Volume 6, Number 2 **ISSN 1544-0036**

JOURNAL OF LEGAL, ETHICAL AND REGULATORY ISSUES

An official Journal of the
Allied Academies, Inc.

Sarah Pitts, Co-Editor
Christian Brothers University

Aileen Smith, Co-Editor
Stephen F. Austin State University

Academy Information
is published on the Allied Academies web page
www.alliedacademies.org

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Whitney Press, Inc.

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

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JOURNAL OF LEGAL, ETHICAL AND REGULATORY ISSUES

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LETTER FROM THE EDITORS

Welcome to the *Journal of Legal, Ethical and Regulatory Issues.* This journal was formerly named the *Academy for Studies in Business Law Journal*. It is owned and published by the Allied Academies, Inc., a non profit association of scholars whose purpose is to encourage and support the advancement and exchange of knowledge, understanding and teaching throughout the world. The *JLERI* is a principal vehicle for achieving the objectives of the organization. The editorial mission of this journal is to publish empirical and theoretical manuscripts which advance understanding of business law, ethics and the regulatory environment of business.

We changed the name of the journal to better reflect our broader mission. Readers should note more clearly now that our mission goes beyond studies involving business law or the effect of legislation on businesses and organizations. We are also interested in articles involving ethics. We would like to publish more manuscripts dealing with the ethical environment, business ethics and the impact of ethics on organizations and businesses. In addition, we invite articles exploring the regulatory environment in which we all exist. These include manuscripts exploring accounting regulations, governmental regulations, international trade regulations, etc., and their effect on businesses and organizations. Of course, we continue to be interested in articles exploring issues in business law.

The articles contained in this volume have been double blind refereed. The acceptance rate, 25%, conforms to the Allied Academies' editorial policy.

Please visit the Allied Academies' web page to learn how to submit manuscripts for review as well as to view details of forthcoming conferences. We invite your comments and suggestions at any time. Please send these to info@alliedacademies.org.

Sarah Pitts
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Stephen F. Austin State University

www.alliedacademies.org

LEGAL ISSUES

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THE EVOLUTION OF ONLINE PRIVACY: 2000 - 2003

Sandra McKay, Southeastern Louisiana University

ABSTRACT

Prior to the terrorist attacks on the World Trade Center and the Pentagon, Congress and the courts were backing demands for greater accountability and restraint from online companies and law enforcement agencies over wiretapping and other intelligence-gathering activities. The FTC conducted investigations exposing some online data-gathering companies of misuse of consumer information, brought privacy-invasion lawsuits against others for selling personal information, and called on Congress to more rigorously protect consumers through laws that establish standard practices for the collection and use of online information. As a result, by September 11, an abundance of Internet privacy bills were floating around Congress.

In a national crises atmosphere of fear, paranoia, and patriotism in the wake of September 11, the momentum that had been tilting toward more effective online consumer protection was instantly reversed. Understandably, public opinion, as well as governmental priorities, over the balance of individual rights and national security, shifted dramatically. Internet privacy bills have taken a backseat to a spate of bills, some already passed into law, that focus on allowing the government greater liberty to use surveillance technology, including Internet wiretaps

In fear of terrorism and war, are Americans allowing too much power and authority without little oversight or accountability? This paper traces the direction of regulatory activities with regard to Internet privacy over the last several years.

INTRODUCTION

The Internet dramatically increased the amount of data that can be collected about individuals, simultaneously increasing the potential to invade information privacy. In the years immediately preceding the terrorist attacks on the World Trade Center and the Pentagon, Internet privacy was a volatile issue. Public disclosure regarding the collection and misuse of personal data by some online companies heightened user concern. Privacy advocates, human rights groups, and government regulatory agencies were pushing for stringent privacy protection measures. The debate focused primarily on tracking and data-compilation technologies widely used on the Internet without users' knowledge or consent. The controversy prompted both the industry and Congress to take action. The industry took steps toward self-regulation, while Congress introduced a plethora of bills designed to protect consumer online information.

The tragic events of September 11 softened both public and government commitment to privacy. The administration's position changed from protecting online information to obtaining the ability to access online information. Congress postponed the legislative agenda to work on anti-terrorism legislation. The Federal Trade Commission reversed its stance advocating tough new laws regulating online privacy to better enforcement of existing regulations and letting the industry police online activities.

The purpose of this paper is to trace the direction of activities, including regulations and proposed regulations with regard to online information privacy, over the last few years. Specifically, the paper discusses government activities before the terrorist attacks as well as the impact of that event on regulatory actions.

ISSUES AND ACTIVITIES PRIOR TO 9/11

Internet privacy issues revolved around tracking devices, such as cookies and Web bugs, and data aggregation. A cookie is a piece of information created by a Web server, and then written to a user's hard drive (Eichelberger, 2000). Web bugs are invisible gifs-transparent pictures that are placed on Web pages to more easily track page usage and returning users (Teinowitz, 2001a). Both cookies and Web bugs are embedded without a user's knowledge or consent. DoubleClick, the largest online marketing firm, has agreements with over 11,000 Web sites, maintains cookies on 100 million users, and has placed Web bugs on over 60,000 different Web pages, each linking to hundreds of pieces of information about a user's browsing habits. Yahoo can track a single user across 4,000 merchant sites within its cybermall (Bicknell, 1999).

Data compilation technologies provide ways to combine data from multiple channels and construct rich customer profiles. Common practices online involve combining cookie-derived data (e.g., sites visited and purchases made) with other information (e.g., demographic and psychographic data); matching online data with offline purchasing data; and collecting buying patterns from multiple and disparate Web sites, passing standard customer information from vendor to vendor. Predictive Networks uses artificial intelligence technology to track actual behavior to create user profiles, compiling precise targeting and specifications (Schaefer, 2001). Acxiom, the world's leading information management and direct marketing support provider, matches online data with offline data through a product called AbiliTec. The program can narrow down buying information for individual users and is so accurate that it can recognize consumers who change their maiden names and customers with multiple addresses and credit cards (Briody, 2000). The Customer Profile Exchange provides a way to collect user data across Web sites.

Public exposure of online tracking and data aggregation practices led to a number of investigations and lawsuits initiated by the FTC, as well as complaints by privacy advocacy groups. When DoubleClick purchased Abacus Direct Corp. in early 2000 and announced plans to merge the Abacus database of offline names and purchasing habits with its own cookie-derived information,

it fueled the fire for Internet privacy. Abacus, a direct-marketing services company, maintained a database of names, addresses, and offline retail purchasing habits compiled primarily by sharing relationships with catalog and direct mail marketers. Abacus' repository contained 2.9 billion transactions linked to individual consumers from 90% of American households (Rodger, 2000). Attorneys general representing ten states inquired about DoubleClick's practices of collecting and using data from and about online users. The states were concerned about merging non-personally identifiable information with personally identifiable data. The FTC initiated an investigation of the company, concerned about possible violations of DoubleClick's existing privacy policy that guaranteed observed data collected about users' activities would never be linked directly to individual consumers. The Center for Democracy and Technology staged an organized protest against the company accusing DoubleClick of using its relationships with other Internet companies to track online activities of individuals, then merging that data with those individuals' offline activities. DoubleClick was also a defendant in a number of class action suits aimed at forcing the company to stop using Web bugs and to let people see and correct information about them (Buchholz & Rosenthal, 2002). The brouhaha put enough pressure on DoubleClick to make it reverse course and drop its plan to merge the two databases (ADoubleClick Caves . . .@ 2000).

Other online companies also faced investigations and lawsuits. For example, Amazon.com and its Alexa Internet software subsidiary were subjected to several privacy-invasion lawsuits and an FTC inquiry (Tynan, 2000). And America Online became the target of a class action suit that accused its Netscape subsidiary of using the software program, SmartDownload, to eavesdrop and secretly track downloads of .exe and .zip files.

The most publicized event was probably the FTC suit against Toysmart.com, the failed online retailer of children's toys, to block the company from selling its 200,000-customer database as part of its assets. The lawsuit stemmed from the fact that Toysmart.com had a privacy policy that promised "personal information voluntarily submitted by visitors to our site, such as name, address, billing information, and shopping preferences, is never shared with a third party." The FTC's position was that even a bankrupt company must abide by their promise to protect the privacy rights of their customers. The FTC and Toysmart.com reached a settlement in the case that forbids the sale of customer information except under very limited circumstances, such as to a similar business (Joyce, 2000). However, a U.S. bankruptcy judge declined to approve the agreement (Naraine, 2000). Toysmart continues to face separate suits filed by 45 state attorneys general and consumer groups for trying to sell information it promised it would never sell. Further, the FTC has filed an amended complaint in Massachusetts, the home base of Toysmart, charging the defunct company of collecting personal information from children in violation of the Children=s Online Privacy Protection Act of 1998 (Jarvis, 2001a). In addition to Toysmart, two other failing Internet companies--Boo.com and CraftShop.com--were discovered trying to sell customer information such as phone and credit card numbers, home addresses, and data on shopping habits (Rosen & Bacheldor, 2000).

The privacy firestorm prompted many online companies not only to review existing privacy policies but also to establish privacy boards and to develop online privacy guidelines. Microsoft's Expedia posted a new policy clearly stating that it would not sell customer information even if the company fails (Rosen, 2000). Other online companies, such as Amazon.com and eBay Inc, went in the opposite direction and posted notices reserving the right to sell customer data as business assets (Rendleman & Rosen, 2001). DoubleClick created a privacy board and hired a chief privacy officer, as did Excite@Home. Groups such as the Online Privacy Alliance and the Network Advertising Initiative met with the FTC to develop alternative methods of user protection and the Internet Advertising Bureau developed a set of privacy guidelines for its 300 member companies. Online companies also turned to technological solutions, such as the Platform for Privacy Preferences (P3P) standard which will allow users to set privacy preferences (e.g., "high," medium," "medium-low," and "low") in their browsers. Critics of the technology maintain that the standard is too server-centric, because P3P will share information from a Web server with a browser that "heads" the privacy policy and does not provide a mechanism for users to determine if site a actually complies with its stated policy (Glover, 2001).

Underlying the controversy surrounding tracking and data compilation practices, the online privacy debate eventually centered on four key issues (Glover 2001):

Notice	Whether consumers should be warned of company privacy policies.
Choice	Whether consumers decide to participate in information sharing through an opt-in or opt-out approach.
Access	Whether consumers should be allowed to see the information marketers collect.
Security	Whether the data that is collected is secure enough to prevent abuse.

Of the four issues, opt in vs. opt out became the central theme. With opt-in, Web sites collect or use personal data only if consumers give specific permission for the data to be collected; with opt-out, Web sites assume users want to participate and collect personal data until users ask to be removed from commercial lists (Gavin, 2001). Of those online companies offering either, opt-out was (and is) the most frequently used policy (Lemke, 2002). The penchant for an opt-out approach by online companies goes against users' preferences; two separate studies found that a majority of adults favor an opt-in policy. Studies conducted by both Pew Internet (Joachim, 2001) and Harris Interactive (Jarvis, 2001b) found that 86 percent of respondents would choose an opt-in policy.

Privacy activists maintain that the chance to opt out is not enough protection from privacy invasion, because the chance to do so comes only in the form of a few lines of text placed in the privacy policies of participating Web sites, often buried two or three levels down. Yahoo's policy illustrates the burden placed on consumers who want to opt out of Web tracking. The statement is two pages long and packed with links to other pages users must read to fully comprehend it. Sixteen

paragraphs in, users learn that Yahoo does not vouch for the advertising networks that insert banners onto its pages; that those pages place their own cookies onto users computer; and that they have their own privacy policies (Weber, 2000). If Yahoo users want to opt out, they must visit the Web sites of every ad network Yahoo works with. The opt-out procedure at DoubleClick further underscores how difficult it can be to opt out; in fact, users cannot opt out directly, but rather must request a special DoubleClick cookie that prohibits tracking. Although opt-out policies are better than no choice at all, the complexity of Web tracking systems all but precludes user opt outs.

As a result of an FTC survey that found only 20 percent of all Web sites and less than half of the 100 most popular sites used industry-accepted fair information practices, such as letting users opt out, the agency called on Congress to protect consumers through laws that would establish standard practices for collection and use of online data (Pitofsky, 2000). Legislators responded and an abundance of privacy bills were introduced into Congress during the years and months immediately preceding the events of September 11, 2001.1 After the 2000 Congressional session in which dozens of Internet privacy bills died in committee and others languished without any indication of being recommended for a full vote, the general conviction was that year 2001 could be the year for breaking the impasse over Internet privacy.

Early 2001, privacy advocates, industry trade groups, and legislators alike believed that some federal government actions seemed unavoidable. Privacy advocates saw hope in the Senate's sudden shift to Democratic control, due to Sen. James Jeffords' decision to leave the GOP. Pres. Bush's decision to implement the medical privacy regulations approved late in the Clinton administration provided further expectations of federal action in the belief that it would heighten awareness of privacy issues. And the FTC remained a strong advocate of new federal laws on privacy.

The American Electronics Association (AeA), the country's oldest and largest high-tech trade association reversed its long-standing opposition to federal privacy legislation and called for federal laws that would preempt state laws (Soat, 2001). On the same day, a coalition of groups including the American Library Association, Electronic Privacy Information Center and Consumer Federation of America circulated a letter to members of Congress and George W. Bush calling for a much stronger set of privacy rules (Benson & Simpson, 2001). A number of trade groups such as the Association for Internet Media and the Direct Marketing Association, anticipated intense congressional debate on the privacy issue and were lobbying Congress on behalf of online marketers (Jarvis, 2001a). The question for many industry executives had shifted from "will" there be new legislation to "what" issues will new laws address.

In Congress, there was bipartisan support for some type of privacy legislation and as many as twelve Congressional hearings had been held in the months leading up to September 11 (Tillman, 2002). Rep. Billy Tauzin, R-LA, chairman of the House Energy and Commerce Committee, speaking at the first hearing of the committee's panel on Commerce, Trade and Consumer Protection, made it clear that Internet privacy issues were a top priority (Peterson, Steel & Scrivo, 2001).

Referring to the House's failure to act on privacy in 2000, Tauzin said, "Punting might be good in football, but this committee is finished with punting" (Teinowitz, 2001b). Sen. Ernest Hollings, D-SC, chairman of the Senate Commerce Committee (an important battleground for privacy issues), pushed privacy protection from the bottom of the committee's agenda to the top, increasing the possibility that at least one of the privacy proposals would emerge from committee (Anonymous, 2001; Rendleman & Rosen, 2001). The Congressional Privacy Caucus, chaired by Sen. Richard Shelby, R-AL, and co-chaired by Rep. Joe Barton, R-TX, held hearings in early March with a primary interest in the use of undisclosed Web bugs (Teinowitz, 2001a). Sen. Fred Thompson (R-TN), chairman of the Governmental Affairs Committee, released a report from the Office of the Inspector General, which found that 64 federal Web sites were using unauthorized tracking devices and many lacked privacy policies. Thompson called for action to correct the government's failure to comply with its own Internet privacy policy (Mearian, 2001). Rep. Jay Inslee (D-WA) labeled the findings "disturbing," and called for additional statutory action to enforce standards (Inslee, 2001).

Some members of Congress were growing impatient with law enforcement agencies' secrecy surrounding eavesdropping technology. Rep. Richard Armey (R-TX) sponsored a bill that would require federal law-enforcement officials to be more forthright about Carnivore and other electronic surveillance systems (Bowman, 2001). Carnivore consists of specialized eavesdropping hardware installed directly in commercial systems that link consumers to the Internet, offering the ability to scan any email that travels over the network. The Electronic Privacy Information Center sued the FBI for not providing enough information about the system, claiming that Carnivore could be used to monitor the innocent (EPIC Reports, 2001). Congressional leaders have publicly criticized the program. For example, Rep. Bob Barr (R-GA) blasted the FBI's secrecy over Carnivore and demanded greater accountability (Olsen & Hansen, 2001). Barr also led efforts to unveil details of another controversial system known as Echelon, although the U.S. government had not yet confirmed its existence. In an unprecedented move, the National Security Agency invoked attorney-client privilege in blocking a congressional inquiry seeking details about Echelon (Olsen & Hansen, 200l). President Clinton then signed legislation requiring the NSA to report on the legal basis for Echelon. The courts were also clamping down on surveillance powers. For example, a federal judge ordered the FBI to provide details of computer technology that records keystrokes to capture passwords and deleted information (Olsen, 2001a).

ISSUES AND ACTIVITIES POST 9/11

The heinous terrorist acts of September 11 marked a significant turning point in the debate over privacy. Such an event changes the balance between security and privacy, giving new weight to calls for broader government surveillance powers. Swept up in a tide of emotional fear and anger, the immediate response of most Americans was for greater security and protection from further

attacks. In the face of potential catastrophic danger, most would choose to relinquish some privacy rights in favor of a safer, more secure world.

Polls showed that many were willing to tolerate increased surveillance, higher encryption standards and other measures for the sake of security. For example, a study conducted by Princeton Survey Research Associates, September 13 & 14, found widespread support for a ban on "uncrackable" encryption products. Seventy-two percent of Americans polled believed that anti-encryption laws would be "somewhat" or "very" helpful in preventing future terrorist attacks (McAuliffe, 2001).

In the week immediately after the disaster, government officials began to call for measures to expand the government's ability to use intelligence-gathering tools. On Wednesday, September 12, Rep. Bob Barr (R-GA), taking a decidedly different position regarding government's investigative tactics, called on colleagues to take steps toward untying the hands of military and intelligence leaders (Olsen & Hansen, 2001). On September 13, the Senate passed by voice vote an amendment (S.AMDT. 1562) allowing the government greater liberty to use surveillance technology, including Internet wiretaps. The amendment broadens emergency powers for wiretaps, allowing any U.S. attorney to authorize the installation of "trap and trace" equipment for up to 48 hours. Sen. Orrin Hatch (R-UT), sponsor of the amendment, stated that it was essential to give law enforcement authorities every tool at hand to combat persons who threaten Americans. Attorney General John Ashcroft announced at a press conference that the Department of Justice would soon send a proposal to Congress asking for expanded rights to conduct computer and telephone wiretaps. And FTC Chairman Timothy J. Muris reversed the commission's position as a strong advocate for stringent privacy laws, opposing new legislation in favoring of enforcing existing laws (Szynal, 2002). Some congressional leaders tried to reassure the public that constitutional protections would be respected in the use of technology in anti-terrorism measures. Sen. Patrick Leahy (D-VT), chairman of the Senate Judiciary Committee, urged members of Congress to resist the temptation to abandon civil liberties in the face of terrorist threats.

The drive toward greater government disclosure and accountability was shifting in the opposite direction. Civil rights advocates expressed concern that government officials rushing to defend the country by any means necessary could clear the way for a raft of controversial technologies, including Internet wiretaps, online video cameras, and face-recognition & fingerprint-scanning devices. There was also fear that the terrorist attacks could provide the impetus for the widespread use of Carnivore and Echelon. And once these technologies were in place, they could stay in place afterward.

In the ensuing months and through 2002 and into 2003, a number of anti-terrorist bills have been introduced and some hastily passed. For example, the U.S.A. Act of 2001 (S.1510), sponsored by Thomas Daschle (D-SD), passed the Senate by house vote (96-1) October 11. The Anti-Terrorism Act of 2001 (H.R. 2975), sponsored by James Sensenbrenner (WI), was passed as the U.S.A. Act of 2001 on October 12. Both bills broaden the use of law enforcement investigatory

tools to deter and punish terrorists and open the door for the use of Carnivore and other surveillance systems (thomas.loc.gov). Of greatest interest are the USA Patriot Act, the Homeland Security Act of 2002, and the Domestic Security Enhancement Act of 2003.

The USA Patriot Act (Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism) was hastily passed2 in October 2001. The Senate Judiciary Committee had an hour and a half hearing in which Attorney General John Ashcroft testified but took no questions. In the House, there was no testimony from opponents of the bill. The law broadens law enforcement's ability to gather intelligence extensively, including "roving" wiretaps; expands law enforcement officials powers to monitor suspected terrorists and criminals by, among other things, lowering judicial oversight of monitoring tactics, increasing information sharing among agencies, broadening the definition of a terrorist, and increasing the amount of information agents can seek from ISPs (USA Patriot Act of 2001).

Before the Patriot Act, police could use trap-and-trace surveillance techniques to record the sources of a suspect's incoming phone calls but not the content of those calls, and could apply a pen register technique to do the same for outgoing calls. The Patriot Act extended this power to online communications, making email addresses and URLs legally comparable to phone numbers and permitting police to identify a suspect's email correspondents without knowing the content of the email messages. This can be done without a warrant only if relevant to an ongoing investigation (Kandra, 2002). Civil libertarians believe that the law erodes fundamental freedoms and are concerned that the newly endowed surveillance powers may provide too much leeway to collect private information on people on the periphery of investigations, entangling innocent citizens and undermining constitutional rights to privacy (Olsen, 2001b).

Since the law was passed, intelligence-gathering activities appear to have increased somewhat. For example, Internet Service Providers indicate that surveillance requests have increased and several have been asked to install the wiretap device, Carnivore, since named DCS1000 (Lemos, 2001). Of 1,026 libraries surveyed by the American Library Association in early 2002, 85 had received requests for records from government agencies (Borland and Bowman, 2002). At the end of the first year of the law's existence, federal officials claim that the provisions of the law have been used effectively, aggressively, and responsibly. Privacy advocates counter that is difficult to determine how valuable or responsible surveillance has been because operations conducted under the new law remain undisclosed (Madigan, 2002).

During the last half of 2002, the debate on privacy vs. security focused on the Homeland Security Act of 2002 and the Defense Advance Research Project Agency's Total Information Awareness Program. The Homeland Security Act, sponsored by Richard Armey (R-TX), was introduced 6/24/02 and passed into law 11/25/02 (Public Law No. 107-296). The gargantuan bill (484 pages) set the stage for the largest federal reorganization since the Defense Department was formed in 1947, creating a 170,000-employee Homeland Security Department by transferring twenty-two agencies to Homeland Security (including the Coast Guard, Customs Services, the

Secret Service, Immigration and Naturalization Service, Border Patrol, etc.). But it did more than reshuffle government agencies. It gave the government a major role in securing operating systems, hardware and the Internet, including allowing for more police surveillance of the Net; punishing malicious computer hackers with up to life in prison; establishing a national clearinghouse for computer and network security work; and spending at least half a billion dollars a year for homeland security research. It also allows commercial airline pilots to carry guns in cockpits; includes liability protections for pharmaceutical and other companies that make anti-terrorism technologies (the most debated provision in the bill); and exempts from the Freedom of Information Act any "critical infrastructure" information that is voluntarily submitted to a Federal agency (Sec.214).

In a provision of the bill called "Cyber Security Enhancement"(Sec. 225), Internet Service Providers, such as America Online or Netscape, could give the government more information about subscribers. If the companies believe "in good faith" that there is a risk, they can turn over details about customers, including their emails, without a warrant. Chris Hoofnagle, EPIC's legislative counsel, contends that the bill's language lets Internet providers reveal subscriber information to any government officials, not just investigators (Birdis, 2002). Traditionally, U.S. companies have refused to act as agents for prosecutors without court-approved warrants.

