT OF 2005

To consider the effect of an increasing unemployment rate on consumer credit, we must take into account recent regulatory changes. The process by which a consumer debtor seeks relief through bankruptcy was restructured by the Bankruptcy Abuse and Consumer Protection Act of 2005. Using the "means test" described above, the Bankruptcy Court determines if a consumer is eligible for a Chapter 7 or "straight" bankruptcy filing, under which the bankruptcy trustee liquidates the filer's non-exempt assets to pay his debts, a process which almost universally yields pennies on the dollar for creditors. Thus creditors of consumers who proceed through Chapter 7 bankruptcy seldom see any significant recovery. Consumers who are not eligible for a Chapter 7 discharge are forced into a Chapter 13 debt reorganization. Under Chapter 13, the consumer's debt is not discharged, but rather it is typically restructured and the principal if often reduced.

For consumers who are forced into Chapter 13 reorganizations, their debt remains on the books of the debt holders based on the expectation of payment by the debtors. Only the reduction in the debt is charged off by the lender at that time. It is obvious that such a result has a far less adverse impact upon the value of the debt than a full discharge of the debt under a straight Chapter 7 discharge. However, Evans and Lown (2008) indicate that only about one third of Chapter 13 filers complete their repayment plans. Thus forcing reluctant debtors into Chapter 13 bankruptcy might only delay charge-offs.

The rising unemployment rate will also play a significant role in the performance of consumer credit outstanding. As noted above, unemployment is highly correlated with bankruptcy filings. Under conditions of full employment, more consumers seeking relief from consumer debt would meet the "means test" and thus their debt would be restructured under Chapter 13. On the other hand, under conditions of high unemployment, more consumers who file bankruptcy will qualify under the "means test" for Chapter 7 bankruptcy by virtue of their loss of wages (Levitan, 2008). The situation is exacerbated by the increasing duration of unemployment and the probability that workers will exhaust unemployment benefits before finding employment. Thus, a portion of consumer debt will be worthless, or to use the popular jargon, "toxic". The impact of a substantial increase in uncollectible consumer debt on the financial markets and the US economy remains to be seen.

EXPECTED EFFECT OF THE CREDIT CARD ACT OF 2009

The passage of the Credit Card Accountability Responsibility and Disclosure Act of 2009 enacted major change in the regulation of credit cards. The Act has been heralded for its new and sweeping regulation of credit card lenders. The relevant question for lenders and investors in securitized credit card debt is the effect of this Act on consumer credit. The answer lies in the focus and purpose of the legislation.

The Credit CARD Act was a response to perceived unfair practices of credit card companies. As a result, the Act primarily addresses the protection of consumers from practices such as short billing cycles, double cycle billing, and application of payments to the balance having the lowest interest rate. The Act also requires credit card issuers to offer cardholders the option of a fixed credit limit that cannot be exceeded, thereby precluding over-limit fees for those borrowers. Several types of fees are limited or prohibited. Thus the Act can be expected to reduce the charges and fees collected by credit card lenders. The only limitation on cardholder freedom contained in the Act comes in Title III, Protection of Young Consumers, wherein the extension of credit to persons under age 21 is prohibited, unless specific conditions are met.

In summary, the Act addresses some perceived unfair practices of the credit card industry. However, it does not attempt to address or control the large amount of consumer credit card debt outstanding. Thus the Credit Card Accountability Responsibility and Disclosure Act of 2009 is not expected to significantly affect the availability of credit. However, the profitability for lenders will probably be somewhat reduced.

SUMMARY AND CONCLUSIONS

This research examines consumer credit outstanding and considers the benefits and risks to the various market participants in light of the financial crisis. We find that substantial risk exists for market participants as a result of high unemployment, which is strongly correlated with consumer default. In addition, record numbers of unemployed are projected to exhaust their unemployment benefits before finding work. We conclude that there is a substantial risk to financial markets resulting from the amount of outstanding consumer credit in this economy.

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