The provision also gave U.S. authorities the power to trace emails and other Internet traffic without first obtaining even perfunctory court approval. That could happen only during an "immediate threat to national security" or during an attack against a "protected computer." Prosecutors would need to obtain a judge's approval within 48 hours. Oddly enough, in all the debate about the Homeland Security Act regarding civil liberties, the Cyber Security Enhancement provision received scant attention in either the House or the Senate. Experts have noted that U.S. law considers as protected nearly any computer logged onto the Internet. Privacy advocacy groups have frequently complained that obtaining permission from a judge is too easy for this type of email tracing; if an investigator merely attests that the information is relevant to an ongoing investigation, a judge can't deny the request (Kary, 2002). Marc Rotenberg, executive director of the Electronic Privacy Information Center, called for the establishment of a federal-level independent agency charged with safeguarding privacy rights in the United States and to have oversight for the homeland security department to ensure that basic civil liberties of people are not violated (Getz, 2002).

The Homeland Security Department became fully operational Saturday, February 29, shifting 170,000 employees from other areas of the federal government to the Department (Fournier, 2002). The change was mostly on paper; most of the department's workers will continue to work from the same offices. Only about 10 percent work in the Washington area and about 1,000 will work from the department's headquarters, temporarily located at a secure office complex run by the Navy. Some dramatic changes did occur; the Immigration and Naturalization Services ceased to exist, bringing an end to an agency whose roots go back to the first immigration office created in 1864.

Total Information Awareness is a project of the Defense Advanced Research Projects Agency, the high-tech innovators who helped create the Internet and a host of cutting-edge military

technologies. The system would process, store and mine billions of minute details of electronic activity and would provide intelligence agency analysts and law enforcement officials with instant access to information from email, calling records, credit card and banking transactions, travel records, etc., without a search warrant (Borin, 2002). However, the system is indiscriminate and would collect data on every citizen's transactions, not just those of suspected terrorists or criminals. John Poindexter visualized T.I.A. immediately after September 11 and convinced the Bush administration of the system's potential value in tracking terrorist. Currently, head of the Total Information Awareness office, Poindexter is the retired Navy rear admiral who was Ronald Reagan's national security adviser, and in that capacity, helped devise the plan to sell arms to Iran and illegally divert the proceeds to the rebels in Nicaragua. Convicted of five felony counts of lying to Congress, destroying official documents, and obstructing the congressional inquiry, he was sentenced to six months in jail-a conviction later overturned on appeal (Salley, 2002). The admiral was never particularly contrite about his deceit, asserting at one point that it was his duty to withhold information from the American people ("A Snooper's Dream," 2002).

Much has been written linking the Total Information Awareness program with the Homeland Security Act (e.g., Markoff, 2002). T.I.A. is not directly included in or funded by the Homeland Security Act. However, in order to deploy a system like Total Information Awareness, legislation would be required and it is the Homeland Security Act that provides this legislation. Included in the bill is a Homeland Security Advanced Research Projects Agency (HSARPA), modeled after the Defense Advanced Research Projects Agency, which will "promote revolutionary changes in technologies that would promote homeland security, advance the development of technologies, and accelerate the prototyping and deployment of technologies that would address homeland vulnerabilities" (Sec. 307). It is possible that HSARPA will link up with the Information Awareness Office and the T.I.A. program (McCullagh, 2002b). The problem with the Homeland Security Act coupled with the Total Information awareness program is threefold: The union creates the institutional alignment that enables data sharing among federal agencies; creates the technological capability to link databases and to profile the information obtained from these various data bases; and, undermines the framework of the Privacy Act of 1974 that safeguards personal information held by federal agencies and prevents profiling.

Constitutional scholars, civil libertarians and practically every major newspaper in America have universally decried the project. Phil Kent, president of the Southeastern Legal Foundation, believes the system will give carte blanche to eavesdrop on Americans on the flimsiest of evidence, calling it an unprecedented electronic dragnet and a sweeping threat to civil liberties (Hudson, 2002). William Safire, columnist for the New York Times, compared the database to George Orwell's Big Brother government (Safire, 2002). An editorial in the New York Times ("A Snooper's Dream," 2002) called on Congress to shut down the program pending a thorough investigation; and the Washington Post ("Total Information Awareness," 2002) called on the defense secretary to appoint an outside committee to oversee the project before it proceeds. Executives from

a nonpartisan coalition of organizations from across the country sent letters to Senators Tom Daschle and Trent Lott urging them to adopt an amendment to stop further development of the project (Rotenberg, et al., 2002).

On January 23, Congress passed an amendment (S.AMDT.59) placing certain limitations and prohibitions on the development and deployment of the Total Information Awareness program. The amendment, sponsored by Senator Ron Wyden (OR), specifies that no funds appropriated to the Department of Defense or any other element of the federal government may be obligated or expended on research and development on the Total Information Awareness program unless the President certifies to Congress in writing within sixty days after the enactment of the amendment that the cessation of research and development of T.I.A would endanger the national security of the United States. The amendment further indicates that no element of the federal government may deploy or implement the program until the Secretary of Defense notifies Congress with a specific and detailed description of each element and the method and scope of the intended deployment or implementation and has received specific authorization by law from Congress for such deployment.

Congressional legislative and committee staffs have anticipated follow-up legislation to the USA Patriot Act for sometime. The Administration consistently indicated that, although many ideas were being considered, specific proposals weren't ready to be shared with Congress. In October 2002, Deputy Assistant Attorney General Alice Fisher, told the Senate Judiciary Subcommittee on Technology, Terrorism, and Government Information, that the Justice Department had been looking at potential proposals on following up on the Patriot Act for new tools necessary in the war on terrorism. Assistant Attorney General for Legal Policy Viet Dinh, who was the principal author of the Patriot Act, indicated that there was an ongoing process to continue evaluating and re-evaluating authorities with respect to counterterrorism, but declined to confirm that a new bill was forthcoming (Lewis, 2003).

However, on Friday, Feb. 7, 2003, the nonpartisan Center for Public Integrity (CPI) posted on its website a copy of a confidential draft of proposed legislation dated Jan. 9, 2003, entitled the "Domestic Security Enhancement Act of 2003," together with a "control sheet" which appears to show that the confidential draft had been transmitted on Jan. 10 to House Speaker Hastert (IL) and Vice-President Cheney (Lewis and Mayle, 2003). Bill Moyers publicized availability of the document on the Feb. 7, 2003, PBS TV program, "Now with Bill Moyers," in an interview with Charles Lewis, the head of CPI (Transcipt - Bill Moyers Interviews Chuck Lewis, 2003). The Justice Department did not dispute the authenticity of the draft, although it denied that it had been sent Rep. Hastert or Vice President Cheney. Addressed to and from Hastert and Cheney, the control sheet indicates that the document was referred to ten internal divisions of the department (CRM, FBI, ODAG, ASG, OLC, OIPR, INS, EOIR, CIV, and TAX) with the subject line: Attached for your review and comment is a draft legislative proposal entitled the "Domestic Security Enhancement Act of 2003" (Department of Justice, Office of Legislative Affairs, control sheet, 1/10/03). The document was from Greg Jones, Office of Legislative Affairs, and asked for

comments by 1/13/03. According to an article by Ryan Singel, the to and from addresses are suppressed recipient lists ("A Chilly Response to 'Patriot II,' " 2003). Both Hastert and Cheney deny receiving the draft.

After the CPI posted the draft, Barbara Comstock, director of public affairs for the Justice Department, released a statement saying that, "Department staff have not presented any final proposals to either the Attorney General or the White House. It would be premature to speculate on any future decisions, particularly ideas or proposals that are still being discussed at staff levels" (Comstock, 2003).

Some of the key provisions of the Domestic Security Enhancement Act of 2003, frequently referred to as Patriot II, include (CPI, ACLU, FCNL):

Section 201.	Prohibition of Disclosure of Terrorism Investigation Detainee Information. Would enhance the Justice Department's ability to deny releasing material on suspected terrorists in government custody through FOIA. This provision makes it a criminal act for any member of the government or any citizen to release any information concerning the incarceration or whereabouts of detainees, including who they are.
Section 202.	Distribution of "Worst Case Scenario" Information. Under the Clean Air Act, the EPA requires private companies that use potentially dangerous chemicals to produce a "worst case scenario" report detailing the effect that the release of controlled substances would have on the surrounding community. This provision would restrict FOIA requests to these reports and allows corporations to keep secret their activities with toxic biological, chemical, or radiological materials.
Section 301-306.	Terrorist Identification Database. These sections would authorize creation of a DNA database on "suspected terrorists," expansively defined to include association with suspected terrorist groups and noncitizens suspected of certain crimes or of having supported any group designated as terrorist.
Section 312.	Appropriate Remedies with Respect to Law Enforcement Surveillance Activities. Would give immunity to law enforcement officials engaging in spying operations and would place restrictions on court injunctions against Federal violations of civil rights.
Section 501.	Expatriation of Terrorists. Would establish that an American citizen could be expatriated "if, with the intent to relinquish his nationality, he becomes a member of, or provides material support to, a group that the United States has designated as a 'terrorist organization'." A citizen formerly had to state intent to relinquish citizenship; this provision would affirm that "intent to relinquish nationality need not be manifested in words, but can be inferred from conduct." Engaging in lawful activities of a group designated as a "terrorist organization" could be presumptive grounds for expatriation.

Reactions to the draft were similar to those following public knowledge of the Total Information Awareness project. An abundance of articles and editorials were published, some merely reiterating the provisions of the proposal, others highly critical not only of the draft per se

but also of the Justice Department. A google search with keywords "domestic security enhancement" displayed 201,000 entries; of the first 100, only 11 were not about the DSEA. A sample of typical reactions follows:

Mel Lipman, President of the American Humanist Association:	*"The Domestic Security Enhancement Act of 2003 encroaches on the rights and protections of Americans even more than its predecessor did. At its core this legislation is intended to drastically expand the powers of law enforcement and federal intelligence agencies with apparent disregard for the rights it tramples upon"* (Speckhardt, February 13, 2003).
Errol Louis, New York Sun editorial:	*"[The] document is a catalog of authoritarianism that runs counter to the basic tenets of modern democracy"* (February 10, 2003).
Nat Hentoff, The Village Voice:	*"'We the People' must turn to Congress to protect us from this out-of control Justice Department, since the president has yet to keep it within the bounds of the Constitution and its principles* (February 26, 2003).
James Gill, The Times Picayune:	*" . . . the Constitution does not provide in any circumstances for the tyranny that Ashcroft plans to impose"* (February 26, 2003)
Brian Morton, Baltimore Citypaper Online:	*"If the Patriot Act made you shiver with Orwellian foreshadowing, the newest incarnation, the Domestic Security Enhancement Act of 2003, will have you checking out Southwest Airlines fares to Helena while you still are 'free to move about the country'"* (February 25, 2003).
Friends Committee on National Legislation:	*"The provisions of the proposed act would represent a fundamental change from the Constitutional framework of separation of powers of the branches of government, to delegating power to the Administration without oversight or accountability "* (February 13, 2003).
Charles Lewis, head of CPI:	*"What seemed to be merely self-serving shenanigans by the latest occupant of 1600 Pennsylvania Avenue in the months prior to September 11 now appears to have been the dawn's early light of a wholesale assault on access to information in this country"* (February 12, 2003).
Editorial, startribune.com:	*"When Osama bin Laden's henchmen ended their evil mission on 9/11, they toppled more than Manhattan's towers. They also demolished the American assumption that freedom and security can coexist"* (February 21, 2003).
Brian White, Philadelphia citypaper.net:	*"The first Patriot Act was passed while Americans were distracted by the September 11 attacks and the newly launched war on Afghanistan; citizens must be vigilant that Patriot II does not slip through Congress during the upcoming war on Iraq"* (March 5, 2003).

Many members of Congress expressed concern about the proposal and the secrecy surrounding its development, including Bob Barr (R-GA), Russell Feingold (D-WI), John Conyers (D-MI), and John Edwards (D-NC) (Stock, 2003). Conyers, top Democrat on the House Judiciary

Committee, said that the proposed legislation turns the Bill of Rights completely on its head . . . and constitutes yet another egregious blow to our citizens' civil liberties (Anderson, 2003). Feingold, the only senator to vote against the Patriot Act, hoped that the Senate would give this bill more scrutiny than the first Patriot Act (Singel, 2003). Senator Patrick Leahy (D-VT), ranking Democrat on the Senate Judiciary Committee, issued a statement in reference to the Justice Department's secrecy in drafting the sequel to the USA Patriot Act, stating in part, "If there is going to be a sequel to the USA Patriot Act, the process of writing it should be open and accountable. It should not be shrouded in secrecy, steeped in unilateralism or tinged with partisanship. The early signals from the Administration about its intentions for this bill are ominous, and I hope Justice Department officials will change the way they are handling this" (Leahy, 2003).

At least one article, among the thousands, was written in defense of John Ashcroft and the Justice Department. In an article, sarcastically titled, "That Devil Ashcroft," David Tell blasted CPI for exposing the proposal (maintaining that it was secret simply because it was a draft and unfinished), and the overheated commentaries and the minions of unsigned editorials it occasioned (Tell, 2003). Tell maintains that the Justice proposal fully embraces the classic mens rea standards of criminal law: The government would first have to prove that one had knowingly and intentionally violated any of the provisions of the proposal before taking action.

CONCLUSION

Every citizen supports efforts to apprehend those responsible for past terrorist attacks and to prevent future attacks. And Americans are fairly resigned to having personal data floating around in cyberspace. But it was some consolation that no one agency had custody of all that information. To obtain data on a specific person, government agencies at least had to ask for it, and in most cases seek court permission. That may no longer be the case. According to a report by Privacy International and the Electronic Privacy Information Center, four trends with regard to privacy rights since the September 11 catastrophes have become apparent: the swift erosion of pro-privacy laws; greater data sharing among corporations, police and spy agencies; greater eavesdropping; and sharply increased interest in people-tracking technologies, such as face recognition systems and national ID cards (McCullagh, 2002a).

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ENDNOTES

[1] A sample of proposed privacy legislation in the 106th and 107th Congressional sessions (EPIC Bill Track; Thomas-Congress Online):

H.R.112. The Electronic Privacy Protection Act; Rush Holt (D-NJ). Introduced 1/3/01. Combats "spyware," computer programs that collect information about users and transmit it back to the software company. Referred to Subcommittee on Telecommunications, Trade and Consumer Protection 2/17/01.
H.R.220. The Identity Theft Protection Act of 2001; Ron Paul (R-TX). Introduced 1/3/01. Would protect the use of Social Security number and ban the use of any federal identification number. Referred to Subcommittee on Government Efficiency, Management, and Intergovernmental Relations 2/13/01.
H.R.237. Consumer Internet Privacy Enhancement Act; Anna Eshoo (D-CA). Introduced 10/10/0. Would protect the privacy of consumers who use the Internet. Referred to Subcommittee on Commerce, Trade and Consumer Protection 2/14/01.
H.R.313. Consumer Internet Privacy Protection Act of 1999; Bruce Vento (D-NM). Introduced 1/16/99. Would prohibit an interactive computer service from disclosing to a third party any personally identifiable information provided by a subscriber without the subscriber's written consent. Referred to Committee on Telecommunications, Trade, & Consumer Protection 4/12/99.
H.R.334. Electronic Privacy Bill of Rights Act; Edward Markey (MA). Introduced 1/10/99. Referred to Subcommittee on Financial, Institutional, and Consumer Credit 12/2/99.
H.R.34. Consumer Online Privacy and Disclosure Act; Gene Green (D-TX). Introduced 1/31/01. Would require the FTC to write privacy regulations to cover the use of personal data collected online. Referred to Subcommittee on Commerce, Trade and Consumer Protection 2/14/01.
H.R.367. Social Security Online Privacy Protection Act; Bob Franks (R-NJ). Introduced 1/19/99. Would regulate the use by interactive computer services of Social Security account numbers and related personally identifiable information. Referred to Committee on Telecommunications, Trade, and Commerce 1/29/99.
H.R.583. The Privacy Commission Act; Asa Hutchinson (R-AR). Introduced 2/13/01. Would create a privacy-protection commission to study online collection of information involving financial, medical, employment and government records. Referred to Subcommittee to Full Committee 5/8/01.
H.R.2135. The Consumer Privacy Protection Act; Tom Sawyer (D-OH). Introduced 6/12/01. Would protect consumer privacy. Referred to Committee on Commerce, Trade, and Consumer Protection 6/18/01.
H.R3560. Online Privacy Protection Act; Rodney Frelinghuysen (NJ-ll). Introduced 1/31/00. Would require the FTC to publish regulations affecting Website operators. Referred to Committee on Telecommunications, Trade, & Commerce 2/4/00.
H.R.5571. The Electronic Privacy Protection Act; Rush Holt (D-NJ). Introduced 10/26/00. Combats "spyware," computer programs that collect information about users and transmit it back to the software company. Referred to Subcommittee on Telecommunications, Trade and Consumer Protection 10/31/00.
S.197. Spyware Control and Privacy Protection Act; John Edwards (D-NC). Introduced 1/29/01. Would require companies installing software containing "spyware" to tell consumers what information will be collected and to whom it will be transmitted, and get the consumer's consent. Referred to Commerce, Science & Transportation Committee 1/29/01.
S.900. Financial Services Modernization Act of 1999 (Gramm, Leach, Bliley Act); Phil Gramm (D-TX). Introduced 4/28/99. An act to enhance competition in the financial services industry. Became Public Law No. 106-102, 11/22/99.

S.2201. Online Privacy Protection Act; Ernest Hollings (D-SC); Introduced 4/18/02. A bill to protect the online privacy of individuals who use the Internet. Referred to Commerce, Science & Transportation Committee 4/25/02. Hearings held.
S.2606. Consumer Privacy Protection Act; Ernest Hollings (D-SC). Introduced 5/23/00. Would require notice and opt in for collection and disclosure of personally identifiable information. Referred to Committee on Commerce, Science & Transportation 10/3/00.
S.2928. Consumer Internet Privacy Enhancement Act; McCain, Kerry, Abraham, Boxer. Introduced 7/26/00. Would require Web sites to provide "clear, conspicuous, and easily understood notice" of their information practices, as well as obvious opt-out mechanisms. Referred to Committee on Commerce, Science & Transportation 10/3/00.

[2] *H.R.3162,* the USA Patriot Act; James Sensenbrenner (WI). Introduced 10/23/01. On motion to suspend the rules and pass the bill, passed by house vote, 357-66, 10/24/01 (ll:03am). Received in Senate 10/24/01. Passed Senate without amendment by house vote 98-1, 10/25/01. Signed by President and became Public Law No. 107-56, 10/26/01. The law incorporates provisions of both S.1510 and H.R. 2975. Provisions of H.R. 3004, the Financial Anti-Terrorism Act, were incorporated as Title III.

HARASSMENT - CONSTRUCTIVE DISCHARGE AND THE AFFIRMATIVE DEFENSE

Gerald E. Calvasina, Southern Utah University
Richard V. Calvasina, University of West Florida
Eugene J. Calvasina, Southern University

ABSTRACT

Allegations of harassment in violation of federal anti-discrimination legislation continue to be a daunting complex human resource management problem for decision makers. While the 1998 Supreme Court decisions in Burlington Industries, Inc. v. Ellerth and Faragher v. City of Boca Raton, and the 1999 decision in Kolstad v. American Dental Association provided employers with valuable guidance in dealing with harassment, subsequent court decisions continue to both clarify and further confuse decision makers attempting to properly prevent and remedy harassment allegations. Conflicting court decisions with respect to the applicability of the affirmative defense when an employee alleges they were constructively discharged, is the most recent example of how federal court decisions can further complicate the ability of employers to effectively prevent and remedy harassment allegations. This is a critical issue for organizations in cases where supervisors are alleged to be directly involved in the harassment. The purpose of this paper is to examine recent court decisions dealing with allegations of harassment, constructive discharge and the affirmative defense, and to present implications of these decisions for human resource management decision makers.

INTRODUCTION

Allegations of discrimination and harassment in violation of federal anti-discrimination legislation continue to be a daunting complex human resource management problem for decision makers. The most recent Equal Employment Opportunity Commission (EEOC) statistical reports show that discrimination charges in general (84,442 in FY 2002) were four and a half percent higher than FY 2001 and nearly 17 percent higher than FY 1992. The EEOC reported a growing trend in harassment charges on all bases through FY 1999 with charges filed with both the EEOC and state and local Fair Employment Practices Agencies (FEPAs). EEOC reports on sexual harassment charges did show a slight decrease in FY 2002, with a continued increase in the percent of charges filed by males (EEOC, 2003).

While the 1998 Supreme Court Decisions in Burlington Industries and Ellerth and Faragher provided guidance, conflicting court decisions in the interim continue to contribute to the complexity of dealing with harassment in the workplace. The most recent example of how federal court decisions can further complicate the ability of employers to effectively prevent and remedy harassment allegations concerns the applicability of the affirmative defense when an employee alleges they were constructively discharged. This is a critical issue for organizations in cases where supervisors are alleged to be directly involved in the harassment. The purpose of this paper is to examine recent court decisions dealing with allegations of harassment, constructive discharge and the affirmative defense, and to present implications of these decisions for human resource management decision makers.

LEGAL BACKGROUND AND RECENT CASES

In Burlington Industries v. Ellerth and Faragher v. City of Boca Raton, the U.S. Supreme Court decided that under Title VII, employers are vicariously liable for sexual harassment by supervisors regardless of whether the harassed employee suffered a tangible adverse employment action such as discharge, demotion, failure to promote, or significant change in the important terms of employment. When an employee has not suffered a tangible adverse employment action, an employer can avoid liability by proving that:

> (*1) the employer exercised reasonable care to prevent and promptly correct any sexually harassing behavior; and (2) the employee un-reasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to otherwise avoid harm Burlington Industries v. Ellerth, 1998 & Faragher v. City of Boca Raton, 1998).*

According to the EEOC, the standard of liability set forth in these decisions is premised on two principles:

> *1) an employer is responsible for the acts of its supervisors, and 2) employers should be encouraged to prevent harassment and employees should be encouraged to avoid or limit the harm from harassment (EEOC, 1999).*

An additional obstacle for employers attempting to utilize the affirmative defense presents itself when the harasser is sufficiently high up in the organization's hierarchy, such as an owner, president, proprietor, partner, or corporate officer. If the court determines that he/she is the employer's "proxy", or "alter ego", the employer is strictly liable for his behavior because the behavior is effectively that of the employer itself (Baker & Daniels, 2001 and Mallinson-Montague v. Pocrnick, 2000).

In the Mallinson-Montague v. Pocrnick cases, Pocrnick served as a senior vice president at ProBank. He had the authority to hire and fire all employees in the consumer- lending department, the authority to approve or deny consumer loans, and reported directly to the president of the bank. Mallinson-Montague alleged that Pocrnick began harassing her almost immediately after being hired. She also alleged that when she rejected his advances he retaliated against her by denying her business leads necessary for her to meet sales goals and rejecting loans that she originated that resulted in lost commissions and performance bonuses. The court concluded that even if the conduct of Pocrnick had not resulted in a tangible employment action, the affirmative defense would not have been available to the bank because of the "alter ego" exception.

EEOC regulations and court decisions have also recognized that employers can be held liable for co-worker and non-employee harassment as well (Morrell, 2000). The EEOC's guidance on employer liability for harassment by co-workers states "an employer is liable if it knew or should have known of the misconduct, unless it can show that it took immediate and appropriate corrective action" (EEOC, 1999).

With respect to non-employee harassment, the standard is the same, but the employer's control over such individuals' misconduct is considered. When the misconduct is committed by non-employees, employers are expected to take "reasonable steps" to stop the conduct (Morrell, 2000). In Lockard v. Pizza Hut, a manager ignored an employee's complaints that a customer verbally and physically harassed her. The physical harassment included the customer pulling the employee's hair and grabbing her breast. The manager ignored the employee's complaints and ordered the employee to continue to wait on the customer. The court held that because the manager failed to take reasonable steps to remedy or prevent the hostile environment, the employer was liable for its manager's failure to act (Lockard v. Pizza Hut, 1998).

While the Burlington v. Ellerth and Faragher v. City of Boca Raton decisions dealt with sexual harassment, the Supreme Court cited numerous cases involving harassment on other protected bases in it's rulings. The EEOC has "always taken the position that the same basic standards apply to all types of prohibited harassment" and that "the standard of liability set forth in the Ellerth and Faragher decisions applies to all forms of unlawful harassment (EEOC, 1999). Subsequent to the 1998 Supreme Court decisions, numerous courts have applied Ellerth and Faragher to harassment on different bases (see for example Miller v. Kenworth of Dothan, 2002, Hafford v. Seidner, 1999, Wright-Simmons v. City of Oklahoma City, 1998, and Gotfryd v. Book covers, Inc., 1999).

Finally, in assessing the issue of liability, there must first be a determination that unlawful harassment has in fact occurred. This has proven to be a difficult task for employers, in spite of fairly specific pronouncements in EEOC Enforcement Guidance and U.S. Supreme Court decisions.

> *the anti-discrimination statutes are not a "general civility code" (Oncale, 1998). thus federal law does not prohibit simple teasing, offhand comments, or isolated incidents that are not "extremely serious"(Faragher, 1998). Rather, the conduct must be "so objectively offensive as to alter the conditions of the victim's employment"(Oncale, 1998). The conditions of employment are altered only if the harassment culminated in a tangible employment action or was sufficiently severe or pervasive to create a hostile work environment(EEOC, 1999).*

In Faragher, the Supreme Court noted further the "mere utterance of an ethnic or racial epithet which engenders offensive feelings in an employee would not sufficiently alter terms and conditions of employment to violate Title VII". Further the court noted that "discourtesy or rudeness should not be confused with racial harassment and that a lack of racial sensitivity does not, alone, amount to actionable harassment (Faragher v. City of Boca Raton, 1998). Courts, in determining whether an environment is sufficiently hostile or abusive, have been directed by the Supreme Court to look at all the circumstances surrounding the allegation, including:

> *the frequency of the discriminatory conduct; its severity; whether it is physically threatening or humiliating, or a mere offensive utterance; and whether it unreasonably interferes with an employee's work performance…simple teasing, offhand comments, and isolated incidents (unless extremely serious) will not amount to discriminatory changes in the terms and conditions of employment (Faragher v. City of Boca Raton, 1998).*

The Supreme Court in Faragher made it clear that "conduct must be extreme to amount to a change in the terms and conditions of employment" and that these standards, if "properly applied, will filter out complaints attacking the ordinary tribulations of the workplace, such as the sporadic use of abusive language, gender-related jokes, and occasional teasing" (Lindeman & Kadue cited in Faragher, 1998).

CONSTRUCTIVE DISCHARGE

Black's Law Dictionary defines constructive discharge as:

> *that which occurs when an employer deliberately makes employee's working conditions so intolerable that the employee is forced into voluntary resignation (Black's Law Dictionary, 1990, 863).*

Conditions must be so intolerable that a reasonable person is forced to quit (Bourque v. Powell Electrical Manufacturing Co., 1980). An employee is not required to show the employer's

intent in order to prove constructive discharge, only that the employer knowingly permitted the conditions to exist (Goss v. Exxon Office Systems, 1984).

Sovereign states that the "clearest form of constructive discharge occurs when an employer tells an employee that she or he has an opportunity to resign, but that if the employee does not do so she or he will be discharged" (Sovereign, 1994, 183-184). In the Goss case the plaintiff, a saleswoman, was verbally harassed by her supervisor about her plans to have children. After returning from sick leave as a result of a miscarriage, her sales territory was taken away and replaced with a less lucrative territory. When she objected, Goss was told to either accept the assignment or resign (Goss v. Exxon Office Systems, 1984).

According to Walsh, "constructive discharge is not a legal claim in itself' but when a court finds that an employee who resigned was constructively discharged, the employee may bring any legal claims for wrongful discharge that would be available had he/she been discharged." The nature of constructive discharges, and the incredible lengths to which employers sometimes go to drive employees out, lends itself to other legal claims. The two most likely are hostile environment harassment and infliction of emotional distress" (Walsh, 2003, 483-484).

In determining if an employee who resigned has been constructively discharged, courts will examine a number of factors:

> *demotions; cuts in salary; reductions in job responsibilities; reassignment to menial or degrading work; reassignment to work under a younger supervisor; badgering, harassment, and humiliation calculated to encourage resignation; and offers of early retirement on terms less favorable than the employee's former status (Walsh, 2003, 483, & Logan v. Denny's, 29 F. 3d 558,at 569 (6th Cir. 2001).*

Not everything that makes an employee unhappy is an actionable adverse action (Fenney v. Dakota, Minnesota & Eastern Railroad Co., 2003). Harassment can be the basis for a constructive discharge, but courts generally require that the severity of the harassment must exceed the minimum level necessary to establish a hostile environment claim (Jones v. Fitzgerald, 2002). According to Sovereign, plaintiffs must prove "that the unlawful condition created by the employer is so offensive that the reasonable person would have found it intolerable. Failing in this proof, the employee must continue working while seeking to remedy the allegedly unlawful practice" (Sovereign, 1999, 168). At the same time, an employee's subjective assessment of what is tolerable is not sufficient to lead to a finding of constructive discharge. Courts will generally consider the negative effect on the employee's prestige - but this must be severe - and whether the employee was embarrassed by the employer's action. When evaluating embarrassment claims, courts will attempt to determine if the embarrassment would be daily and unavoidable and whether there was some radical change in job responsibilities to warrant embarrassment (Sovereign, 1999). An employee's general dissatisfaction with working conditions generally will not establish a constructive discharge. To be reasonable, an

employee has an obligation not to assume the worst and not to jump to conclusions too quickly. In addition, an employee who quits without giving their employer a reasonable chance to work out a problem has not been constructively discharged (Duncan v. General Motors Corporation, 2002 and Contreras v. Waffle House, 2002).

In Contreras v. Waffle House, Contreras, a manager trainee, quit her job without explaining why to company representatives. She subsequently filed an EEOC complaint and eventually a law suit alleging sexual harassment. The district court granted Waffle House's motion for summary discharge of the suit concluding that Contreras failed to show that the conditions at Waffle House were so intolerable that a reasonable employee would have felt compelled to resign. In addition, since she resigned without giving Waffle House an opportunity to remedy the alleged harassment, she could not establish that she was constructively discharged. The court noted that Waffle had extensive policies and procedures in place for handling complaints of sexual harassment and that the plaintiff was well acquainted with them. Contrera's stated that she was "too embarrassed" to use the complaint procedure and the court concluded that "embarrassment" is not sufficient to justify failure to use an anonymous hotline to complain (Contreas v. Waffle House Inc., 2002).

In Duncan v. General Motors Corporation (GMC), Duncan testified to numerous incidents of her supervisor's inappropriate behavior including requiring her to utilize a computer with a screen saver that was a picture of a naked woman, that the supervisor had a planter in his office that was shaped like a slouched man wearing a sombrero, and that the planter had a hole in the front of the man's pants that allowed for a cactus to protrude. The supervisor also kept a child's pacifier that was shaped like a penis in his office that he occasionally showed to his coworkers and to the plaintiff on two occasions. The supervisor also created a poster and posted it on the bulletin board that portrayed Duncan as the president and CEO of the Man Hater's Club of America. Duncan further testified that she complained to "anyone who would listen to her" about the supervisor's behavior. Her complaints eventually resulted in an investigation involving GMC's Equal Employment Opportunity coordinator and preparation of a written statement with a list of suggested corrective actions for GMC to initiate. Duncan resigned and filed an EEOC complaint prior to submitting her written allegations to GMC and prior to GMC's initiation of any corrective actions. The court concluded that the behavior was not so severe or pervasive as to alter a term, condition of employment and that she did not give GMC a reasonable opportunity to work out the problem with her supervisor prior to submitting her resignation (Duncan v. General Motors Corporation, 2002).

In another Eight Circuit Case, Alagna v. Smithville R-II School District, the court reaffirmed the level that the harassment must rise to support a reasonable person's motivation to resign in light of harassing behavior. Alagna alleged that a colleague, David Yates, who was five-feet, nine-inches tall and weighed between 300 and 450 pounds, harassed her repeatedly during the 1998-99 school years. Alagna alleged that Yates visited her office on a regular basis and purportedly called her at home to discuss his depression, suicidal thoughts, and marital problems. Alagna also alleged that on several occasions Yates would end conversations by moving close to her, touching her arm,

looking her up and down, and saying he loved her and that she was very special. Alagna was not the only target of Yates's inappropriate behavior during the period and several other female faculty and students reported that Yates told them they looked pretty, told them "I love you", and invaded their personal space. After Alagna complained to an assistant superintendent about Yates behavior, Yates was orally reprimanded about his conduct, instructed not to speak with females alone, given a pamphlet on sexual harassment, and required to attend a previously scheduled sexual harassment seminar (Alagna v. Smithville R-II School District, 2003).

Behavior of this nature continued into the summer of 1999 and into the next school year, and Yates was again reminded of his earlier reprimand. Alagna alleged that her fear of Yates led her to work with her door locked and carry pepper spray. Yates was eventually warned to stop all inappropriate behavior toward Alagna and that any violation of those directions could result in his discharge. In January of 2000, after having spoken to an attorney and requesting additional interventions regarding Yates, Alagna took an extended leave of absence from which she did not return. In February of 2000, Yates informed the school district that he was resigning effective with the end of the school year. Alagna was informed of Yates retiring and that her job was available for the next school year and of Yates resignation. Alagna never contacted anyone at the school to discuss the disciplinary measures taken against Yates and subsequently resigned on May 23, 2000. The district court granted the employer's motion for summary judgment on her sexual harassment and constructive discharge claims and the appeals court affirmed that Yates's conduct, however inappropriate, was not sufficiently severe or pervasive to satisfy the high threshold for actionable harm. The court further concluded that Alagna's work environment was not objectively hostile and was not so intolerable as to compel a reasonable person to resign (Alagna v. Smithville R-II School District, 2003).

In Fenney, the Eight Circuit Court of Appeals in deciding a "constructive demotion" case examined the issue of a transfer from one job to another. The court observed that a transfer from one job to another isn't an adverse employment action if it involves only minor changes in the employee's working conditions with no reduction in pay or benefits. Fenney was able to offer strong evidence to show a significant detrimental change in his working conditions. Fenney was given the choice of taking a lower-paying job, one that he could report to on time, or repeatedly show up for work late and risk discharge. The court concluded "A reasonable person could conclude that Fenney had no choice at all. Through its actions, Dakota had created an environment in which Fenney had no choice other that to demote himself" (Fenney v. Dakota, Minnesota & Eastern Railroad Co., 2003).

RECENT CASES

The U.S. Third Circuit Court of Appeals and the N.J. Superior Court Appellate Division recently issued decisions that "expose" companies within their jurisdiction to greater potential

vicarious liability for workplace harassment (Cerasia and Labbe, 2003). In Suders v. Easton the court held that a constructive discharge, if proved, constitutes a "tangible employment action" within the meaning of the U.S. Supreme Court's decisions in Faragher v. City of Boca Raton, and Burlington Industries, Inc. v. Ellerth (1998) - thus, if an employee proves that he/she was constructively discharged, the employer is precluded from asserting the affirmative defense to avoid liability for the supervisor's harassment. The court stated "removing constructive discharge form the category of tangible employment actions could have the perverse effect of discouraging an employer from actively pursuing remedial measures and of possibly encouraging intensified harassment". (Suders v. Easton, 2003). This decision aligns the Third Circuit with the Eight Circuit (see Jaros v. LodgeNet entertainment Corp., 2002) in finding that a constructive discharge is a tangible employment action that prevents employers from raising the affirmative defense to liability in harassment litigation. The Second and Sixth Circuit Courts of Appeal have ruled that "when an employee resigns or quits, regardless of the circumstances, employers may raise the defense" while the remaining district courts of appeal have yet to issue a definitive ruling on the issue (Hazard, 2003).

In Suders v. Easton, Nancy Suders was hired as a police communications operator with the Pennsylvania State Police in March 1998. She alleged that she was forced to resign from her job in August 1998 because of a sexually hostile work environment created by her male supervisors, Sergeant Eric Easton, Patrol Corporal Baker, and Corporal Eric Prenergast. Suders contended that she could not use the State Police complaint system because she feared retaliation since the harassers were her supervisors. Suders also contacted the State Police Equal Employment Opportunity Officer Smith Elliott twice, and received little if any assistance. Suders felt that on her second attempt to deal with her situation, that Smith-Elliott was "entirely unhelpful, appearing insensitive at times"(Suders v. Easton, 2003). The court also determined that Suders had established the following as to her hostile work environment claim:

> *(1) her own Station Commander had a preoccupation with discussing bestiality and oral sex with her; (2) Easton's (Station Commander) "conversation" were accompanied by leering, and suggestive posturing--conduct that Suders found offensive; (3) Baker (Patrol Corporal) routinely engaged in sexually-charged acts intended to humiliate or demean Suders, even after he was politely asked to stop. Viewed in the most generous light, his repeated reenactments of the wrestling move were indicative of an immense immaturity and could reasonably be perceived as innuendo; and (4) When not making offensive gestures with his crotch, Baker attempted to engage Suders in conversations about piercing his genitals (Suders v. Easton, 2003).*

In addressing Suders constructive discharge claim, the court agreed with Suder's allegation in her complaint that she was "forced to suffer a termination of employment because she would not yield to sexual suggestions, innuendoes and solicitatious behavior. The court of appeals also noted that the record was replete with testimony relating to harassment, discrimination, false charges of

theft, and Suders' eventual resignation and that taken as a whole resulted in working conditions so intolerable that a reasonable employee would be forced to resign (Suders v. Easton, 2003).

In Jaros v. LodgeNet Entertainment Corp., affirmed the jury's decision that Brenda Jaros had been sexually harassed by her supervisor, a senior LodgeNet executive, and that she was constructively discharged when the company failed to respond adequately to her complaints. The harassment of Jaros began shortly after she was hired as an executive secretary to LodgeNet vice president for sales Ted Racz. At trial, Jaros testified that Racz boasted about his sexual abilities, commented frequently on her body type and appearance, and suggested that they watch pornographic movies and engage in sex with one another. Additional testimony indicated that a co-worker of Jaros, also made sexual overtures to Jaros including calling her late at night, asking her about her recent sex life, and threatening to come over to her home. When Jaros complained to Racz about the phone incident, Racz told her that it was just a phone call. The co-worker was reprimanded over the late-night phone call but Jaros was never informed of the reprimand or of an investigation of the incident. In December of 1999, Jaros complained to LodgeNet's director of human resources Don McCoy that she was being sexually harassed by Racz. Jaros was reluctant to provide details fearing that Racz would find out and make her life "a living hell". She asked McCoy to promise that whatever details she provided would be kept secret with McCoy replying that he would have to investigate which would mean telling Racz and upper management. McCoy did not remind Jaros that LodgeNet's sexual harassment policy also prohibited retaliation and failed to tell her that she would be protected from harassment if she complained. The court concluded that McCoy's failure to adequately respond to complaints about the harassment by the co-worker and Racz and nothing to lessen her fear of retaliation supported Jaros's fear that Racz would retaliate against her and that there was sufficient evidence from which the jury could find the fear justified. In January of 2000, Jaros resigned. After tending her resignation, Jaros met twice with senior LodgeNet management and gave them details of the harassment. The investigation eventually turned up evidence that Racz had made comments to other women employees about their bodies and their appearance. He received a written warning and later left the company. LodgeNet did not act to remove Jaros from Racz's direct supervision or attempt to discourage her from resigning. In affirming the jury's verdict, the appeals court supported a judgment of $300,000 for the plaintiff, $24,907.44 in back pay, and $74,592.20 in attorney fees to the plaintiff (Jaros v. LodgeNet Entertainment Corp., 2002).

IMPLICATIONS FOR EMPLOYERS

The most immediate implication of the recent court decisions asserting that a constructive discharge is a tangible job action for employers is the limiting of the use of the affirmative defense when an employee quits or in some cases is demoted. In these types of cases, if the employee can substantiate that they were constructively discharged or constructively demoted, the employer is

precluded from asserting the affirmative defense to avoid liability for supervisory harassment. While this assertion is currently viable in at least 11 states and the Virgin Islands, other states are moving in that direction.

The U.S. District Court for the District of Arizona has recently joined the "pro-employee camp" holding that constructive discharge does constitute a tangible employment action (Louise-Schmerfeld, 2003). The judge in the Contreras v. Waffle House case also stated that a constructive discharge is an adverse employment action sufficient to support the fourth element of a Title VII claim (Contreras v. Waffle House, 2002).The issue will eventually be decided by the U.S. Supreme Court. In the mean time, it would appear that the number of cases where constructive discharge is being alleged and substantiated as a tangible employment action is increasing.

As to reducing harassment complaints and employer liability under the affirmative defense, the importance of employers making good-faith efforts to prevent and respond to allegations of harassment is still critical. Since the overwhelming number of harassment cases involves hostile work environments created by midlevel supervisors, employers must double their efforts to properly train and supervise these managers (Holland & Hart, 2000). In addition, the training and supervision of human resource and equal employment opportunity managers must also be enhanced. The Jaros v. LodgeNet and Suders v. Easton cases clearly reinforce this. Other cases where ineffective human resource management practices and or training led to negative consequences occurred in Cadena v. The Pacesetter Corporation, 2000, Mathis v. Phillips Chevrolet, 2001 and Smith v. First Union National Bank, 2000.

In Cadena v. The Pacesetter Corporation, the court cited deposition testimony of the manager responsible for sexual harassment training at the office where the harassed employee worked. The training manager said she believed that it wouldn't be sexual harassment if a male exposed himself to a female subordinate or grabbed her breasts so long as he apologized after the incident. The court noted that based on the manager's "admitted ignorance", a jury could reasonably infer that Pacesetter failed to make a good faith effort to adequately educate employees about its non discrimination policy and Title VII (Cadena v. The Pacesetter Corporation, 2000).

In Mathis v. Phillips Chevrolet, Inc., the seventh circuit court of appeals found that the company's failure to provide age discrimination training to its managers constituted "reckless indifference" in upholding an award of liquidated damages against an employer in an age discrimination case. The manager at the center of this case testified that he was not aware that it was illegal to consider age in making hiring decisions (Mathis v. Phillips Chevrolet, Inc., 2001).

In Smith v. First Union, the court cited evidence that management-level employees were discouraging the use of the bank's complaint process by warning employees to never complain to human resources if they wanted to get anywhere. The court also concluded that the bank did not exercise reasonable care to promptly correct the situation. The bank's human resource manager in responding to Smith's complaints, focused his investigation on Smith's manager's management style and ignored her allegations of sexual harassment which included a remark about slitting a woman's

throat, "that the only way for a woman to get ahead at First Union was to spread her legs", and that he would frequently remark that when a female employee was upset, it was because she was menstruating or that she needed a "good banging". The supervisor did not make these remarks about male employees (Smith v. First Union, 2000).

Designing and implementing an effective training program to prevent harassment can be achieved if organizations are willing to take the following steps. Make sure competent trainers deliver the training. If you are going to outsource this training, check trainers' references thoroughly. Evaluate training materials to make sure that harassment training covers all protected classes not just sex. Timing of training is also critical. New employee orientation is ideal for initial training, but organizations must reinforce the lessons learned in this area on a regular basis. Additionally, all levels of management must be trained on an ongoing basis. Including how effectively managers at all levels implement and manage the organization's efforts to prevent and remedy harassment allegations should become a regular part of a manager's performance review. Managers must be impressed with the importance of taking all complaints seriously even where employees are reluctant to provide details. Once a member of management is put on notice by an employee of an allegation of harassment, the organization's policies and procedures should be initiated and consistently followed. Employers should be sure that their anti-harassment policies and complaint procedures ensure that employees have several avenues of complaint beyond their immediate supervisor (Cerasia and Labbe, New Jersey Law Journal, 2003).

Employees must also be reminded that being embarrassed is generally not sufficient to justify failure to utilize the procedures the employer has in place to remedy allegations of harassment. Of course, employers must consistently remind supervisors that threats of retaliation and discouraging employees from utilizing complaint procedures will not be tolerated and may be damaging to the employer's efforts to limit liability (Contreras v. Waffle House, 2002). Employers must show that they are making continuous efforts to implement and enforce their anti-discrimination and anti-harassment policies through education and training. Active mechanisms for renewing employees' awareness of policies through either specific education programs or periodic re-dissemination or revision of their written materials is critical (Romano v. U-Haul International, 2000).

Employers must also expand their training with respect to harassment to include education of employees on other forms of harassment. In Walker v. Thompson, the Fifth Circuit Court of Appeals overturned summary judgment for the employer, in part based on the employer's failure to institute a complaint procedure specifically addressing racial harassment. The court noted that the complaint procedure instructed employees who believed they had been subjected to sexual harassment to notify management and testimony of the company president that there were no specific policies to follow if a race discrimination complaint against an office manager was received (Walker v. Thompson, 2000).

Monitor the effectiveness of training. This can be facilitated through the development of effective complaint procedures and regular audits of complaints. Exit interviews if properly done can also be an effective tool to identify potential problems with respect constructive discharge.

The implications for managers from recent court decisions are clear. Organizations must implement effective training programs to facilitate operation of policies and practices designed to prevent and remedy allegations of harassment in the workplace. The training must be effective and must include all protected basis under federal law, not just sexual harassment. Managers at all levels must also be impressed with the negative consequences associated with making an employee's job environment miserable so they will quit. Constructive discharge, while not actually new law, is being used with increased frequency to limit the ability of employers to reduce their liability associated with harassment litigation. Without proper training and reinforcement of the objectives of the training, the ability of organizations to utilize the defense spelled out in U.S. Supreme Court decisions in Faragher v. City of Boca Raton and Burlington Industries, Inc. v. Ellerth will be limited.

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ETHICAL ISSUES

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A COMPARATIVE STUDY: ETHICAL PERSPECTIVES OF AMERICAN AND JORDANIAN STUDENTS

Khaled Alshare, Emporia State University
James Wenger, Emporia State University
Donald S. Miller, Emporia State University

ABSTRACT

Technological advancements in the global business environment and consolidation of corporations lead many people to believe that the coverage of ethics in universities is best achieved by having a diverse classroom, including a variety of nationalities and cultures. This paper attempted to analyze ethical perspectives of American and Jordanian students. Results indicated that students, in both countries, seemed to lack understanding of the relationship between ethics and professional responsibility. The results showed that cultural factors affected students' perception of the relationship between ethics and professional responsibility. For example, Jordanian students were more likely than American students to risk their jobs because of social responsibility. The results showed a gender difference in the perception of ethics and professional responsibility. Females were more likely than males to demonstrate ethical behaviors. There were no significant differences in perceptions of ethics and professional responsibility between students in lower- and upper-level classes or between business and non business majors.

INTRODUCTORY OVERVIEW

Relatively few studies have been done on ethics dealing with cultural diversity in the classroom (primarily by classification, sex, or major). This study evaluated responses pertaining to ethical scenarios by examining and analyzing student comments involving ethics and professional responsibilities. More specifically, it investigated perceptions related to factors that affected the students' assessment of the relationship between ethics and professional responsibility. The study tested statistical differences involving these perceptions using various variables such as country (United States/American students versus Jordan/Jordanian students), gender, student classification lower-level (freshmen and sophomores) versus upper-level (juniors and seniors), and major (business versus non-business). The following hypotheses were tested:

H1:	There is a significant difference in perception of the relationship between ethics and professional responsibility between American and Jordanian students.
H2:	There is a significant difference in perception of the relationship between ethics and professional responsibility between males and females.
H3:	There is a significant difference in perception of the relationship between ethics and professional responsibility between students in lower-level and upper-level classes.
H4:	There is a significant difference in perception of the relationship between ethics and professional responsibility between business and non-business majors.

RESEARCH METHODOLOGY

The research process used student responses to a case study (Appendix A) adapted from a Management Information Systems textbook. During the 2002-2003 academic year, questionnaires were distributed to random samples of students from one university in the United States and one university in Jordan. This case dealt with the privacy of customer information in a small business. Based upon a variety of scenarios, students were asked various questions with ethical implications. Participants were given the opportunity to comment on why they would change their decision and distribute confidential information based upon these different scenarios. The study requested student data regarding demographic variables such as gender, major, and classification. The case was administered in its original form (English) to avoid any problem of translation from English to Arabic. A detailed explanation of survey items was given to Jordanian students by instructors who were knowledgeable in the English language. Statistical analysis utilized the SAS package to compute frequencies, means, percentages, and Chi-Square values. Since the data were nominal in nature, contingency tables and the Chi-Square statistical procedure were used to test for significant differences.

BACKGROUND PERSPECTIVES

Events of the times influence public reaction and focus attention on issues. Nearly two decades ago, scandals involving the savings and loan industry, insider trading, and inappropriate junk bond transactions directed attention toward business ethics. In more recent times, names like Enron and WorldCom have been in newspaper and television headlines and, once again, brought ethics to the forefront of public attention. Consequently, educators and business practitioners are challenged to direct emphasis on greater ethical awareness. Verschoor (2001) noted greater involvement by professionals in development of ethical standards, more evidence of employee concerns about ethical values, and a growing importance of trustworthiness by participants in global business. Conaway and Fernandez (2000) surveyed regional business leaders and found sensitivity

toward on the job ethical issues. Firms represented by half of the respondents either had or were developing codes of ethics. Emphasis upon ethics and legal responsibilities continues to be included in accreditation standards adopted by AACSB International, a primary business school accreditation organization.

Using a national sample of business managers, Paolillo and Vitell (2002) conducted an exploratory study of factors influencing ethical and unethical decisions. The researchers concluded that moral intensity was a significant factor in the decision process. Codes of ethics are representative approaches to recognize and emphasize the importance of ethics. While many firms adopted them, evidence indicated mixed results about their effectiveness (Robbins & Coulter, 2002). Gibson (2000) observed that codes of ethics are more suitable for situations involving straightforward issues or legal concerns and less suited to circumstances having vague or complex considerations. Wood (2000) studied codes of ethics among firms operating in the private sector of Australian business and compared them to codes established by American and Canadian companies. Data showed that companies in all of these cultures encountered similar reasons for development of codes for ethical conduct. Interestingly, researchers seemingly have not focused on usage of pre employment selection techniques involving workplace ethics of job applicants (Pawlowski & Hollowitz, 2000).

Any variety of personal and professional life experiences can influence ethical values. To examine ethics from a cultural perspective, Armstrong and Sweeney (1994) surveyed international managers from Hong Kong and Australia. Respondents from Hong Kong indicated fewer ethical problems at their firms. From an historical perspective, the researchers noted that Hong Kong had a more extensive history of international trading experience with other cultures. Ergeneli and Arikan (2002) studied ethical perceptions of salespersons in Turkish clothing and medical equipment fields. They found no significant gender differences in ethical perceptions. Milton Smith (1997) reviewed literature related to business ethics in Australia and New Zealand and found an absence of leadership on the part of business schools relating to a failure to emphasize ethics as a strategic issue.

Increasingly, schools of business have recognized a necessity to prepare students for working in a more complex, global marketplace. Growing diversity of student cultures was evident at many business schools, including Insead-a prominent business school located in France. Recently, fewer than ten percent of the students enrolled at Insead were French, and approximately 16 percent of the faculty were from France (Galbraith, 2002). Stewart and Felicetti (1996) surveyed business students at two middle sized United States universities. Respondents considered ethics to be an important component of the curriculum and felt that good ethical practices served to increase profits and financial returns. Whipple and Swords (1992) compared ethical judgments of students in the United States and United Kingdom. While demographic profiles differed, the researchers found that such differences did not influence ethical judgments. Small (1992) noted that United States and Western Australian students shared similar perspectives in attitudes toward business ethics.

Some researchers (Carlson & Burke, 1998; Gautschi & Jones, 1998) found that course work enhances student awareness of ethical issues. Other research initiatives addressed ethics from the viewpoint of gender and academic status of students. A study by Luthar, DiBattista, and Gautschi (1997) showed that female business students were more favorably inclined toward ethical behaviors than males. As compared to seniors, freshmen believed good business ethics were more positively associated with successful business results. Sikula and Costa (1994) reported no significant differences in ethical values between male and female business management students who were enrolled at a state university located in California.

Ford and Richardson (1994) reviewed empirical literature related to ethics and decision making. Studies involving the criterion of nationality showed mixed, inconclusive results. Fourteen studies that involved gender were examined; half revealed that females were more ethical than males. Other researchers found gender to be unrelated to ethical beliefs. Eight empirical studies used age as a variable influencing ethics; three studies showed significant differences between younger and older respondents. Research that used number of years of education as a criterion for analysis also showed mixed results. Borkowski and Ugras (1998) conducted a meta analysis of empirical ethical studies for the time period 1985 through 1994 that involved U.S. students. Their conclusion showed that females had stronger ethical attitudes than males. As related to age, studies indicated that students tended to be more ethical as they grew older. In terms of undergraduate majors, meta analysis revealed no significant difference between business students and other majors.

DATA ANALYSIS

The case study was randomly distributed to five lower-level and five upper-level classes in each university during the 2002-2003 academic year. Ninety-seven students from the United States and 123 students from Jordan responded. This represented a response rate of 27 percent for American and 24 percent for Jordanian students. The average response rate was 24.4 percent.

The results of the study were based on the combined data obtained from responses from 97 (44 percent) American and 123 (56 percent) Jordanian students. Table 1 shows a summary of frequency distributions for key variables. Some 58 percent of the American student sample were males compared to 46 percent of the Jordanian sample. Forty-nine percent of the American students majored in business compared to 45 percent of the Jordanian students. Thirty-two percent of American and 30 percent of Jordanian students were lower-division (freshmen and sophomores).

RESULTS OF THE STUDY

The results of this analysis summarized respondents' reactions to the case study. Additionally, it analyzed students' perspectives involving the relationship between ethics and professional responsibility using the Chi-Square test.

TABLE 1: FREQUENCY DISTRIBUTIONS FOR VARIABLES				
Variables	Students in USA (n1=97)		Students in Jordan (n2=123)	
	No. of Responses	Percent	No. of Responses	Percent
Gender				
Male	56	57.73	57	46 .34
Female	41	42.27	66	53.66
Major				
Business	48	49.48	55	44.71
Other	49	50.52	68	55.29
Classification				
Lower Level	31	31.95	37	30.08
Upper Level	66	68.05	86	69.92
Telling her				
Yes	19	19.59	64	52.03
No	78	80.41	59	47.97
Factors				
Yes	82	84.54	66	53.65
No	15	15.46	57	46.35
Sister				
Yes	73	75.26	86	69.91
No	24	24.74	37	30.09
Brother				
Yes	30	30.93	60	48.68
No	67	69.07	63	51.32
Savings				
Yes	45	46.39	82	66.67
No	52	53.61	41	33.33
Married				
Yes	21	21.65	66	53.65
No	76	78.35	57	46.35

After reading the case, approximately two-thirds of the respondents reported that they would not divulge business information to the woman. However, it should be noted that 80 percent of American, compared to 48 percent of Jordanian students, stated they would not tell her. Two-thirds

of the respondents reported that various factors could make them change their decisions whether or not to tell. While 85 percent of American students would change their decisions based on a variety of factors, 46 percent of Jordanian students would not. Approximately, three-quarters of the respondents (75 percent of American and 70 percent of Jordanian students) would change their decision if the woman was their sister. On the other hand, if the man was their brother, 41 percent of the respondents (31 percent of American and 49 percent of Jordanian students) would change their decision. Fifty-eight percent of the respondents (46 percent of American and 67 percent of Jordanian students) would change their decisions if the woman was about to give her life savings to the man. On the other hand, 60 percent of the respondents (78 percent of American and 46 percent of Jordanian students) would not change their decisions if the woman was married.

The Chi-Square procedure was used to test the significance of various factors. These included students' perspectives of ethics and professional responsibility related to country, gender, classification, and major. Table 2 summarizes the Chi-Square results.

TABLE 2: CHI-SQUARE RESULTS

Factors	Chi-Square			
	Country	Gender	Classification	Major
Telling her	24.29***	5.77**	0.33	0.11
Factors	22.64***	0.12	1.43	0.74
Sister	0.27	0.28	0.25	1.11
Brother	7.37***	0.65	0.41	1.03
Savings	9.51***	0.43	0.55	1.14
Married	22.46***	0.03	0.61	2.54
**. $P < 0.05$	***. $P < 0.01$			

The most important factors that affected students' responses were country followed by gender. There were no significant differences using numerous scenarios between students in upper- and lower-level classes or business versus non-business majors. Thus, the first two hypotheses that were presented in the introductory overview section were accepted, and the last two hypotheses were rejected.

Country, considered to represent a cultural variable, was a significant element in affecting students' perspectives. For example, Jordanian students were three times more likely than American students to inform the woman in the case. Jordanians were three times more likely than Americans not to change their decisions due to other factors and were twice as likely to change their decisions if the woman was married. In addition, they were more likely than American students to change their decisions if the woman was about to give her life savings to the man. Americans were more likely

than Jordanian students not to change their decisions if the man was their brother. It should be noted that the majority of American and Jordanian students (75 percent versus 72 percent) would change their decisions if the woman was their sister.

Males were less likely than females (30 percent versus 46 percent) to inform the woman. However, other factors could make both males (67 percent) and females (69 percent) change their decisions. It was interesting to note that the majority of both males and females (71 percent versus 75 percent) would change their minds if the woman was their sister. Only 38 percent of males compared to 44 percent of females would change their mind if the man was their brother. Some 56 percent of males and 60 percent of females would change their decisions if the woman was about to give her life savings to the man. The majority of males and females (62 percent versus 60 percent) would not change their minds if the woman was married.

Table 3 and Table 4 summarize American and Jordanian students' comments regarding the reasons why they would change their minds.

Responsibility toward family was the highest priority for American and Jordanian students. Both groups were willing to give up their jobs to protect their families. For example, 82 percent of Americans versus 56 percent of Jordanians reported that family was more important to them; therefore, they would tell the woman if she was their sister. If the woman was their sister, only three percent of Americans versus 2 percent of Jordanians acknowledged that an obligation to job and profession would affect their decision. Some six percent of both groups cited that it was not their business to become involved. It should be noted that 16 percent of Jordanian, compared to none of the American students, reported that they would tell the woman because of cultural and religious factors.

If the man was their brother, 48 percent of Americans versus 41 percent of Jordanians would advise him not to send the flowers. Some 31 percent of Jordanian students would tell the female because of cultural and religious factors. Due to an obligation to the job and profession, some seven percent of Americans and three percent of Jordanians would not tell the woman. It is interesting to note that 14 percent of American and 17 percent of Jordanian students would not tell her because they did not feel it was any of their business.

If the woman was about to give her life savings to the man, 26 percent of American and 43 percent of Jordanian students would inform her because they felt it is the right thing to do to protect her from being cheated. Some 11 percent of American versus 23 percent of Jordanian students would not tell her because of professional responsibility. Twenty-five percent of American students, compared to none of the Jordanian students, stated they would not tell the woman because they did not care and did not believe it was any of their business. Twenty-four percent of Jordanian students would tell the woman because of cultural and religious factors. Some 10 percent or less of both groups would inform her because of sympathy.

If the woman was already married, some 37 percent of Jordanian students would share information with her in order to protect her marriage, and 16 percent of them would tell her because

of cultural and religious factors. None of the American students indicated reasons based on these two factors.

TABLE 3: A SUMMARY OF AMERICAN STUDENTS COMMENTS		
	Facts	The reason for your decision
1.	The woman is your sister.	- Family is more important. (Responsibility) (82%)
		- It is not my business. She can figure it out by herself. (6%)
		- Let her know without breaking the rules. (5%)
		- He is not a good man for my sister. (4%)
		- I have an obligation to my job and profession. (3%)
2.	The man is your brother.	- Talk/ask my brother not to do that. Family is important.(48%)
		- My brother is a man; he can do whatever he wants. (20%)
		- It is not my business. (14%)
		- I have an obligation to my job and profession. (7%)
		- I will confront my brother, and I'll tell her. (6%)
		- I will tell her because my brother should not do that. (5%)
3.	The woman is about to give the man her life savings as a down payment on a house in the belief that they will soon be married.	- It is the right thing to do/help her from being cheated. (26%)
		- She needs to know about other women. (26%)
		- I do not care. It is not my business. (25%)
		- I have an obligation to my job and profession. (11%)
		- I will tell her. If I were the woman, I hope someone would tell me about that (show sympathy to her). (4%)
		- She is stupid. (3%)
		- Ask the man not to do that. (2%)
4.	The woman is already married.	- I do not care. She is already married anyway. Both of them are playing games. (62%)
		- She deserves to know the man is with other women. (13%)
		- I have an obligation to my job and profession. (10%)
		- She might know already and not care. (7%)
		- I do not know the women. (3%)
		- I will tell the woman not to be involved with the man. (2%)
		- I will tell the man not to do that. (2%)
		- I will tell her husband. (1%)

TABLE 4: A SUMMARY OF JORDANIAN STUDENTS COMMENTS	
Facts	The reason for your decision
1. The woman is your sister.	- Family is more important (my sister). (56%)
	- Cultural and religious factors are important. (16%)
	- He is not a good man for her. (10%)
	- Give her advice. (10%)
	- It is not my business. (6%)
	- I have an obligation to my job and profession. (2%)
2. The man is your brother.	- Give him advice. (41%)
	- Cultural and religious factors are important. (31%)
	- It is not my business. (17%)
	- Consider her feelings. (8%)
	- I have an obligation to my job and profession. (3%)
3. The woman is about to give the man her life savings as a down payment on a house in the belief that they will soon be married .	- Protect her savings (help her from being cheated). (43%)
	- Cultural and religious factors are important. (24%)
	- I have an obligation to my job and profession. (23%)
	- Show sympathy to her. (10%)
4. The woman is already married.	- Her business (she is married). (44%)
	- Protect her marriage. (37%)
	- Cultural and religious factors are important. (16%)
	- I have an obligation to my job and profession. (3%)

CONCLUSIONS AND IMPLICATIONS

This study showed that cultural factors significantly affected students' perception of the relationship between ethics and professional responsibility. There was evidence that Jordanian students were more affected by social responsibility, which is driven by cultural and religious forces, while American students were more affected by professional responsibility. In the case scenario, Jordanian students were more willing to risk their jobs by providing confidential information than American students. In addition, Jordanian students were more apt to change their decisions from not informing clients if it involved life savings. Some 64 percent of Jordanian, compared to 47 percent of American students, would have changed their minds. Jordanians (39 percent) were more likely than Americans (17 percent) to change their minds if the woman was married.

This case study demonstrated that gender bias still exists in both cultures. Females were more likely than males to show greater social responsibility and sympathy. Males were willing to change their minds and tell the woman if she was their sister, but they were less likely to change their minds if the man was their brother. Some 71 percent of the respondents would have changed their decision if the woman was their sister compared to 30 percent if the man was their brother. It seemed that gender bias is a universal problem despite efforts by many policy makers and educators to minimize it. On the other hand, students' classification and academic major had no significant influence on respondent behaviors.

In both countries, students, especially in Jordan, seemed to lack well-defined guidelines for the relationship between ethics and professional responsibility. Therefore, it is important for educators to consider incorporating more exposure to ethics in their curriculums. Additionally, educators might utilize information technology (such as on-line chatting) to conduct cross-cultural discussions on ethics in business among different nationalities. The results of this study magnified this problem and suggested that business communities need to be prepared to deal with issues involving ethics and professional responsibility. Companies and educators in higher educational institutions should address and provide solutions for this problem by establishing a common ground involving basic principles that may be included in curriculums. For example, discussing real cases, analyzing codes of ethics, and inviting business professionals to share their experiences with students require a joint effort from the business community and educators.

A renewed emphasis on ethics has been reinforced by accreditation agencies. Classroom diversity, which involves students from different nationalities and cultures, may assist educators in reinforcing business ethics. It is imperative that schools of business attempt to include a variety of cultures in classrooms to support ethical issues and give students a satisfactory foundation on how organizations should be managed. If this type of environment is not reinforced, students may be limited in their abilities to deal with the business-decision process. Additionally, without a diverse classroom comprised of students from different nationalities, it may be difficult to provide a global understanding of ethical patterns and how they impact business decisions. In the absence of such a diverse environment, students may not understand how to deal with multicultural issues. A better understanding of the relationship of codes of ethics found in different cultures also needs to be addressed.

Unforeseen and uncontrollable cultural variables may have limited this study but were not noted by the authors. To our knowledge, previous research studies have not emphasized ethical perspectives comparing American and Middle-eastern students. The authors of this study recommend that future studies be completed involving the comparison of different cultures, which may lead to a better understanding of ethics and professional responsibility in the global decision making process.

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APPENDIX A

THE CASE STUDY*

Gender:	a. Male	b. Female
Major:	a. Business	b. Non-business
Classification:	a. Lower-level classes	b. Upper-level classes

You have access to the sales and customer information in a flower shop. You discover that the boyfriend of a woman you know is sending roses to three other women on a regular basis. The woman you know is on the flower list, but she believes that she's the only woman in his romantic life. You really think you should tell the woman. Your dilemma is that you have a professional responsibility to keep the company's information private. However, you also believe that you have a responsibility to the woman.

Do you tell her?	A. Yes	B. No
Are there factors that would change your decision?	A. Yes	B. No

Consider the additional information below and then indicate whether any one or more of these factors would change your decision.

Additional Facts	Yes	No	Why
1. The woman is your sister.			
2. The man is your brother.			
3. The woman is about to give the man her life savings as a down payment on a house in the belief that they will soon be married.			
4. The woman is already married.			

* Adapted with permission from *Management Information Systems for the Information Age,* (2nd Ed.), by Haag, Cummings, and Dawkins (Irwin-McGraw-Hill Company ---2002).

REGULATORY ISSUES

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FOCUSING ON THE COOKIES (AS OPPOSED TO THE OVEN THEY WERE BAKED IN): ASSESSING THE DEFENSE DEPARTMENT'S SHIFT TO PERFORMANCE-BASED CONTRACTING

David C. Wyld, Southeastern Louisiana University

ABSTRACT

In this article, the Department of Defense's shift to performance-based contracting for services - which are increasingly comprising a larger and larger portion of total federal procurement dollars - is examined. This shift away from fixed-price and labor hour contracts has been characterized as nothing less than a paradigm shift in the way federal contracting operates, forging new possibilities for partnerships between the public and private sectors for improving overall government service delivery. However, the transition is also fraught with problems stemming from a lack of both agreement and awareness of just what makes contracts performance-based. In this article, an examination is offered of the development and definition of performance-based contracting, along with an overview of some of the criticisms of the concept.

Today's budget constraints on all levels of government will only heighten the focus on producing results and getting more "bang for the buck" from federal spending. Nowhere is this more true than in the Department of Defense, where contracted services play a strategic role in enabling the military to carryout its all important mission in a dangerous global theater.

INTRODUCTION

According to the General Accounting Office (GAO, 2002), in Fiscal Year 2001, the federal government procured services totaling $136 billion. By far, the Department of Defense (DOD) contracts for more services than any other federal agency. In FY2001, DOD spending on services contracting was approximately $59 billion, and for FY2003, the Pentagon's proposed budget calls for this amount to rise to $68.7 billion (Sherman, 2002).

Within the Department of Defense, spending for services is accounting for an increasingly large share of the total procurement budget. Over the decade of the Nineties, the Defense Department's annual budget for procurement of goods-such as aircraft-actually decreased from $59.8 billion to $53.5 billion (Friel, 2000b). As can be seen in Figure 1, over 1/6th of total DOD spending has shifted from the procurement of materials to the acquisition of services in the last ten years. The

size and scope of services contracting is growing rapidly in the military realm, as DOD contracting actions worth more than $100,000 increased by 28 percent in that same time span.

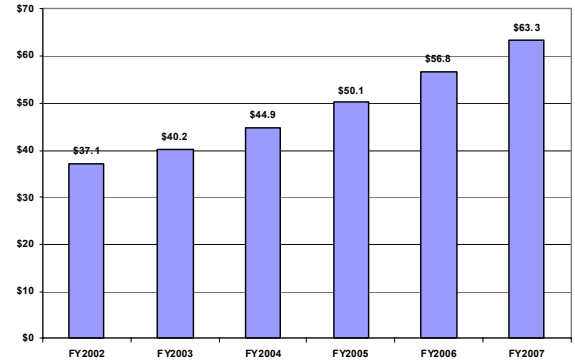
Figure 1

Spending Trends in the Department of Defense in the Past Decade

Source Data: Department of the Navy, Acquisition Reform Office (2000).

Much of the focus today is on information technology (IT) spending for hardware, software, and increasingly - services. As can be seen in Figure 1, federal spending for all categories of IT is expected to grow by over two-thirds over the next five years - to over $60 billion annually.

Figure 2
Total Projected Federal Spending on IT Goods and Services, 2002-2007 (in Billions)



Source: INPUT, Inc. - *Federal Information Systems and Services Market, FY 2002–FY 2007* (2002) - (www.immixgroup.com/docs/inputfy07.pdf).

While services constitute a significant portion of IT purchases, the government in fact buys a wide spectrum of services. The Department of Defense clearly outweighs all other federal agencies in services spending, both in terms of the number and dollar value of procurements. This can be seen in data reported by the Federal Procurement Data Center (2002) in just two representative areas of service spending: research and development (Table 1) and construction (Table 2).

Table 1: Top 10 Federal Research and Development Contractors (FY2001) for Defense and Civilian Areas
(in thousands of U.S. dollars)

TOP 10 DEPARTMENT OF DEFENSE CONTRACTORS			
RANK	COMPANY	NUMBER OF ACTIONS	DOLLAR VALUE
1	LOCKHEED MARTIN	1,097	$ 4,325,823
2	BOEING	759	$ 3,340,255
3	NORTHROP GRUMMAN	841	$ 865,514
4	UNITED TECHNOLOGIES	103	$ 738,307
5	RAYTHEON	606	$ 616,335
6	TRW INC	436	$ 540,916
7	BOEING SIKORSKY COMANCHE TEAM	12	$ 527,657
8	AEROSPACE CORPORATION	9	$ 442,933
9	GENERAL DYNAMICS	215	$ 426,585
10	MITRE CORPORATION	62	$ 419,930
TOTAL DEPARTMENT OF DEFENSE		4,140	$12,244,255
TOP TEN CIVILIAN AGENCY CONTRACTORS			
1	BOEING	201	$ 755,094
2	BATTELLE MEMORIAL INSTITUTE	143	$ 421,886
3	UNIVERSITY OF CALIFORNIA	110	$ 416,805
4	RAYTHEON COMPANY	74	$ 188,664
5	WESTAT INC	76	$ 141,718
6	JOHNS HOPKINS UNIVERSITY	79	$ 129,999
7	S. E. UNIVERSITIES RESEARCH	18	$ 106,313
8	NORTHROP GRUMMAN	182	$ 97,740
9	LOCKHEEDMARTIN	182	$ 92,074
10	TRW INC	78	$ 84,631
TOTAL CIVILIAN AGENCIES		1143	$ 2,434,924

Source Data: Federal Procurement Report - FY2001 - Federal Procurement Data Center (www.fpdc.gov) (2002) - pp. 16.

Table 2: Top 10 Federal Construction Contractors (FY2001) for Defense and Civilian Areas
(in thousands of U.S. dollars)

TOP 10 DEPARTMENT OF DEFENSE CONTRACTORS			
RANK	COMPANY	NUMBER OF ACTIONS	DOLLAR VALUE(000)
1	THE IT GROUP INC	1,705	$ 389,029
2	PHILIPP HOLZMANN AG	1,035	$ 235,814
3	FEDERAL REPUBLIC OF GERMANY	501	$ 218,137
4	HENSEL PHELPS CONSTRUCTION	87	$ 201,354
5	GREAT LAKES DREDGE & DOCK	119	$ 186,480
6	HUNT BUILDING CORPORATION	93	$ 149,325
7	CONTRACK INTERNATIONAL	50	$ 131,321
8	CADDELL CONSTRUCTION	121	$ 130,132
9	CENTENNIAL CONTRACTORS	1,220	$ 128,208
10	ABB SUSA/A ARENSON JV	2	$ 124,241
	TOTAL DEPARTMENT OF DEFENSE	4,933	$1,894,041
TOP TEN CIVILIAN AGENCY CONTRACTORS			
1	HENSEL PHELPS CONSTRUCTION	49	$ 348,765
2	BECHTEL GROUP INC	7	$ 339,471
3	MCCARTHY CONSTRUCTION	2	$ 106,276
4	THE HASKELL COMPANY	2	$ 90,676
5	FLINT RESOURCES COMPANY	21	$ 89,229
6	HALLIBURTON	227	$ 82,933
7	PHILIPP HOLZMANN AG	87	$ 75,262
8	PERINI CORPORATION	39	$ 74,524
9	TOMPKINS/GRUNLEY-WALSH JV	2	$ 56,834
10	DUKE STONE & WEBSTER COGEMA	7	$ 46,491
	TOTAL CIVILIAN AGENCIES	443	$1,310,461

Source Data: Federal Procurement Report - FY2001 - Federal Procurement Data Center (www.fpdc.gov) (2002) - pp. 16.

In her testimony before the U.S. Senate, the Administrator of the Office of Federal Procurement Policy, Angela Styles, recently observed that: "Significant portions of the military budget go not to 'war-fighting' but to infrastructure and overhead. The logistics that keep our armed

forces housed, trained and mobile are essential to our success on the battlefield and maintaining and improving 'non-war-fighting' capabilities" (United States Senate, 2002, n.p.). As Balk and Calista (2001) point out, by contracting out more of their activities on the periphery, agencies are able to better concentrate on their core missions.

Always - and especially in the post-September 11th environment of today, no federal agency's mission is more important than the Department of Defense. Yet, as Sherman (2002) observed in *Defense News*, DOD acquisition rules, aimed at governing primarily the procurement of goods, rather than services, have severely lagged behind this transition in the acquisition environment.

Performance-based contracting is seen as a new and better way of monitoring services spending to ensure that the taxpayers get a better "bang for their buck." However, Lawrence Martin (2002a) observed that "the transition to service contracting constitutes a fundamental paradigm shift for federal procurement" (p. 7). This has been a difficult transition for the federal government overall and for the Department of Defense in particular. The size and scope of the "paradigm shift" to services acquisition in federal procurement is readily evident in the results of a report from the Department of Defense's Inspector General, released in 2000.

In the report, *Contracts for Professional, Administrative and Management Support Services (D-2000-100)*, the Inspector General reviewed 105 service contracts in the DOD, with the audit finding problems with every one of them. Among the major findings of the report included:

♦	Contracts that continued for extended periods of time without proper oversight and review. The paramount example of this was one between the Army and Raytheon for engineering services for the HAWK missile system that extended for a total of 39 years.
♦	Lax oversight of contractor performance was being - or rather not being - conducted. Rather than conducting performance reviews and audits, DOD acquisition staff often made use of contractor-prepared status reports in assessing the quality of the contractors' work.
♦	The strain of stretching procurement officials too thin was showing. In one case, a technical monitor was responsible for preparing 13 new contract awards, valued at $115 million, while also tracking performance on 43 existing contracts, worth $621 million. In another instance, a technical reviewer had only a single day to complete a technical assessment on a contract valued at $9 million.
♦	A contracting officer, acting at the behest of a program official, awarded 30 task orders without seeking competitive bids (Office of the Secretary of Defense, Inspector General, 2000).

Much of the "blame" in the IG's report was placed on the fact that the DOD's acquisition workforce was overworked, shifted too frequently between assignments, and not properly trained to effectively deal with services contracting (Office of the Secretary of Defense, Inspector General, 2000). In reaction to the report, the Defense Department simply responded that "the military services recognize the need for improvement in contracting for services" (cited in Friel, 2002b, n.p.).

For certain, especially in the area of defense acquisition, the development of proper performance measures is more difficult for services than for goods and equipment. As Friel (2002a) observed, "making sure all the tanks that were ordered under a product contract were delivered" at the proper time and in battle-ready condition is a far-easier prospect" (n.p.).

In this article, we will examine the development of performance-based contracting for services in federal procurement. We will examine the development of performance-based contracting, as well as the conflicting definitions of the practice. We will look at major performance-based contracting efforts in the federal government and assess where we stand today, in the midst of this "paradigm shift" in military procurement from focusing on process to concentrating on outcomes.

THE ACRONYMS FOR SERVICES CONTRACTING: FASA, ID/IQ, AND MAC

The 1994 Federal Acquisition Streamlining Act (FASA) was aimed at speeding small purchases in the federal sector, in order to reduce the number of contracts having to be actively competed in contract shops across all federal agencies. However, the act had what Anne Laurent (1999), writing in *Government Executive*, classified as "a buried bombshell" (n.p.). This was because for the first time, FASA allowed - and encouraged - agencies to use multiple award task and delivery order contracts. These are commonly known as indefinite delivery/indefinite quantity (ID/IQ) or umbrella contracts, which are discussed at FAR Part 16.504. Rather than fully competing every acquisition, an ID/IQ contract allowed federal agencies to purchase - within time and price limits - of goods or services, with delivery or service performance to be scheduled by placing orders with the contractor (Goan, 2002). Having an ID/IQ in place enabled agencies to speed their purchasing cycle and to make do with less contracting personnel. While the former benefit speeded purchasing overall, particularly in the IT (information technology) area, the latter gain was also important, especially as the procurement "brain drain" which began in the 1990's has continued to accelerate to the present day (Laurent, 1999).

FASA also made awards to multiple companies the preferred approach to services contracting. Hence, the concept of Multiple Award ID/IQ contracts (MAC) was born. Under these contracts, task and delivery order contracts for the same or similar products and/or services can be acquired under a single solicitation from two or more competing sources for that particular order. FAR Part 16 states a preference for these multiple award ID/IQ vehicles and requires that each multiple awardee be given a "fair opportunity for consideration" for any order of $2,500 or greater. This provision built competition into the process, even though the contest was exclusive to the awardees and not open to "all comers." Yet, criticism has been directed at the Department of Defense over just how competitive these processes really are.

In 2000, at the behest of the U.S. Senate's Armed Services Committee's Subcommittee on Readiness and Management Support, the General Accounting Office examined the use of multiple

award contracts (MAC) for large information technology buys of both goods and services. The resulting GAO Report, *Contract Management: Few Competing Proposals for Large DoD Information Technology Orders (NSIAD-00-56)*, found that in many instances, competition was simply not occurring. The GAO looked at 22 DOD task orders over $5 million, most of which involved IT services for ongoing defense programs, awarded between October 1, 1997, and December 31, 1998. The GAO found that only 6 of the 22 orders had competing proposals. This translated into the fact that $443.7 million, or just over eighty percent of the $553.1 million total value of the contracts examined, was awarded via noncompetitive processes (General Accounting Office, 2000).

The rationales that competitive proposals were not forthcoming in these instances centered around three primary reasons. First, incumbent contractors often had an inherent advantage that precluded potential bidders from expending the time and effort necessary to submit a proposal. For instance, in 9 of 10 instances where there was an incumbent contractor, only the existing prime contractor submitted a proposal. This was attributed to the requirements that potential bidders would have to meet should they be successful in gaining the contract. Several of the contracts also contained "poison pill" provisions that meant that a successful offeror would have to have had staff in place (with proper security clearances and fully-functioning offices) within days of the award. This made bidding - and winning - on a contract would only serve to put the successful company in an untenable position. Finally, the GAO cited the fact that in some instances, potential offerors were not given a reasonable amount of time to respond with proposals. For instance, on an Air Force contract, only the current contractor responded with a proposal on a 3-year, $11 million contract within the two day time frame given by the agency.

A secondly reason was that contracting officers in the DOD used statutory exceptions to FASA to not have competitive bidding on services contracts that were a "logical follow-on" to a contract that had been competitively sourced initially. The GAO (2000) offered several such instances of this practice.

In one instance, the Defense Information Systems Agency made an award, valued at $300,000, to a multiple-award contractor of a for two-month's work. Citing a FASA exception because the work in question was highly-specialized, the agency awarded a second order, covering another 10 months of work at an estimated cost of $6.7 million as a logical follow-on to the initial award. The agency subsequently awarded the incumbent contractor another award as a logical follow-on, valued at $7 million for another 11 months of work.

In similar fashion, the National Institutes of Health (NIH) placed an order for an Army communication system. The original NIH order covered one year and was valued at $1.6 million. A subsequent award was made noncompetitively as a logical follow-on. This follow-on order was valued at approximately $8.5 million annually, as spanned 45 months of work for $32.1 million. The work description for this follow-on order included two task areas that the original $1.6 million order's work description did not mention, which necessitated the contractor to increase staffing to

almost three times that proposed for the original order). With the increased scope, the contractor also proposed to increase expenditures for other direct costs (such as supplies and equipment) to about $2.6 million annually, whereas these were under $40,000 in the original task order.

The GAO (2000) concluded that such logical follow-on orders were inconsistent with guidance from the Office of Federal Procurement Policy. In response to the critical report, the Defense Department disagreed with the GAO that outreach efforts can produce an increase in the number of bidders and the competition for such contracts. A DOD spokesperson commented that: "It does not seem appropriate to go beyond notification to more active encouragement. It is unlikely that active campaigning on the part of the government will overcome a contractor's business judgment (to not bid)" (quoted in Saldarini, 2000, n.p.).

THE PUSH FOR PERFORMANCE-BASED CONTRACTING

According to Dick Hill, Vice President for Automation for the Dedham, Massachusetts-based ARC Advisory Group, the "standard bidding approach" most often leads to the buyer seeing that "you get what you pay for when you pick the low-cost bid." In contrast, performance-based contracting is "based on a partnership in which the buyer has more control over the work being done, and the vendor works harder to achieve benefits for the buyer and for itself" (quoted in Mullin, 2002, p. 27). Performance-based contracting offers the opportunity to align the interests of both the government and the contractor - to the betterment of both. For the first time, the process "brings customers, technical personnel, and contracting staff together as a team" (Hutcheson, 2001, p. 17).

Performance-based contracting evolved out of the "shared savings" concept from energy management in the 1980s. It is seen in the corporate world as a means to make gains in business process efficiency, without having to make capital outlays (Mullin, 2002).

Allan Burman (2001), a former administrator with the Office of Federal Procurement Policy, gave what he labeled as "the 30-second elevator speech" describing what performance-based contracting is, expressed it as simply being: "Tell the contractor the result you want, not how to do the work, and then be sure you can measure whether that result has been achieved. Performance metrics and incentives or disincentives that focus the contractor's actions on the agency's goals provide the framework for evaluation" (p. 88).

Writing in *Government Executive*, Joshua Dean (2002) has hailed performance-based contracting as nothing less than "a revolutionary way of doing business" (p. 54). Yet, what exactly is it? For the relative simplicity of the concept, there have been a variety of definitions given for performance-based contracting. These include:

According to the FAR (Federal Acquisition Regulations) 37.601:

"Performance-based contracting methods are intended to ensure that required performance quality levels are achieved and that total payment is related to the degree that services performed meet contract standards. Performance-based contracts-

(a) Describe the requirements in terms of results required rather than the methods of performance of the work;

(b) Use measurable performance standards (i.e., terms of quality, timeliness, quantity, etc.) and quality assurance surveillance plans (see 46.103(a) and 46.401(a));

(c) Specify procedures for reductions of fee or for reductions to the price of a fixed-price contract when services are not performed or do not meet contract requirements (see 46.407); and

(d) Include performance incentives where appropriate."

(http://www.arnet.gov/far/current/html/Subpart_37_6.html).

According to the Department of Defense's (2001) Guidebook for Performance-Based Services Acquisition (PBSA) in the Department of Defense, to be considered performance-based, an acquisition should contain, at a minimum, the following elements:

1.	*Performance work statement*-Describes the requirement in terms of measurable outcomes rather than by means of prescriptive methods.
2.	*Measurable performance standards*-To determine whether performance outcomes have been met, defines what is considered acceptable performance.
3.	*Remedies*-Procedures that address how to manage performance that does not meet performance standards. While not mandatory, incentives should be used, where appropriate, to encourage performance that will exceed performance standards. Remedies and incentives complement each other.
4.	*Performance Assessment Plan*-Describes how contractor performance will be measured and assessed against performance standards. (Quality Assurance Plan or Quality Assurance Surveillance Plan) (p. 1).

According to the National Association of State Purchasing Officials (NASPO, 1997), performance-based contracting is characterized by "specification of the outcome expectations of the contract and the requirement that any renewals or extensions be based on the achievement of the identified outcomes" (p. 1).

Seeking to clarify the muddled picture, Lawrence Martin (2002b) has recently offered a "consensus definition" for performance-based services contracting, defining the practice as: "A performance-based contract can be defined as one that focuses on the *outputs, quality and outcomes* of service provision and may tie at least a portion of a contractor's payment as well as any contract extension or renewal to their achievement" (emphasis in the original) (pp. 57-58).

The federal government has established stretch goals for the shift to performance-based contracting. In April 2000, then Under Secretary of Defense Jacques Gansler established the goal that 50 percent of DOD's service acquisitions, as measured by both dollars and actions, were to be

performance-based by the year 2005 (Department of Defense, 2000, p. 1). The Office of Management and Budget (OMB) (2001) initially mandated that 20 percent of all eligible federal service contracts over $25,000 should be performance-based for fiscal 2002. This goal has since been pushed back to fiscal 2004 (Frank, 2002a). However, the Procurement Executives Council has established that fully half of all service contracting should be performance-based by fiscal 2005 (Martin, 2002a). Angela Styles, Administrator of the Office of Federal Procurement Policy, observed that attaining these targeted goals is especially difficult, in large part because federal agencies still disagree on what makes a contract truly performance-based (opinion cited in Frank, 2002b).

From the viewpoint of Michael Sade, Director of Acquisition Management at the Department of Commerce, while performance-based contracting sounds fairly simple, it is extremely difficult to put into practice. Sade observed that: "Conceptually, people get it…but it's when you go to sit down and try to write a performance-based statement of work that the problems begin" (opinion cited in Frank, 2002b, n.p.). According to Richard White, President of Fedmarket.com: "While the concept is simple (pay based on performance), implementation isn't. That's because performance-based work statements, which set the terms of payment and work to be performed, are difficult to draft" (White, 2002, n.p.). Essentially, a performance-based statement of work (SOW) describes the work "in terms of 'what' the required service is rather than 'how' to perform the work" (Hutcheson, 2001, p. 17). Writing in *Supply Management*, Sam Tulip (2002) cautioned that "the object of the exercise" in services contracting should be to focus on value received, rather than solely on costs (p. 38).

THE NEED FOR APPROPRIATE GUIDELINES AND MEASURES

Gary Krump, a procurement executive for the Veteran's Administration, observed that to effectively administer contracts in a performance-based environment, one should heed the advice of former President Ronald Reagan to "trust, but verify" (cited in Burman, 2001, p. 89)

When developing appropriate metrics for performance-based contracting, it is essential to have appropriate measures in place. Indeed, performance - and having the means to ensure accountability for delivering outcomes - are the central issues in this area (Greve, 2001). Under performance-based contracting, buyers are essentially "buying a business outcome." As such, the key to success in a performance-based environment is to have accurate measures in place (Mullin, 2002, p. 27). Yet, at what price should accuracy be achieved? Tulip (2002) points out that there are instances where qualitative observations must be utilized in assessing performance, due to the impracticality or unavailability of quantitative outcomes. He gives a quintessential example in that "you could monitor a cleaning contract in terms of microbes per square meter of floor, for example, but this would require the full-time services of a pathology lab" (p. 39).

There is certainly difficulty in transitioning to performance-based contracting and drafting the all-important statements of work (SOW). In testimony before the House Government Reform Committee's Subcommittee on Technology and Procurement Policy, Colonel Aaron B. Floyd, the President of the Retired Military Officers Association, characterized most statements of work as being "boiler-plates, voluminous and poorly written, and often fuel(ing) disputes between the contractor and the government contracting community" (United States House of Representatives, 2001, n.p.). Earlier this year, Angela Styles, OMB's Administrator for Federal Procurement Policy, characterized traditional statements of work as often being "process driven," in that they are "telling a contractor 'how to do the work' instead of telling a contractor what the desired outcome should be" (United States Senate, 2002, n.p.).

The differences between the "old-style" statements of work and those that would be necessary in a performance-based system are significant. This was best illustrated in an interesting allegory on performance-based service contracting that NAVSEA (the Naval Sea Systems Command) developed for educational purposes. The "Chocolate Chip Cookie Example" is presented in Table 3.

The beauty of this illustration is that it takes what can be a complex topic - the difference between the two contracting methods - and presents in a way that anyone could understand. The traditional SOW outlines exactly how the contractor shall perform the work, providing precise direction (ingredients, temperature and process) and little flexibility. In contrast, the performance-based SOW describes the effort in terms of measurable performance standards (outputs = chocolate chip cookies). These standards should include such elements as "what, when, where, how many, and how well," leaving the contractor to establish their own "recipe" or processes to produce the desired output.

Although the cookie example is simplistic, the premise is sound: by providing the contractor with clear direction as to the program manager's desired output and allowing the contractor to utilize its own established processes, program managers will recognize cost savings and increased satisfaction with the quality of the contractor's product.

Drafting such performance-based statements of work can, in practice, be quite difficult however. This can be seen in a recently released GAO report on performance-based contracting for services across the federal government. In September 2002, the General Accounting Office released *Contract Management: Guidance Needed for Using Performance Based Service Contracting (GAO-02-1049)*,in which the GAO sampled twenty-five federal performance-based contracts from five federal agencies significantly involved in services contracting: the Department of Defense (DOD); the Department of Energy (DOE); the Department of the Treasury (DOT); the General Services Administration (GSA); and National Aeronautics and Space Administration (NASA).

The purpose of the exercise was to examine how well federal agencies were *actually* making use of performance-based measures. To assess whether the contracts were indeed performance-based, the GAO (2002) looked at whether or not they included the four essential

elements for performance-based contracting, spelled out in the FAR (Federal Acquisition Regulations), in that they: (1.) described what outcomes the government was looking for and left it up to the contractor to decide how best to achieve these outcomes; (2.) set measurable performance standards; (3.) subjected the contractor to a quality assurance plan; and (4.) included performance penalties and incentives when appropriate.

Table 3: The Chocolate Chip Cookie Example

Traditional SOW (Statement of Work) for Chocolate Chip Cookies	Performance Based SOW (Statement of Work) for Chocolate Chip Cookies
Ingredients: 1 cup butter (or 3/4 cup butter and 1/4 cup butter-flavored Crisco) 2 1/4 cups all purpose flour 1 cup dark brown sugar 1/2 cup granulated sugar 2 large eggs, beaten 2 teaspoons real bourbon vanilla extract 12 ounces semi-sweet chocolate chips 1 cup Diamond shelled walnuts 1 teaspoon milk 1/2 teaspoon water 1 teaspoon baking soda 1/2 teaspoon salt Directions: 1. Preheat your oven to 325 degrees (F). 2. Use an electric mixer to mix sugars and butter in a large bowl. Add the other wet ingredients, mixing well. Then mix in flour, baking soda, and salt. Finally, mix in chocolate and nuts. 3. Place tablespoon-sized balls of cookie dough on an ungreased baking sheet, and cook for about 11 minutes (your cooking times may vary). The cookies will be extremely soft when removed from the oven. Carefully lift the cookies with a spatula and place them on a rack to cool. Packaging: Packaging should provide adequate moisture protection so that the cookies remain fresh and no more than 5% of the delivered cookies experience breakage. Delivery: Delivery must be made not later than 7 days after contract award, at the Washington Navy Yard, Bldg 171, on the lobby of the 5th floor. Acceptance: Acceptance will be made by Program Manager and Contracting Officer after tasting a random sample.	What - Chocolate Chip Cookies When - one week from today Where - Washington Navy Yard, Bldg 171, Lobby of 5th floor How many - 5 dozen (60 cookies) How well - Must taste good and not be broke

Source Info: Naval Sea Systems Command - SeaPort (2001). "Learn: What Does 'Performance Based' Mean? Please Give an Example." Available at http://www.seaport.navy.mil/main/learn/what_does_pb_mean.html.

The GAO found that most of these contracts did exhibit some of these elements. Specifically, the GAO discovered that nine of the twenty-five clearly exhibited all four of the essential

characteristics. These were for services commonly performed in the private sector, including: advertising; building maintenance and custodial services; information technology support services, and tour guides. In these instances, all of which involved services that were not unique to the government or especially risky for the contractor to perform, the measurement and assessment of outcomes was relatively straight-forward, and the contractors were able to determine the best methods for delivering services to meet or exceed the quality goals.

On the opposite end of the spectrum, four of the twenty-five contracts were deemed by the GAO investigators to *clearly* have not met the definition of performance-based contracting. These contracts were all for commercial-type services, all of which were suitable for performance-based contracting. The contracts reviewed were two for the Air Force, involving a single base's garbage collection/recycling and housing maintenance, and two for the Department of the Treasury, involving food service and dormitory management at a training facility. Overall, the GAO found that while the contracts did specify performance targets and positive rewards and negative consequences for the contractor's performance, all four contracts were overly prescriptive in specifying how the contractor should carry-out the assignment.

In the GAO's review, the Treasury Department was found to have been relying upon "old style" government contracting methods of having highly detailed statements of work in what were supposed to be performance-based contracts. For instance, their contract for dormitory management Federal Law Enforcement Training Center had a 47-page list of specifications, including: "the cotton/polyester fiber content of towels, bed linens, and ironing board pads; the components necessary for making up a bed; monogramming of contractor employee uniforms; minimum thickness standards for trash can liners; and when and how to perform maintenance on water coolers and air conditioning equipment" (GAO, 2002, p. 6). Likewise, Treasury specified 33 pages worth of guidelines for a contractor providing food service at the same facility, including: what sandwiches were to be served; what should be included in picnic baskets; and what length the corn-on-the-cob should be (GAO, 2002).

While the preceding examples of detail-orientation in government contracting at its best may seem humorous and could be used by late-night talk show hosts quite effectively, these statements of work can also stifle the ability and imagination of the contractor to find new and better ways of providing the services, while achieving the necessary outcomes, and perhaps saving taxpayer dollars as well.

Between the two extremes, the GAO (2002) found that roughly half of the examined contracts were for services that were unique to the governmental market and not applicable to the private sector and/or were highly risky, technical or complex. These contracts were for such things as: operating a nuclear facility; administering an Army DNA registry; launching and recovering the space shuttle; and overseeing Navy tactical missile and ordinance test ranges.

The GAO found that due to the risk and complexity of the subjects of these contracts, the agencies, while striving for true performance-based contracting, could not refrain from instituting

extensive specifications and oversight without putting their mission - and indeed employee and public safety - at risk. Thus, while the agencies involved were to be complimented for working to include important elements of performance-based contracting, they could not be considered as such, due to their strategic nature.

Two of the contracts cited by the GAO (2002) as falling into this final category were contracts let by the DOE (Department of Energy) and NASA (the National Aeronautics and Space Administration). In the former agency's case, a contract for operating the Savannah River Nuclear Facility had fourteen highly detailed "work authorizations" that contained exhaustive protocols and specifications for employees to follow at the nuclear plant. Likewise, the NASA contract for space shuttle services was very comprehensive, being comprised of 107 pages of work specifications and 190 pages of performance metrics. NASA administrators believed that the shuttle contract had "went as far as it could toward building in performance-based attributes without putting astronauts' lives at risk as well as risking highly expensive equipment" (i.e., the space shuttle itself) (GSA, 2002, pp. 7-8). Interestingly though, in a "Catch 22"-like twist, the GAO admitted that in prior reports, it had cited these two agencies for needing stricter oversight to prevent performance problems and cost overruns such as those that were found in these current contracts.

The GAO (2002) report indeed found that across the board, agencies wanted more guidance in how to better apply performance-based contracting, particularly in complex and mission-critical situations. Yet, it also urged the development of more stringent criteria for labeling contracts as truly being performance-based. According to Ballard (2002), the GAO report has also prompted the Office of Federal Procurement Policy to reexamine its targets for future fiscal years and to issue revised guidance on performance-based contracting. As of November 2002, it now appears that rather than government-wide goals for performance-based contracting, the Office of Management and Budget (OMB) will set agency-by-agency benchmarks. Peckenpaugh (2002) commented that this will make it more difficult for observers to track how much progress is being made on competitive sourcing across the federal government.

PERFORMANCE-BASED CONTRACTING AND THE PRESIDENT'S MANAGEMENT AGENDA

Both in the private and public sectors, performance-based contracting has been a "buzzword" for the past decade. Indeed, the overall trend in the public sector is toward performance-based services contracting and away from the fixed-price or labor-hour models of the past. As Martin (2002b) demonstrated, performance-based contracting has been used successfully at the state and local levels in a diverse range of settings. Under the Bush Administration, the concept appears to be moving from idea to full-blown implementation in federal services contracting (Weinstock, 2001).

President George W. Bush's Management Agenda is based on three guiding principles. These are that the federal government should be: "citizen-centered, not bureaucracy-centered; results-oriented; market-based, actively promoting rather than stifling innovation through competition (Executive Office of the President, Office of Management and Budget, 2001, n.p.). Angela Styles, OMB's Administrator for Federal Procurement Policy, observed that: "Competition has made the American economy the envy of the world. The President, through his Management Agenda, wishes to inject this spirit of competition in as many places in the Federal Government as possible" (United States Senate, 2002, n.p.).

As part of pursuing this agenda to foster real competition, the Bush Administration has determined that the government should curtail its practice of having outside contractors providing services on a labor-hour basis off the GSA (General Services Administration) Schedule. This practice has been widespread in the Department of Defense and particularly applied in the area of information technology (IT) services. In fact, the Department of Defense accounts for 54 percent of all GSA Schedule sales, and IT service purchases make up 57 percent of GSA Federal Supply Service (FSS) schedule sales (Dorobek, 2002c).

Section 803, so named because of the provision of the fiscal 2002 Defense Authorization Act, would have required contracting officers in the Department of Defense to notify all vendors on a multiple-award contract or at least seek bids a sufficient number of potential vendors that proposals from at least three eligible parties would be received on task orders of $50,000 or more (Dorobek, 2002b). While proponents of Section 803 argued that it would have promoted competition in military services contacting, Deidre Lee, Director of DOD Procurement, observed that too often, the perception amongst the vendor community is that agencies know the vendor they want to get the business and then simply "find two other companies to 'make it look good'" (cited in Dorobek, 2002b, n.p.).

Section 803 would have prohibited long-standing practice of hiring outside contractors to supply IT services on a labor-hour basis. Aimed at promoting competition for these contracts, the rule would have had the effect of eliminating the use of (GSA) General Services Administration schedule contracts. In fact, according to Steve Kelman, a Professor of Public Management at John F. Kennedy School of Government at Harvard and a former administrator of the Office of Federal Procurement Policy (OFPP), if made operative, Section 803 "would have a devastating impact on the schedule program," (opinion cited in Dorobek, 2002c, n.p.). However, despite much clamor on the proposed rule for much of the current year (2002), the proposal will apparently not become law until sometime during 2003, if at all (Dorobek, 2002a).

SUMMARY

In the 2002 report, *A Vision of the Government as a World-Class Buyer: Major Procurement Issues for the Coming Decade*, Jacques Gansler observed that "the government must learn to use

incentives rather than regulations as the way to create higher performance at lower costs" (p. 22). Yet, the tension between the use of regulations versus incentives is present still today. Richard Sylvester, Deputy Director of Acquisition Initiatives for the Department of Defense, observed that increased oversight of contractors is "an attempt to deal with acquisition of services in a more strategic manner," (cited in Sherman, 2002, n.p.). Performance-based contracting - despite its problems - appears to be the mechanism for managing the increasing presence of services in federal procurement. However, one must be mindful that, as Lawrence Martin (2002b) observed, performance-based contracting is one of those instances "where practice is outpacing theory" (p. 56). The Director of the Office of Management and Budget, Mitch Daniels, has made it clear that the Bush Administration is going to be looking squarely at outcomes data in assessing agency performance and future funding requests. In testimony to a joint hearing of subcommittees from the House Government Reform and Rules Committees, Daniels stated: "For far too long the question we seemed to address is 'How much?' not 'How well? It is time to put the burden of proof for spending where it should be-on the proponent of spending" (cited in Weinstock, 2002, n.p.).

In fact, outcomes will be vital in assessing not only contractor performance, but the performance of agencies using services contractors in support of their mission - and ultimately, the public's trust. In a grant report for IBM Endowment for the Business of Government, Chris Wye, Director of the Center for Improving Government Performance for the National Academy of Public Administration, made several astute observations in this regard. Writing in *Performance Management: A "Start Where You Are, Use What You Have" Guide*, Wye (2002) commented that:

> *Performance-based management itself is not complicated. Outcome indicators can be only as good as the human beings who design them and the resources available to implement them. If we had infinite time and resources, it might be possible to think about perfection. However, no appropriation was made for designing and implementing indicators. Also, implementers are squeezing their attention to performance into already crowded schedules. The best that can be done is always related to the time and resources available. The worst is not to do something with what we have. We need to start where we are and do what we can* (p. 8).

From this perspective, doing *something* is important. In fact, doing nothing to measure and improve performance can be viewed as nothing less than a dereliction of duty to public service. As Wye (2002) wrote, those in public service should always be mindful "that the money supporting public endeavors is not ours but the public's, and that we are their trustees" (p. 8). This is the simple "core concept" of public service that should enable and motivate public sector leaders to more creatively and effectively make use of performance-based management (Gruber, 2002).

As we have seen in this paper, the shift to performance-based contracting constitutes a paradigm shift in the way the federal government will procure services. Nowhere will the impact of this change be more felt than in the Department of Defense, due to its leading role in services acquisition. Thus, while there have been missteps and mistakes along the road to transition, overall,

the move to make service acquisitions performance-based should make for better value and better quality services being delivered to all government stakeholders. Yet, for public sector managers and contractors alike, the shift to operating on a performance-basis will continue to be a challenge for years to come. Thus, it is incumbent that more research continue to examine the road to performance-based contracting, both to recount the foibles and to triumph the successes of various federal agencies as they change the way they buy necessary services.

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REFLECTIONS ON THE U.S. ELECTRIC POWER PRODUCTION INDUSTRY: PRECEDENT DECISIONS VS. MARKET PRESSURES

Robert F. Cope III, Southeastern Louisiana University
David E. Dismukes, Louisiana State University
John W. Yeargain, Southeastern Louisiana University

ABSTRACT

This research chronologically explores how the unique strategies of over-capitalization through regulated nuclear power ventures and deregulated market power and manipulation were used to increase investor-owned electric utility shareholder wealth. Under regulation, shareholder wealth was relatively stable and expected to grow into the immediate future through nuclear power over-capitalization. With the introduction of deregulated power markets, some utilities seem to be resorting to strategies of market power and manipulation to increase shareholder wealth at the expense of rate payers.

One can argue that the over-capitalization strategy started with The National Energy Conservation Policy Act in 1978. When combined with a broad interpretation of prudence, support was provided for investor-owned utility management's decision to venture into nuclear power production. Several years later, the United States Congress enacted legislation to fully deregulate the electric utility industry with The Energy Policy Act of 1992. Deregulation has severely undervalued nuclear power ventures to the point where investor-owned electric utilities are asking for stranded cost recovery from state regulatory agencies. Without recovery, utilities seem to be resorting to strategies of increasing shareholder wealth through market power and manipulation to subsidize their losses and increase revenues. No better evidence exists than California's recent energy crisis.

INTRODUCTION

The electric power industry of the United States is in the midst of a revolutionary transition from vertically integrated, regulated run monopolies to fully unbundled industries with competitive generation facilities, and regulated transmission and distribution systems. State legislative bodies and regulatory agencies throughout the country are struggling with the challenges of restructuring.

Industrial customers, as well as residential and commercial customers are still questioning current regulatory practices.

Before 1973, the electric power industry was characterized by predictable regulatory policies and steady growth. Power production strategies focused on economies of scale, and competition within the industry did not exist. After 1973, the industry entered a second period that was much more turbulent and less predictable due to soaring energy prices. An energy policy shift in 1978 combined with a broad interpretation of prudence provided support for investor-owned utility management's fuel choice decision to venture into nuclear power production. Under regulation, shareholder wealth continued to be relatively stable and expected to grow into immediate future.

Several years later, the United States Congress set in motion plans to fully deregulate the electric utility industry. The Energy Policy Act of 1992 is currently restructuring the industry from vertically integrated and regulated run monopolies to fully competitive unbundled industries of generation, transmission, and distribution. Deregulation has severely undervalued nuclear power ventures to the point where investor-owned electric utilities are asking for stranded cost (fixed cost) recovery from state regulatory agencies. Without recovery, some utilities seem to be resorting to market power and manipulation to subsidize their losses and increase revenues for shareholders. No better evidence exists than California's recent energy crisis.

Harvey Averch and Leland Johnson (1962) published their landmark paper hypothesizing the performance of monopolies subject to regulation. The concerns of Averch and Johnson, and most economists, reflect distortions in the economy that are counter to economic efficiency. Their hypothesis and methods still embody a widely accepted interpretation of the over-capitalization of an investor-owned monopoly under regulation. Our research explores how the unique strategies of over-capitalization through regulated nuclear power ventures and deregulated market power and manipulation were used to increase investor-owned electric utility shareholder wealth through time at the expense of rate payers.

THE AVERCH-JOHNSON APPROACH TO REGULATORY ECONOMICS

The Averch-Johnson approach to economic regulation focuses on the actions of the regulated firm subject to a regulatory constraint, rather than on actions and behavior of the regulatory body itself. It assumes that the regulatory body follows a traditional social welfare-maximizing role where the actions of the regulated firm, subject to the regulatory constraint, become the focus of inquiry. The constraint is merely a cap, set by the regulatory body, on the maximum allowable rate-of-return that the regulated firm can earn. For the regulated firm, the Averch-Johnson hypothesis constitutes a profit percentage constraint net of labor cost and capital depreciation.

The constraint is mathematically formulated in equation 1 where inputs of demand, labor, depreciation, and the cost of capital are formulated to be less than the profit percentage of the rate base. Table 1 describes the variables and symbols used.

$$\frac{pz - r_2x_2 - u_1}{c_1x_1 - U_1} \leq s_1 . \quad (1)$$

The constraint requires:

$$z = z(x_1, x_2) \text{ for } x_1 \geq 0 \text{ and } x_2 \geq 0 , \quad (2)$$

$$\frac{\partial z}{\partial x_1} > 0 , \quad (3)$$

$$\frac{\partial z}{\partial x_2} > 0 , \text{ and} \quad (4)$$

$$z(0, x_2) = z(x_1, 0) = 0 . \quad (5)$$

Averch and Johnson further assumed that depreciation (u_1 and U_1) is zero and the per unit acquisition cost of capital (c_1) is 100%. The constraint can therefore be reduced to:

$$pz - s_1x_1 - r_2x_2 \leq 0 . \quad (6)$$

Table 1: Explanation of Variables used in Equation 1.

Variable	Meaning
p	An inverse demand function with p = p(z).
z	The quantity produce of a single homogeneous product requiring two inputs.
x_1	The physical quantity input of plant and equipment.
x_2	The quantity input of labor.
c_1	The acquisition cost per unit of plant and equipment in the rate base.
r_2	The labor wage rate.
u_1	The value of depreciation of plant and equipment during a time period in question.
U_1	The cumulative value of depreciation.
s_1	The specified maximum profit percentage of the rate base.

Upon reduction of the constraint, Averch and Johnson reached two controversial conclusions. Specifically, they concluded that a regulatory bias exists when the regulated allowed rate-of-return (s_1) is greater than the cost of capital. This encourages the regulated firm to make inefficient capital-intensive investments. A second, but often overlooked conclusion, is that regulated firms also have the incentive to cross-subsidize less profitable operations at the expense of its more profitable operations, so long as the firm's overall rate-of-return remains unchanged. Both of these conclusions provide formal evidence that rate-of-return regulation can impose social costs in the form of input and output inefficiencies, and over-capitalization can lead to the acquisition of inefficient assets.

LITERATURE REVIEW OF THE AVERCH-JOHNSON APPROACH

The initial Averch-Johnson work has been subject to a great deal of criticism and theoretical modifications and additions. The idea that the regulated firm pads its rate base is not new to practitioners of economic regulation. However, Averch and Johnson were the first to be able to incorporate this idea into a stylized model which has survived the test of time, though many have criticized the model for making unreasonable assumptions, and being overly simplistic for applied work (Corey, 1971).

Empirical tests of the Averch-Johnson approach are varied and reach differing conclusions. Petersen (1975) found that lower rates-of-return were significantly associated with higher costs and large proportions of capital-related costs. In his model, Petersen reformulated the Averch-Johnson hypothesis in terms of cost-minimization subject to the regulatory constraint. He shows that as the cost of capital approaches the allowed rate-of-return, the regulated firm incurs higher unit costs and spends a larger portion of total cost of capital than otherwise. As Petersen explains, regulation would be considered to be "tightened" if the allowed rate-of-return and the cost of capital were equated. Other extensive empirical studies presented by both Spann (1974), and Courville (1974) support the over-capitalization hypothesis.

Other studies, however have failed to support the Averch-Johnson over-capitalization hypothesis. Baron and Taggart (1977) conducted an empirical investigation of the Averch-Johnson hypothesis by forming a financial model of shareholder preferences of input choices for the regulated firm. Instead of focusing upon actual production outcomes, shareholder preferences serve as an indicator of over-capitalization or under-capitalization. The empirical evidence revealed that an increase in the regulated firm's capital stock results in a shareholder-anticipated reduction in the price of the regulated firm's equity. Thus, in order to maintain shareholder profitability and support, the regulated firm will not choose an input level that is biased towards capital – contrary to the Averch-Johnson conclusions. Boyes (1976) and Smithson (1978), using different empirical models, also failed to find any evidence of over-capitalization.

To summarize, the Averch-Johnson approach has become accepted as the mainstream, traditional approach to modeling economic regulation. The regulatory constraint, while not escaping

criticism, is considered by many as a proper description of how the regulated firm maximizes profit in a regulatory environment. The original apparatus, as presented by Averch and Johnson, has undergone a number of significant modifications and revisions. The empirical evidence to date, however, has remained mixed – some studies supporting the over-capitalization hypothesis, some not supporting it. In general, while mainstream, the Averch-Johnson over-capitalization hypothesis takes a technical approach to the study of economic regulation. Regulation is merely seen as an optimization problem, rather than an intricate balance of the interactions of numerous economic agents and interests.

POLICY SHIFTS IN THE U.S. ELECTRIC POWER INDUSTRY

Before 1973, the industry was characterized by steady growth. Many large baseload steam generation plants were built, technology advances were routine, fuel prices were relatively stable, and electricity demand grew and was expected to continue in the immediate future. Regulatory policies were predictable during the early period. In addition, generation production planning focused on economies of scale, and competition within the industry did not exist.

After 1973, the industry entered a second period that was much more turbulent and less predictable. The energy crisis of the middle to late 1970s and early 1980s sent energy prices soaring. As a result, growth in demand for electricity fell sharply. Few technological advances were made during this period. The main steam generation advancement pertained to nuclear power, and it was far overshadowed by the many accident-related setbacks that occurred during its development.

A major change in the industry occurred when federal regulatory policy shifted to compensate for the energy crisis. The shift resulted from the enactment of the National Energy Conservation Policy Act (1978). This Act was composed of five statutes:

1.	Public Utilities Regulatory Policy Act (PURPA),
2.	National Energy Tax Act,
3.	National Energy Conservation Policy Act,
4.	Power Plant and Industrial Fuels Act (PPIFA), and
5.	Natural Gas Policy Act.

The National Energy Conservation Policy Act was intended to ensure continued economic growth during a period in which both the availability and the price of future energy resources were in jeopardy. The two important themes backed by this piece of legislation were:

1.	to promote conservation and the use of other energy sources, and
2.	to reduce the country's dependence on foreign oil.

While all statutes of the National Energy Conservation Policy Act affected the electric power industry, PURPA and PPIFA affected it in the most significant manner. PURPA was designed to encourage a more efficient use of energy through the cogeneration of electric power. PURPA required existing electric utility companies to interconnect and purchase power from any non-utility qualifying facility (QF) at a rate not to exceed the connecting electric utility's avoided cost of generation. This new mandate was quite different from traditional monopolistic cost-of-service regulation where prices are set at the electricity producer's cost of production. Under PURPA, prices are set at the local utility's cost of production, not the QF's cost.

While PURPA encouraged cogeneration, PPIFA limited the number of economically feasible generation fuel options available to an electric utility by prohibiting them from constructing any new steam baseload generation facilities that were fueled primarily by oil or natural gas. Natural gas was still available for intermediate, peaking, and cogeneration facilities, but only coal and nuclear fuels could be used for baseload generation facilities. In 1981, oil and natural gas ceased to be steam generation options for power although both continued to be used in combustion turbine and combined cycle generators.

THE OVER-CAPITALIZING FUEL CHOICE: NUCLEAR POWER

In the early 1950s, the United States embarked on an ambitious plan of commercializing nuclear power. In large part, this effort was subsidized by the federal government, and supported by the commercial electric utility industry (Zimmerman, 1982). By the 1960s, many public and privately-owned utilities were prepared to construct and finance their own nuclear projects. The 1960s was a decade which saw an explosion in the number and size of nuclear power plants that were being ordered. Between 1966-1970, 88 nuclear plants with a combined total of 79,480 MW of capacity were ordered (United States Council of Energy Awareness, 1988).

Throughout the 1970s, it became increasingly clear that commercial nuclear power had developed a unique set of problems. Not only was the industry grappling with problems of deploying a new electric generating technology, it was also presented with a host of other obstacles to over come, such as, construction cost escalation, labor shortages, schedule delays, and increased Nuclear Regulatory Commission (NRC) regulations. Of particular concern was the increased incidence of serious safety-related accidents and regulations.

In 1974, the average installed cost per kilowatt (KW) for a nuclear power plant was $297 (UDI, 1990). Installed costs increased by some 53% to $453 per KW in 1975, and by 113% in 1977 to $633 per KW. On two occasions in the 1980s, nuclear construction costs reached unprecedented

peaks. For instance, in 1981 the cost per kilowatt (KW) of nuclear and coal generation was $746.1/KW and 598.2/KW, respectively. In 1983, nuclear construction costs rose to $1,863/KW from a $1,180/KW level a year earlier. Again, in 1987, installed nuclear costs increased to $4,129/KW from a 1986 level of $3,071/KW (Dismukes, 1992). By 1990, the installed cost for a coal generation facility was $1,616.7/KW, while the cost for nuclear generation was $4,167.9/KW – or 2.5 times as much (Dismukes, 1995).

Another disadvantage included the lengthy construction durations required to complete nuclear units. In 1968, it took 3.3 years to construct a nuclear power plant. By 1973, construction durations had increased to 5.6 years. After 1973, a significant and growing number of safety related construction requirements pushed construction durations even higher. By 1987, construction durations had reached an all time high of 11 years.

In addition to the effects of PURPA and PPIFA, federal environmental regulations began increasing the cost of power plant construction. Starting in the early 1970's, the Environmental Protection Agency (EPA) established and strengthened a number of air quality standards that required new coal-fired utility boilers to limit their emission of sulfur dioxide (SO_2), nitrogen oxide (NO_x), and particulate matter. In order to comply with these standards, utilities had to begin constructing plants with a significantly greater amount of environmental emissions equipment, or "scubbers", to reduce SO_2 and particulates.

With the energy constraints from the EPA and PPIFA that had been placed on the industry, it is easy to see that investor-owned electric utility management had to make a choice between two distinctively different learning curves. Should they travel an environmental learning curve for coal plants or a completely new capital-intensive learning curve for a new technology – nuclear power? The choice was simple and supported by the Averch-Johnson hypothesis, that is, when given a choice among options in a regulated environment, choose the one that is capital intensive.

Clearly, cost overruns, schedule delays, increased safety regulations, environmental concerns, and inflation all played a significant part in undermining the performance of nuclear power in the United States. However, there were additional factors that also dragged confidence in the industry to even lower levels.

By the late 1970s, the public began to question the necessity of large nuclear power plants. A majority of the nuclear power projects planned to be completed in the 1970s and 1980s were based upon demand forecasts which estimated a geometrically increasing demand for electric power. The OPEC oil embargo of 1973, however, dramatically altered U.S. consumption patterns, creating a sizable disparity between forecasted and actual electricity demand.

Furthermore, several interested parties began to question the actions and decisions of the utilities constructing nuclear power plants. Many questioned utility construction managers' persistence in continuing their nuclear construction commitments when growing risks appeared evident. These decisions were called into greater question once the demand for these plants never materialized.

Declining demand, as well as the questionable actions of many nuclear construction managers, placed the burden of cost recovery into uncertain arms. The topic was hotly debated among several utilities, investors, commissions, and consumer groups across the United States. Regulatory commissions, responsible to the public interest, were forced to closely scrutinize the nuclear projects in their jurisdictions before allowing the costs of these projects to be recovered through rates. During this period, the prudence of nuclear investments came into question, and the rules of law codifying the prudence concept were revived from infrequent use.

THE PRUDENCE STANDARD

The prudence standard has existed for a long time in state public utility regulation. The first recorded use of the prudence standard was exercised by the Massachusetts Public Service Commission in 1914 (NRRI, 1985). The concept was used to ensure that only prudently incurred capital expenditures would be allowed in a rate base. The definition of a prudent investment was expressed by U.S. Supreme Court Justice Louis Brandeis in 1923 as:

> *"The term prudent investment is not used in a critical sense. There should not be excluded from the finding of the [rate] base, investments which, under ordinary circumstances, would be deemed reasonable. The term is applied for the purpose of excluding what might be found to be dishonest or obviously wasteful or imprudent expenditures. Every investment may be assumed to have been made in the exercise of reasonable judgment unless contrary is shown"*
>
> (Southwestern Bell Telephone Co., 1923).

The prudence standard has been compared to the common law negligence standard for determining whether to exclude value from the rate base. In other words, the utility must show that it used a reasonable decision making process to reach a course of action, and, based on the facts known at the time, responded in a reasonable manner. This may be called foreseeability. Thus, when Congress passed legislation limiting utilities to building new facilities which were either coal generated or nuclear generated, and presented statistical estimates of an increasing demand for electric power, the prudence standard would permit utilities to build nuclear power plants. However, at least one court has held that if during construction of a nuclear facility, the economics changed so as to make the cost of building the nuclear facility increase and the demand for new electric power to decrease, then forseeability at that time would dictate stopping construction of the nuclear facility. A decision to continue construction would be termed imprudent and the utility would not be permitted to pass on its costs of completion to its rate payers (*Gulf States Utilities Co.*, 1991).

Wider use of the prudence standard only occurred after two important Supreme Court decisions in 1942 and 1944 (*Federal Power Commission*, 1942; *Federal Power Commission*, 1944).

Natural Gas Pipeline Co. and *Hope Natural Gas Co.*, taken together, formed the legal basis for the use of the prudence concept in public utility regulation (NRRI, 1985).

Although a firm precedent for the prudence standard was established in the 1940s, it was infrequently invoked. Table 2 presents the number of times the prudence standard was used in some significant manner by state regulatory commissions.

Table 2: Prudence Standard Use in Public Regulation: 1944-1983 (NRRI,1985).

Years	Incidence
1944-1953	5
1954-1963	1
1964-1973	3
1974-1983	42

The predominant reason that the prudence standard was rarely invoked is often attributed to an accepted regulatory compact that had long existed between regulators and utilities. This is not a specific written agreement between regulators and utilities, but a well-established set of rules based upon general constitutional principles, U.S. Supreme Court decisions, federal and state statues, regulatory policy, and tradition (Gioia, 1989). The fundamental goal of the regulatory compact is to serve the public interest. This compact places utilities under the obligation to provide affordable, reliable service without over-capitalizing. In return, the utility is offered recovery of its expenses and capital investments, as well as the opportunity to earn a reasonable rate of return on those investments.

The traditions of public utility regulation, however, proved to be incapable of distributing the financial burdens of constructing nuclear power projects. The challenge to regulators was to review each project in their jurisdiction that was considered to be imprudently constructed. According to Kahn (1988), regulators were forced to come to grips with the

> *"[dramatic challenge], fundamental to original cost regulation, that utility companies are entitled to a fair opportunity to earn a "reasonable" return on all dollars prudently invested in fulfilling their service responsibilities. Regulatory commissions have of course both the authority and responsibility, under the system, to disallow imprudent expenditures. But judgment of prudence can, in principle – and in fairness – be made only as of the time when the pertinent commitments and expenditures were made."*

Clearly, disallowing imprudently incurred construction costs were part of the regulatory compact. However, the magnitude of both the direct and indirect costs of a prudence review placed many regulatory commissions in an uncomfortable position.

While many suggestions for remedying the problems of prudence investigations have been presented, few have gained any widespread support. One suggestion has been to get a definitive court decision, particularly from the U.S. Supreme Court (Studness, 1991). However, recent and past court decisions have shown a tendency to stay away from conclusive definitions regarding prudence investigations. The courts, furthermore, have also moved away, and even overturned, decisions which trample on a state's rights to regulate its public utilities. The courts have treated state commissions as experts in determining prudence, and have steered clear of substituting their judgment for those of commissions (Studness, 1992).

The relationship between prudence investigations and nuclear power has been a controversial one. Recent experience involving the cost recovery of these multi-billion dollar projects has created an adversarial environment between utilities and regulatory commissions. Blame has been placed on a number of factors ranging from increased regulatory requirements to negligence, to political motivation.

SHAREHOLDER WEALTH: PRE-DEREGULATION

Public policy at this time helped to facilitate the shareholder wealth-building strategies of utilities. Recall that PURPA and PPIFA banned natural gas and oil-fired stream generating facilities. Sheltered by the prudence standard and the length of time required for capital outlays, investor-owned utility management proceeded with nuclear projects during the 1960s, 1970s, and 1980s. Most utilities saw nuclear power as an exceptional opportunity to both reduce production rates and increase shareholder value. The biggest advantage of nuclear power was its ability to increase the overall utility rate base ("net plant in service"), which in turn increased opportunities for returns to shareholders based on the amount of capital they had in service.

In addition, nuclear projects were a great strategic fit during the cogeneration era since utilities were required to pay cogenerators their (the utility's) avoided cost for production. This was a great strategy for investor-owned utilities since rate based capital costs (investments) were very high and operating costs (usually fuel) were very low for nuclear plants. Given these cost characteristics, it seemed to make sense for utilities to oversize these facilities in a manner that took advantage of their economies of scale in construction. Thus, for utilities, it appeared that nuclear power was a win-win situation: a technology with significant capital investments to build shareholder wealth, and low operating costs that were almost "too cheap to meter" for retail ratepayers.

DEREGULATION OF THE ELECTRIC POWER PRODUCTION INDUSTRY IN THE U.S.

One could argue that electric utility deregulation began with the enactment of PURPA and PPIFA. Together they initiated a new power market where established electric utility generation facilities coexist with cogeneration facilities. These two pieces of legislation were the foundation for competition within the electric utility industry. But, by 1987 PPIFA had been repealed opening the door for combustion turbine and combined cycle technology developments. In addition, the deregulation of electric power generation was avoided in 1982 after the U.S. Supreme Court upheld the legality of PURPA in *FERC vs. Mississippi (Federal Energy Regulatory Commission*, 1982) when a federal judge ruled PURPA to be unconstitutional. Another energy policy act was legislated by the United States Congress several years later. The Energy Policy Act of 1992 set in motion plans to fully deregulate the electric utility industry. The Act is currently revolutionizing and restructuring the industry from vertically integrated and regulated run monopolies to fully competitive unbundled industries of generation, transmission, and distribution. State legislatures and regulatory agencies throughout the country are again struggling with the challenges of change. With widespread competition, electric utilities are using their own electric power generation mix of investments to compete for market share with other suppliers.

The Act added momentum towards competition initially started by PURPA and PPIFA. It provided for the generation of electric energy by independent power producers for wholesale or retail sale. This piece of legislation encourages non-utility power production by creating a new category of electricity providers known as exempt wholesale generators (EWGs). These EWGs differ from QFs in two distinctive ways:

1.	they are not required to meet PURPA's cogeneration or renewable fuels limitations, and
2.	utilities are not required to purchase power from EWGs.

This was a significant step toward deregulation. The situation that now exists between electric utilities and EWGs is commonly known as "wholesale wheeling." *Wheeling* is defined as the transmission of electricity by an entity that does not own or directly use the power it is transmitting (IEEE PES, 1996). A transmission network plays a strategically important role in electric power wheeling. By providing the critical connection between neighboring markets, it enhances the geographical scope of the power system. Wholesale wheeling allows many non-generating utilities to "shop" the newly formed power market for cheap electric power and effectively reduce their historical dependence on electric power generated by their local electric utility.

Table 3 provides a historical view of the industry shortly after deregulation occurred. It shows that the industry was made-up of 3,212 utilities that consisted of investor-owned utilities (IOUs), publicly-owned utilities (POUs), federally-owned utilities (FOUs), and cooperatively-owned utilities (COUs). Although investor-owned utilities accounted for only 7.9% of the make-up of all utilities, the descriptive statistics also indicate that they do account for 76.3% of all sales to final users with an average margin of $0.038/KWh.

Table 3: 1993 Descriptive Statistics of the Electric Utility Industry (DOE/EIA-0437, 1994).

Item	IOUs	POUs	FOUs	COUs	Total
Number of utilities	254	2,007	10	941	3,212
Utilities as a %	7.90	62.50	0.30	29.30	100.00
Final users % sales (KWh)	76.30	14.40	1.60	7.70	100.00
Retail price ($/KWh)	0.072	0.061	0.028	0.070	0.069
KWh sales for resale	18,452,517	7,866,159	6,649,342	10,351,832	43,319,850
Wholesale price ($/MWh)	34	38	33	41	36

Table 4 provides a historical view of the generating capability of electric utilities in the United States shortly after deregulation occurred. At that time there were 109 nuclear generators with generating capabilities totaling 99,041 MW, accounting for 14.1% of total production capabilities.

Table 4: 1993 Generating Capability of U.S. Electric Utilities by Prime Mover and Primary Energy Source (DOE/EIA-0348, 1994).

Prime Mover/Primary Energy Source	Generating Capability (MW)	Number of Generators
Fossil Steam	446,315	2,158
Coal-Fired	300,795	1,223
Petroleum-Fired	41,905	187
Gas-Fired	103,614	748
Nuclear	99,041	109
Hydro Electric	95,910	3,531
Gas Turbine/Internal Combustion	56,494	3,879
Petroleum-Fired	27,614	2,463
Gas-Fired	28,881	1,416
Other	2,211	794
Total	699,971	10,471

Similar to the disallowance problem electric utilities faced in the late 1970s and early 1980s, a new problem has surfaced where embedded rates of investor-owned nuclear power plants far exceed market clearing prices for electric power. Now, electric utilities fear that a reduction in rates is necessary to retain market share. Such rate reductions produce losses in revenue below the amount needed to cover total costs. Thus, utilities are concerned that their over-capitalizing fuel choice decisions for power production facilities are creating stranded costs.

STRANDED COSTS AND THEIR EXPECTED ECONOMIC IMPACT

In the competitive environment, it is possible that prices for electricity could be lower than those ordained through regulation. This development could, in turn, create a corresponding decline in income streams, thereby causing a downward valuation of a given asset (or group of them) in the market. This phenomenon leads to what has commonly come to be known as *stranded costs*. Using a definition that remains consistent with economics and logic:

> *Stranded costs mark the difference between the historical book value of utility assets, net of depreciation, minus the fair market value of these assets under conditions of competitive pricing of electricity. If this value is positive, this difference represents the amount of unrecoverable stranded costs. If it is negative, then the utility faces no stranded costs.*

This concept can be explained by the following equations (net of depreciation). Equation 7 formulates total stranded costs on a unit-of-production cost basis (per Megawatt hour), while equation 8 accounts for total stranded costs based on revenues. Table 5 describes the variables and symbols used.

$$SC = dPV[((MCP - AVC) * MWh) - FC]. \quad (7)$$

$$SC = dPV[Revenues - FC - TVC]. \quad (8)$$

Electric power production stranded costs has become "the" new problem for regulators. Most stranded costs are associated with generation facilities that would be uneconomic in a competitive environment (i.e. marginal production costs and embedded capital costs are higher than the power system's market clearing price for electric power). More specifically, these facilities are over-capitalized assets whose regulated book value is purported to be greater than market value.

Many believe that stranded costs should reflect the portfolio of assets (both nuclear and fossil) held by the firm. For instance, a particular electric utility may operate a nuclear facility with an enormous capital cost. While the facility is productive and boasts low operating costs, its competitive cash flows most likely will never pay off its huge historical cost. At the same time, however, the firm may posses several conventional fossil-fired plants that are partially or even fully depreciated and thus are no longer reflected in the rate base. Today they look like astute investments.

Table 5: Explanation of Variables for Equations 7 and 8.

Variable	Meaning
SC	Stranded Cost
dPV	Discounted Present Value
MCP	Market Clearing Price of Electricity (per unit)
AVC	Average Variable Cost of Electricity (per unit)
MWh	Amount of Power sold (per unit) at the MCP
FC	Fixed Cost of Current Power Production Assets
Revenues	MCP * MWh
TVC	Total Variable Costs of Producing Electricity

Even though there were regulatory dissallowances, over-capitalization remained during deregulation of the industry. Estimates of aggregate stranded costs vary greatly, ranging from a low of $10 to $20 billion to a high of $500 billion depending on the assumptions used to estimate them (DOE/EIA-0562, 1996). McKinsey & Company estimates the value of unnecessary nationwide electric generating plants to be at about $150 billion (Business Week, 12/2/96). The American Public Power Association claims that about 5% to 10% of the capacity assets of investor-owned electric utilities may become stranded (APPA, 1994). In addition, there are groups who believe that a large portion of stranded costs are attributable to nuclear power plants. According to one study from the Department of Energy, of the nearly $120 billion in undepreciated assets in domestic nuclear power plants, nearly $70 billion may be stranded in a competitive environment (Yokell et al., 1995).

Full recovery of nuclear assets does in fact create another interesting question. Nuclear power plants have such low variable costs that once fully recovered, will investor-owned utilities have a competitive advantage to under bid other power producers and maintain market share? If so, then do we really have a deregulated environment if these utilities are able to manipulate market prices? This unfair advantage would be gained at the expense of rate-payers. One must also take into consideration that municipally-owned, federally-owned, and cooperatively-owned power producing utilities do not have a mechanism for stranded cost recovery making their efforts to keep market share much more difficult.

DETERMINING MARKET CLEARING PRICES

Most electric power markets follow the Poolco regime. The Poolco regime is a centralized market structure that consists of a Regional Transmission Organization (RTO) with an independent system operator (ISO) and competitive power exchange (PX). The ISO handles the physical deliveries and coordination of power flows within a regional power system and the PX handles all of the transactional issues associated with system power sales. In the Poolco regime, regional power market competitors submit bid prices and capacity offers into the competitive PX. Load from local distribution companies, representing all electricity end users, are then aggregated by the Poolco. Hour-ahead bid prices are used to construct a least cost dispatched, hourly supply curve. An hourly market clearing price is determined at the point in which the PX determined supply curve intersects total regional aggregated demand. Least cost dispatch information is then transmitted from the PX to the ISO who controls all system coordination and security issues. An example of an economic equilibrium modeling methodology to determine market clearing prices can be found in Cope et. al. (2001).

Traditional ISO dispatch has assumed that sufficient transmission capacity is present to support wheeling transactions. This, in fact, may not be true since the United States bulk electric power system was originally built and operated on the basis of mutually advantageous coordination by regulated entities for the purpose of reliability and security instead of competition and profit. Thus, for deregulation to be successful, the wheeling of electric power at the wholesale level must first be successful.

DEBT TO EQUITY THROUGH MARKET POWER AND MANIPULATION

Rao and Tabors (2000) hypothesize that transmission providers who have remained vertically integrated (i.e. owning both deregulated generation and regulated transmission assets) have learned to profit largely within the existing rules for deregulation. This is accomplished by effectively foreclosing competition and limiting access to key markets to the benefit of their marketing and generation affiliates since existing rules for system security and operation are broadly defined around North American Electric Reliability Council (NERC) operating procedures (and each transmission provider's open access transmission tariff). Monitoring such behavior between the transmission and generation components requires an extensive amount of information that is not openly available for market participants in the public domain. Hence, "policing" within a regulatory framework to support the objectives of FERC Order 888 is difficult and a truly restructured power market cannot be expected.

Congestion problems have surfaced in some areas from deregulation policy. Policy makers are allowing previously regulated power producers to sell a certain percentage of their power on the open market. For example, once a local power producer enters into an open market export

transaction, transmission interconnection capacity is needed to support the transaction. The regional power exchange may now find it difficult to transmit (either locally or through importing) the difference in power lost because the RTO must first solve a newly created load flow problem if limited interconnection capacity exists. In general, as the region loses its ability to use its transmission interconnection infrastructure efficiently for system reliability purposes, *load pockets* are created (Cope et. al., 2001). We define a load pocket to be a service area where local load exceeds transmission interconnection capacity, thus local generation has the ability to exert market power and collect monopoly rents.

With the occurrence of a load pocket, economically produced power is unable to be imported into the region forcing demand to be met by local generation regardless of cost. When a load pocket exists, the regional market clearing price for power increases resulting in inefficient pricing. Power producers with production facilities in neighboring areas within the region have the ability to reap larger than normal profits by inefficiently using transmission interconnection capacity to manipulate regional market clearing prices.

Many more complicated market manipulation strategies have recently been developed at the expense of vague "*self-policing*" rules. According to Ivanovich (2002) they include:

1.	*Artificially Increasing Demand:* This occurs by over-scheduling on the power grid while betting that the PX has underestimated demand to keep the price down. When demand rises, favorable prices are paid for the power.
2.	*Phantom Power Transfer:* This is done by scheduling power to flow through a RTO opposite of congestion. A fee is paid for the line-load relief by the ISO. Power is then purchased (below the fee for line-load relief) outside the RTO to meet demand at the initiation point of the trade (producing a profit).
3.	*Megawatt Laundering:* This occurs when power is scheduled and sold outside the RTO. The power is then repurchased (at a slightly higher price) and sold back to the RTO at a favorable price once demand rises.
4.	*Sell High, Buy Low:* This occurs when ancillary generation and transmission services are purchased by the RTO on a day-ahead basis, but there is no plan to provide such services. The expected provider bets that he can buy the services cheaper from someone else if such services are actually needed. False information is generally submitted to the RTO.
5.	*Trading Places:* This is done when a provider over-schedules power in one region, while under-scheduling power in a neighboring region. Artificial congestion is created which raises the market clearing price for power. Upon agreeing to shift power to relieve congestion, a fee is paid for the line-load relief by the ISO and a profit is produced.

MARKET MAYHEM: THE CALIFORNIA ENERGY CRISIS OF 2000

The process of restructuring in California was initiated when the staff of the California Public Utility Commission issued its *Blue Book* on April 20, 1994. The book ordered utilities to

"voluntarily" divest 50% of their gas-fired generation, and were offered a small rate-of-return incentive if they divested more (Faruqui, et al. 2001). However, the utilities' real motivation for divesting was that they had to "market value" all of their generation for stranded cost valuation and divestiture was the only satisfactory way to do this. The book also provided utilities with an opportunity – but not a guarantee – to recover all of their stranded costs over a five-year period beginning January 1, 1997. These costs were estimated to be $28 billion, and would be recovered when utilities would buy power from the California Power Exchange at approximately $25 per MWh and retail it at $55 per MWh (Van Vactor and Pickel, 2001).

After much discussion and debate, the California legislature unanimously passed Assembly Bill (AB) 1890. On September 23, 1996 Governor Wilson signed it into law and most of the *Blue Book* provisions by the California Public Utility Commission were preserved. One of the provisions gave a 10% rate cut valued at $650 million a year to residential and small commercial customers (Faruqui, et al., 2001). This cut was funded by floating a bond issue (set up by a trust transfer account) paid by customers. The key to this provision was that retail prices would be frozen for the utility companies until the expiration of a five-year window, or until they had paid off their stranded costs, whichever came first. An allowance for stranded cost recovery, called a *Competitive Transition Charge*, was calculated on a "residual basis" by subtracting from the frozen retail rate an amount equal to the regulated cost of delivery service plus the cost of procuring power from the California PX and the ISO (Faruqui, et. al., 2001). The main flaw with this methodology was the expectation that wholesale power prices would be substantially below the allowance for production cost embodied in the retail price, allowing for the recovery of the *Competitive Transition Charge* costs within the five-year window.

Through market changes (e.g. weather related, increased demand, transmission congestion, market power and manipulation, etc.) recent competitive market prices have been known to surge as high as $9500 per MWh (Megawatt Daily, 1999). This leads one to believe that California no longer has a stranded cost issue, but stranded benefits coupled with an over-capitalization bond issue on production facility equity instead of pure debt.

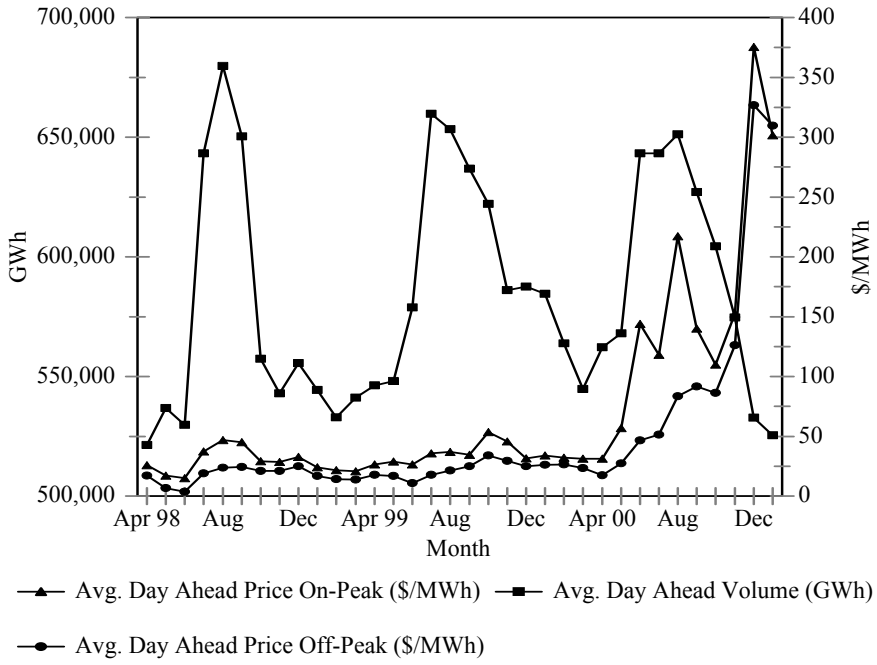
Figure 1 illustrates the average movement in prices at the California Power Exchange from April 1998 through January 2001 where prices are up and demand is down during the last six months of 2000. This phenomenon is counter to the behavior of the market during 1998 and 1999.

SHAREHOLDER WEALTH: POST-DEREGULATION

Stranded cost recovery has quieted in recent years, but its presence has been felt recently through the extraction of excess profits from market power and manipulation. Evidence shows that some California utilities seem to have become accustomed to over-capitalized income streams for increasing shareholder wealth. A few addicted utilities have strategically acquired over-capitalized assets, absorbed losses in equity, and filed for securitization relief (if available). In addition, several

have exerted market power to manipulate the market clearing price of electricity in order to increase revenues or to turn debt (stranded costs) into equity for shareholders. Neither method of capital acquisition is illegal. Securitization is *offered* by state regulatory agencies, while the Federal Energy Regulatory Commission (FERC) allows utilities to "*self-police*" their transmission trading practices.

Figure 1



As a result, several independent power producers in California reported record earnings for the year 2000. They, in turn, moved up in the annual Fortune 500 ranking of corporations. For example, Duke Energy shot up to No. 17 from No. 69. Dynegy moved to No. 54 from No. 112, and Reliant Energy Inc., moved to No. 55 from No. 114 (Moore, 2001). Enron Corporation rose to No. 7 from No. 18 (Moore, 2001).

Insufficient transmission capacity, weather, and market power and manipulation all played significant roles with price increases, but an important question looms. Did collusion among power producers exist to recover stranded costs at any expense?

CONCLUSIONS

Major changes in the electric utility industry occurred when federal regulatory policy shifted twice, first to compensate for the energy crisis and second to accommodate the trend in deregulating monopolies. The shifts resulted from the 1978 enactment of the National Energy Conservation Policy Act and the Energy Policy Act of 1992, respectively. Sheltered by the prudence standard and the length of time required for capital outlays, investor-owned utility management proceeded with nuclear projects during the 1960s, 1970s, and 1980s. Nuclear projects were a great strategic fit during this period of cogeneration since they had large capital outlay and utilities were only required to pay cogenerators their avoided cost for production. This was a great strategy for investor-owned utilities since income streams were large and average variable production costs are small for nuclear plants. When regulators caught on to this strategy it was already too late. Using the prudence standard, they were forced to disallow many escalating construction project costs once utilities decided not to abandon their nuclear construction projects to minimize their losses.

Similar to the disallowance problem electric utilities faced, another such problem associated with deregulation restructuring surfaced in the 1990s where embedded rates of investor-owned nuclear power plants far exceeded market clearing prices for electric power. Once market conditions were known, the strategic importance of constructing a nuclear plant was gone. Under true market conditions, electric utilities were wary of being forced to reduce their rates to retain market share. These price reductions reduced revenues, which in turn reduced total costs, and demonstrate why utilities were concerned about the stranding of over-capitalized power production facilities.

Electricity competition has moved forward without the complete vision of all of the implications associated with the decision-making and policy issues inherent in restructuring the industry. The restructuring so far has shown how difficult it is to regulate markets with both competitive and monopoly sectors where vertically integrated parties have become increasingly skilled in market power and manipulation and become progressively entrenched as the transition process is drawn out. California's proactive approach to restructuring indicates that if power markets are not carefully deregulated, market power and manipulation are inevitable resulting in an influx of capital wealth for shareholders.

The next phase of the restructuring process involves deregulation in the transmission markets. Restructuring problems then become twofold and much more complicated. Thus, if deregulation is going to be successful in the future, the wheeling of electric power must be successful in the wholesale generation *and* open access transmission markets.

ONE FINAL THOUGHT

Roger Cramton (1964) presented an analogy to the problem of regulation that merits consideration. Cramton recounts a story of an old Indian sitting by the sea near a lighthouse:

"Lighthouse, him no good for fog. Lighthouse, him whistle, him blow, him ring bell, him flash light, him raise hell; but fog come in just the same."

At that time, Cramton felt that economic regulation had its place and could accomplish certain limited objectives. He summarizes by stating that:

"The lighthouse can and does perform essential tasks; but it cannot be expected to keep out the fog."

As times changed with the introduction of new technology and deregulation in electric power production, we now have mechanisms in place to "see through the fog." Just as global positioning systems have retired the lighthouse, deregulation has enabled rate payers to "see through the fog" of electric utility regulation and has given greater exposure to the strategies of over-capitalization.

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USING RESEARCH DATA TO ASSIST IN DEVELOPING AND MARKETING STRATEGIES TO ENHANCE KNOWLEDGE OF RELEVANT LAW AMONG FACULTY AND ACADEMIC ADMINISTRATORS IN COLLEGES AND UNIVERSITIES

Le Von E. Wilson, Western Carolina University

ABSTRACT

The purpose of this study was to measure knowledge of constitutional and federal statutory law relevant to public institutions of higher education receiving any form of federal funding. The study was designed to determine the percentage of faculty and academic administrators at higher educational institutions who could demonstrate a proficient knowledge concerning relevant legal issues related to constitutional and federal statutory law.

The investigation built upon that of Goellnitz (1993), who focused on the development and validation of an instrument to measure knowledge of constitutional and federal statutory law relevant to public institutions of higher education. It was the Goellnitz instrument that was used for this study.

The instrument consisted of 25 True-False items. Eighteen items were designed to measure knowledge of constitutional law and 7 items were designed to assess knowledge of federal statutory law. The main question addressed in this study was, "What is the level of knowledge of relevant constitutional and federal statutory law of faculty and academic administrators in four-year public colleges and universities receiving any form of federal funding?"

The study participants were from the 16 constituent universities of the university of North Carolina. Faculty and academic administrators from each institution were included in the study. After administration of the instrument, which was essentially a test, the resultant data were treated by several appropriate statistical tests.

Several significant findings emerged from the analysis of the data. In general, faculty and academic administrators did not have a proficient knowledge of relevant law. Demographic factors, such as level of education, and years of experience, were not correlated with higher levels of knowledge. The most significant, however, was that scores for academic administrators at the various institutions were higher than those for faculty. Specific recommendations for future studies and for development of law-related training programs were made. By using these research data,

senior university administrators may develop strategies and plans to enhance knowledge of relevant law among faculty and academic administrators in institutions of higher education.

INTRODUCTION

An analysis was conducted using an electronically mailed questionnaire to determine the knowledge levels of faculty and academic administrators at selected universities concerning federal statutory and case law related to higher education. The data from this study were analyzed by examining the percentage of respondents who attained the level of proficiency. This could help colleges and universities, and professional organizations plan for the development of instructional methodologies to provide faculty and academic administrators with the necessary law-related training. The demographics of the respondents were also contrasted with responses to identify patterns.

The purpose of this study was to measure level of knowledge of constitutional and federal statutory law relevant to public institutions of higher education receiving any form of federal funding. The study analyzed the legal knowledge levels of faculty and academic administrators at selected higher education institutions. The study determined overall knowledge level of the major legal issues by questioning two groups - faculty and academic administrators - with respect to specific areas of the law that are pertinent to their areas of responsibility and concern. These specific areas included: 1) equal protection, 2) freedom of expression, 3) privacy rights, and 4) due process of law as related to dealings and interactions with students. Information on demographics was also collected.

RESEARCH POPULATION

The population consisted of members of the faculty and administrative staff who are employed at one of the public four-year institutions of higher education in the 16 constituent universities of the University of North Carolina (UNC). Members of the population were identified as a result of their position titles or their affiliations within the institutions.

SAMPLE PROCEDURES

Members of the sample population were selected using a multistage systematic random sampling procedure. The population was determined from the information compiled by and located on the website maintained by the Office of the President of the University of North Carolina. Thereafter, faculty/staff directories were consulted on each of the 16 individual university websites. The number of faculty selected from each institution was based on the university's proportion of total faculty within the University of North Carolina. The same process was used in the selection of

academic administrators. Selection continued until 653 members of the sample population had been selected (336 faculty and 317 academic administrators).

RESEARCH DESIGN

This study employed a descriptive research design using a self-administered instrument (Gall, Borg, & Gall, 1996). The questions sought to measure the level of knowledge of constitutional and federal statutory laws relevant to public institutions of higher education that receive any form of federal funding. Interpretive statistical descriptions, such as frequencies, percentages, mean responses, and standard deviations describe the findings. Analysis of Variance (ANOVA) was used to determine if the means of the two groups differed significantly at the .05 level. An ANOVA was also performed on the proportion of the two groups that achieved the proficiency level to examine the relationship between demographic characteristics and proficiency. Significance was sought at the .05 level.

INSTRUMENTATION

This study used a 25-item True-False instrument developed by Goellnitz (1993) to measure knowledge of legal issues among members of the academic community. The instrument is essentially a test. The responses provided are either correct or incorrect based on legal precedent or statutory proscription. The individual test items were based on current court decisions, federal statutory and regulatory provisions, and recent studies focusing on law and higher education.

DATA COLLECTION

The 25-item instrument was electronically mailed to a random sample of the total population. A cover letter was included, which provided instructions for completing the instrument and a statement addressing anonymity and confidentiality. Individuals were given four weeks to complete and submit the instrument online into an electronic database for storage. A follow-up notice was sent to all members of the sample population two weeks following the initial mailing. No additional contact was made. Upon expiration of the four-week period, the survey data were downloaded from the electronic database for further analysis.

DATA ANALYSIS

Total test scores and subscale scores were tabulated on each instrument submitted. Raw scores, percentages, and frequencies are reported for each group (faculty and academic

administrators). Percentages and frequencies of proficiency level scores for individual groups were also tabulated.

Means for each group were computed. An ANOVA was conducted to determine if the two group means differ at the .05 level of significance. In addition, an ANOVA test was performed on the proportions of the two groups that achieved the proficiency level to examine the relationship between demographic characteristics and proficiency. Significance was sought at the .05 level. Results from data analyses are presented in tables in Chapter IV.

Submitted responses from the study were analyzed, and the total percentage of correct responses for each respondent was determined. A total correct percentage score of 75 or raw score of 18.5 was used as the criterion to determine a proficient knowledge level for faculty and academic administrators.

The demographic data were also examined. Each of the 10 questions (survey items 26 through 35) at the end of the survey was used to further interpret the results.

QUESTIONNAIRE RESPONSES

The instrument was emailed to 653 individuals, including 336 full-time faculty and 317 academic administrators and student support services personnel at the 16 constituent institutions of the University of North Carolina during spring semester 2001. Respondents were given four weeks to respond to the survey. A total of 223 individuals responded to the survey. A total of 209 forms were deemed acceptable for inclusion in the data analysis. Of this total, 122 respondents were faculty, or 40.9 percent of all faculty contacted. Eighty-seven respondents were academic administrators or student services staff members, accounting for 32.2 percent of all such individuals contacted. Of all the respondents, 41.6 percent were academic administrators and 58.4 percent were faculty.

ITEM ANALYSIS

An item analysis of the instrument was conducted to determine the contribution of individual items to total test scores. Pearson correlation coefficients were computed to obtain correlations between individual items and total test scores. All items correlated positively. Individual item correlations ranged from $r = .06$ to $r = .44$. The level of difficulty of each test item, defined as the percentage of individuals who got the item correct, ranged from .26 to .95. Table 1 provides a summary of the participants' responses to the questions regarding federal statutory law. The overall average was 58.0 percent for correct responses. It is safe to say, therefore, that study participants knew relatively little about federal statutory law related to higher education. In Table 2, a summary is presented of the participants' responses to the questions relating to federal constitutional law. With

an average score of 68 percent, it is apparent that participants performed only slightly better on the federal constitutional law questions than on the questions related to federal statutory law.

Table 1: Responses to Questions Related to Federal Statutory Law

Question	Correct		Incorrect	
	N	%	N	%
3	162	77.5	047	22.5
12	092	44.0	117	56.0
14	118	56.5	091	43.5
16	196	93.8	013	06.2
17	166	79.4	043	20.6
19	060	28.7	149	71.3
22	055	26.3	154	73.7
Average		58.0		42.0

STANDARD OF MASTERY LEVEL

Based the mastery levels set out in the Goellnitz (1993) study, of the 209 respondents in the current study, 3 individuals (1.4%) obtained a mastery level score within their specific group. Three faculty (2.5%) out of 122 scored at the faculty mastery level of 21 or better. No academic administrators and student support staff out of 87 scored at the academic administrators' mastery level of 22 or better. However, using a more liberal standard of proficiency of 18.5 or 75 percent that was used in the Chase (1994) study, there were a total of 42 respondents (19 academic administrators and 23 faculty) who scored at or above the proficiency level. It is this standard that has been adopted for this study.

DATA ANALYSIS

The first evaluation examined all of the respondents whether or not they achieved or exceeded the 75 percent criterion for proficiency. In the second evaluation, the demographic responses of only those scoring at or above this level of proficiency were tabulated and contrasted. Test scores for the entire population ranged from a high of 22 to a low of 6 with an overall mean score of 16.3. Faculty scores spread from a high of 22 to a low of 6. Academic administrator scores spread from a high of 21 to a low of 11.

Table 2: Responses to Questions Related to Federal Constitutional Law				
Question	Correct		Incorrect	
	N	%	N	%
1	089	42.6	120	57.4
2	150	71.8	059	28.2
4	162	77.5	047	22.5
5	176	84.2	033	15.8
6	117	56.0	092	44.0
7	117	56.0	092	44.0
8	101	48.3	108	51.7
9	167	79.9	042	20.1
10	199	95.2	010	04.8
11	165	78.9	044	21.1
13	148	70.8	061	29.2
15	098	46.9	111	53.1
18	112	53.6	097	46.4
20	101	48.3	108	51.7
21	172	82.3	037	17.7
23	201	96.2	008	03.8
24	132	63.2	077	36.8
25	151	72.2	057	27.3
Average		68.0		32.0

The mean score of the respondents on the instrument was 16.3. Twenty percent (42) of respondents scored 18.5 or 75 percent or higher on the instrument. A complete breakdown of percentages of respondents who reached the proficiency level is shown in Table 3.

Table 3: Group by Level of Proficiency				
Group		Not Proficient	Proficient	Total
Faculty	Frequency	99	23	122
	Row Percent	81.1	18.9	54.8
Academic Administrators	Frequency	68	19	87
	Row Percent	78.2	21.8	45.2
Total		167	42	209
Percent Total		79.9	20.1	100.0

The demographic data collected were also examined. Each of the ten questions at the end of the survey was used to further interpret the results. An ANOVA was conducted on the means of the two groups (faculty and academic administrators) to determine if their means differed significantly at the .05 level. The results indicated a significant difference in the mean scores of academic administrators (16.74), and faculty (15.99). Table 4 presents the ANOVA results. While statistically significant, as indicated by the p value of .038, the practical difference is insignificant as evidenced by an Eta Squared of .021.

Table 4: Analysis of Variance-academic Administrators and Faculty

Source	df	Mean Squares	F	Sig
Between Groups	1	28.098	4.347	.038*
Within Groups	207	6.463		

* Significant at $p < .05$.

An ANOVA was performed on the proportions of the two groups who achieved the proficiency level. Significance was sought at the .05 level. The analysis revealed that proportions of the two groups demonstrating proficiency did not differ significantly. An ANOVA was run to determine if years of experience in current position was positively linked to proficiency level. The results indicated no significance at the .05 level. Thus, we conclude that level of education makes no difference in terms of total test scores. Table 5 presents these results.

Table 5: Analysis of Variance-years of Experience in Current Position

Source	df	Mean Squares	F	Sig
Between Groups	40	6.216	.925	.603*
Within Groups	164	6.463		

* Not significant at $p < .05$.

An ANOVA revealed no significant results on the general question of whether or not level of education impacted on participants' level of knowledge. These data are presented in Table 6.

An ANOVA revealed that the size of the institution seems to be tied in with total test scores. The difference was most significant when comparing institutions with fewer than 5,000 with those with 10,000 to 20,000 students. Data on size of participants' institution are presented in Table 7.

An overwhelming 92.3 percent of respondents indicated that it is important for faculty and academic administrators to have knowledge of relevant law. Surprisingly, 17.7 percent of respondents indicated they did not know where to go for legal advice. Most (69.4%) respondents thought that the level of law-related training they received from their employer had been inadequate.

The majority of respondents (58.4%) indicated that they do not remain current in their awareness of laws related to their area(s) of concern. An ANOVA revealed that there is no significant difference between participants who have had in service or other law-related training and those who have not. An ANOVA revealed no significant results. While responses were scattered across categories, most (99) respondents indicated they received no legal training that would be of assistance to them in their current position.

Table 6: Study Participants' Level of Education

Education Level	Frequency	Percent of Participants	Cumulative Percent	
Bachelors	015	007.2	007.2	
Masters	039	018.7	026.0	
Non-Law Doctoral	150	071.8	098.1	
Law Doctoral	004	001.9	100.0	
Subtotal	208	099.5		
Missing	001	000.5		
Total	209	100.0		
ANALYSIS OF VARIANCE				
Source	df	Mean Squares	F	Sig
Between Groups	3	4.863	.738	.531*
Within Groups	205	6.592		
* Not significant at $p < .05$.				

THE IMPLICATIONS OF LEGAL ACCOUNTABILITY

The purpose of this study was to measure knowledge of constitutional and federal statutory law relevant to public institutions of higher education receiving any form of federal funding. Legal accountability has become more prevalent among members of the academic community. Courts have demonstrated a willingness to hold both universities and individuals legally responsible if laws or regulations are violated. Having the ability to assess knowledge of legal issues is necessary to meet the challenge of continually updating individuals on changes in the law (Goellnitz, 1993). Because we live in an increasingly litigious society, it is important that we have an understanding of the law and the legal precepts associated with avoiding and managing liability. This is especially important with regard to the legal relationships between colleges and universities and the students who attend them. The law is not a set of static rules and regulations. It is a dynamic, ever changing process, which requires constant analysis and evaluation.

Table 7: Size of Participants' Institution				
Size (Enrollment)	Frequency	Percent of Participants	Cumulative Percent	
Under 5,000	036	017.2	017.2	
05,000 - 10,000	042	020.1	037.3	
10,000 - 20,000	073	034.9	072.2	
Over 20,000	055	026.3	098.5	
No Response	003	001.4	100.0	
Total	209	100.0		
ANALYSIS OF VARIANCE				
Source	df	Mean Squares	F	Sig
Between Groups	4	20.899	3.324	.012*
Within Groups	204	6.286		
Total	208			
* Significant at $p < .05$.				

The relatively mature state of the law of higher education and the general appreciation of the importance of managing legal liability through a preventive risk analysis process creates yet another professional obligation and standard for the faculty and academic administrators in colleges and universities. College and university governing boards and students have every reason to expect faculty and academic administrators to know the law, to minimize legal risks, and to manage institutional resources toward that end. For these professionals to fail in this capacity is to invite, in addition to professional disrespect, the possibility of legal liability.

It is important to provide faculty and academic administrators with the general background necessary to realize legal issues when they emerge on campus and to develop an appreciation for the various resources available to them. These resources may include books, chapters, articles, and papers on subjects of interest or even the legal counsel employed or retained by the institution.

Faculty and academic administrators must be encouraged to participate in resolving legal issues that arise within the institution. Being somewhat familiar with the essentials of the law - the terminology, procedures, and doctrines - affords the academic administrator the background necessary to be an active consumer of legal advice, whether disseminated through writings or imparted by legal counsel (Toma & Palm, 1999). Faculty and academic administrators need to develop a background, which will allow them to recognize legal issues when they emerge on campus. They also need to develop the competence and confidence to engage in discussions about them with legal counsel and colleagues.

THE DISSEMINATION OF INFORMATION: MARKETING LEGAL RESOURCES

Academic administrators should consider the implementation of preventive law strategies as well as plans to market them. Academic administrators and faculty are fortunate that they have several excellent sources of information available on higher education law. According to Toma and Palm (1999), there are several national organizations that disseminate updates on legal issues of note to academic administrators. These organizations often produce monographs or edited collections covering important issues in higher education law. These publications generally take a practical approach to legal issues and are typically written for the non-lawyer.

Koch (1997) notes that in-service training is probably the most important tool that schools have for helping faculty to increase their professional knowledge. It is important to note, however, that liability cannot be removed from the process of educating students. Therefore, it is important that administrators remain vigilant with regard to changes in the law as they occur and work to implement appropriate changes within the institution to limit this liability. Koch believes that it is important for academic administrators to be aware of current trends in liability that may impact colleges and universities and to continuously monitor sources of Hundreds of studies have given us various estimates as to the number of participants law for changes. Administrators would be well advised to stay abreast of these changes through appropriate legal research and training.

DEVELOPING AND MARKETING APPROPRIATE ADULT EDUCATION PROGRAMS

Hundred of studies have given us various estimates as to the number of participants and lists of reasons why adults do or do not participate, according to Merriam and Caffarella (1991). Preparation for work with adult learners ranges from on the job training to formal graduate course work. It is important to understand how adult learners learn best. Merriam and Caffarella cite adults' busy life styles as a major concern. They found that most adults spend at least eight hours a day working and often again as many hours attending to family, household, and community concerns. Studies have given us various estimates as to the number of participants and list of reasons why adults do or do not participate, according to Merriam and Caffarella. Motivating senior college and university administrators to provide learning opportunities and encouraging faculty and academic administrators to attend is a worthy undertaking. Efforts should be made to strongly encourage, if not require, attendance at appropriate on-site law-related training sessions.

Goellnitz (1993) refers to a 1985 survey of educators, which concluded that nearly half of the respondents felt that they were inadequately informed about educational legal issues. In the current study, 69 percent of respondents indicated that the level of law-related training they received from their employer has been inadequate. Although 92 percent of respondents indicated that having knowledge of relevant law is important for faculty and academic administrators in institutions of

higher education, 65 percent reported having regularly received no law-related training in their current position. And less than four percent regularly received more than five hours of law-related training per year. Perhaps the best way to achieve this goal of providing the necessary education is as part of a planned activity, perhaps as part of a required orientation program. All new faculty and academic administrators would be required to have this training upon being hired at any public institution of higher education. This would eliminate the need to try to provide the necessary motivation to get faculty and administrators to attend law-related conferences and workshops sponsored by various professional associations. It would also take away some of the excuses that are most often used as reasons for not participating in adult education activities.

No matter how well and extensively trained professors and academic administrators are, there will undoubtedly always be the need to continue their training on some periodic basis. The society is in a state of constant change with many of the changes reflected in institutions of higher education and more directly in the classroom. Other societal changes and pressures brought on by new laws and court decisions show up in the form of requirements for faculty and academic administrators as professionals. The net effect of societal change is an imperative for educational systems to provide mechanisms to help faculty and academic administrators change in order to meet changing conditions in the academic community (Koch, 1997). Thus, mechanisms need to be implemented to ensure that updating occurs on a regular basis.

The primary means of teacher updating, according to Koch (1997), is in-service training. In-service training can help faculty and academic administrators to keep informed about new law-related educational research and help them experience issues that impact their profession. Professional development is fundamental, and senior university officials must invest resources in training in order to insure that faculty and academic administrators are adequately prepared.

CONCLUSION

The results of this study demonstrate that the majority of faculty and academic administrators in the 16 constituent universities of the University of North Carolina do not have a proficient knowledge of constitutional or federal statutory law. A meager 18.8 percent of faculty, and 21.8 percent of academic administrators were able to achieve the established proficiency level of 75 percent.

Educating faculty and academic administrators needs to continue. The study results show that there are some obvious knowledge gaps in faculty and academic administrators' backgrounds.

Providing education to faculty and academic administrators across the state and nation about relevant law-related issues in higher education needs to be a priority. If faculty and academic administrators are to adequately serve the needs of and preserve the rights of students, they must have a thorough understanding of the law. Senior university administrators should encourage members of the academic community to pursue law-related training at the higher education level so

as to reduce risks of violating students' rights. Senior university administrators should explore other incentives or motivational methods to encourage faculty and academic administrators to change their attitudes about the law and be more responsible about their own knowledge, and actions.

These results show a need on the part of the University of North Carolina, or at the very least, on the part of each constituent institution, to earnestly develop appropriate training programs for faculty and academic administrators to ensure that they receive appropriate law-related training to enhance their level of knowledge of relevant constitutional and federal statutory laws.

An appropriate knowledge and understanding of education law is necessary to enable faculty and academic administrators to apply legal decisions and statutory mandates to the academic community and all its constituents (Goellnitz, 1993). The constantly evolving nature of law requires continuous attention to the education of those affected by such laws. Continuous updating of legal knowledge of the academic community is a tremendous challenge, but a necessary undertaking in today's litigious society. The ability to assess legal knowledge of the academic community provides a starting point for pursuing this difficult but important task. Marketing of law-related educational programs then becomes a major concern.

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