

THE ILLINOIS BUSINESS LAW JOURNAL

A Publication of the Students of the University of Illinois College of Law

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STATISTICAL SAMPLING: WEIGHING COSTS VERSUS PRECISION IN PROVIDING TAXPAYER GUIDANCE

JOHN MICHAEL EKBLAD

I. INTRODUCTION

In the months preceding elections in the United States it is difficult to avoid statistical sampling, as polling projections are everywhere. Only a sample is used to make these projections because it would take too much time and be too expensive to determine how every voter will vote.¹ Statistical sampling has many other uses as well, including being used as evidence in a trial² or being used to estimate how much a taxpayer owes the government on their tax return.³ As with elections, to determine the exact result for a tax return, every item in the population would need to be investigated. As a population gets larger, this gets more time consuming and more expensive, especially when the information is collected by experts, lawyers, and accountants. Furthermore, each additional item of the population collected will not result in a proportionate change in the precision of the estimate, because the precision of an estimate varies inversely with the square root of the sample size.⁴

II. STATISTICAL SAMPLING IN TRIALS AND USAGE BY THE IRS

Statistical sampling has not always been used as evidence in trials or in preparing tax returns. Early courts were skeptical of statistical sampling estimates and did not admit these estimates.⁵ However, modern courts have begun to accept sampled evidence in a wide variety of contexts, including mass torts cases.⁶ Similarly, the Internal Revenue Service ("IRS") utilized statistical sampling in

¹ ROBERT M. LAWLESS, JENNIFER K. ROBBENAULT, & THOMAS S. ULEN, *EMPIRICAL METHODS IN LAW* (forthcoming 2010) (manuscript at 188, released to students).

² *Id.* at 208.

³ Rev. Proc. 2004-29, 2004-20 I.R.B. 918.

⁴ Hans Zeisel & David H. Kaye, *Sampling, in Prove it with Figures* 108-109 (1997).

⁵ LAWLESS, ROBBENAULT, & ULEN, *supra* note 1, at 208.

⁶ *Id.*

performing tax audits as early as 1964,⁷ but it has taken the IRS more time to provide taxpayers guidance for using statistical sampling in preparing tax returns.⁸ Some evidence that the IRS is allowing increased use of statistical sampling for taxpayers, is that the IRS provided guidance on using statistical sampling for substantiating meal and entertainment expenses that are excepted from the 50% disallowance rule under Code section 274(n) in 2004,⁹ and provided guidance for calculating qualified production activities for the Domestic Manufacturing Deduction in 2007.¹⁰

The IRS has yet to provide similar guidance for calculating the Research and Development Tax Credit (“R&D Tax Credit”),¹¹ however recent court decisions have allowed taxpayers to use estimates in calculating their R&D Tax Credits. In *Union Carbide and Subsidiaries v. Commissioner*, the United States Tax Court accepted estimates based on extrapolations “as a close approximation of all of the qualified research activities.”¹² Similarly, the Fifth Circuit in *United States v. McFerrin* held that employee testimony and estimates may be used to substantiate qualified research expenditures, against arguments by the IRS.¹³ As the IRS has not yet provided guidance to taxpayers for using statistical sampling in calculating the R&D Tax Credit,¹⁴ and they may in the future,¹⁵ the R&D Tax Credit provides a good context for examples that follow.

A major benefit for a taxpayer or for a party in a trial, who uses statistical sampling, is the costs that can be saved by using a sample rather than using the entire population.¹⁶ This is especially true when there is a large sample and when amounts are being calculated by expert witnesses, lawyers, or accountants. There are additional benefits as well. For example, additional valuable information can be gained by using the resources available to determine a carefully drawn smaller

⁷ Rev. Proc. 64-4, 1964-1 C.B. 644.

⁸ Will Yancey, *Sampling for Income Tax and Customs*, <http://www.willyancey.com/sampling-income-tax.html#cases> (last visited Oct. 11, 2009).

⁹ Rev. Proc. 2004-29, 2004-20 I.R.B. 918.

¹⁰ Rev. Proc. 2007-35, 2007-23 I.R.B. 1349.

¹¹ Yancey, *supra* note 8.

¹² *Union Carbide Corp. and Subsidiaries v. Comm'r.*, 97 T.C.M. (CCH) 1207, 110 (2009).

¹³ *United States v. McFerrin*, 570 F.3d 672, 679 (5th Cir. 2009).

¹⁴ Yancey, *supra* note 8.

¹⁵ Mary Batcher, *Statistical Sampling in Tax Filings: New Confirmation from the IRS*, TAX EXECUTIVE, May 1, 2004, available at http://www.thefreelibrary.com/_/print/PrintArticle.aspx?id=143304208.

¹⁶ LAWLESS, ROBBENAULT, & ULEN, *supra* note 1, at 208.

sample or to collect more information on each item in the sample.¹⁷ Also, there may be drawbacks from using an entire large population, as one recording the entire sample results may get tired or bored enough to start recording information incorrectly.¹⁸

Even if the costs to calculate a tax deduction or a credit equaled the cost to calculate that deduction or credit, benefits are induced by the presence of the deductions and credits.¹⁹ For example, as the name suggests, the R&D Tax Credit was added to encourage research and development in the United States and as part of the American Jobs Creation Act of 2004, the Domestic Manufacturing Deduction was added to encourage increasing the quality of manufacturing and jobs in the United States.²⁰ A study of the effectiveness of the R&D Credit has shown a positive impact on R&D activity and “[t]here is significant evidence that nations and states that adopt an R&D tax credit will experience an increase in R&D investments.”²¹ If the incentive to participate in these activities was cheaper and easier to calculate, it follows that more people would consider using them.

III. PRECISION V. COSTS TO INCREASE PRECISION

The R&D Tax Credit is a difficult credit to calculate because it requires intrusive examinations to determine how many of the costs of a particular research project qualifies as a research expense for the credit.²² For example, qualified research expenses include qualified wages paid to engineers.²³ It may not be difficult to determine how much a company paid its engineers by looking at payroll detail, but it is more difficult to determine how much of an engineer’s wages qualify as a research expense. This is the case because qualified research expenses, as defined within I.R.C. § 41, which outlines how the R&D Tax Credit

¹⁷ *Id.* at 191-92.

¹⁸ Mary Batcher, *Statistical Sampling: A Potential Win for Business Taxpayers*, TAX EXECUTIVE, Nov. 1, 2001, <http://www.thefreelibrary.com/Statistical+sampling:+a+potential+win+for+business+taxpayers-a095446866>.

¹⁹ Ross Gitell & Edinaldo Tebaldi, *Are Research and Development Tax Credits Effective? The Economic Impacts of a R&D Tax Credit in New Hampshire*, PUB. FIN. & MGMT., 2008, http://findarticles.com/p/articles/mi_qa5334/is_1_8/ai_n29431949/.

²⁰ American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

²¹ Gitell & Tebaldi, *supra* note 19.

²² Batcher, *supra* note 15.

²³ I.R.C. § 41(b)(2)(A)(i) (2000).

is calculated, do not include all wages.²⁴ Even a twenty minute phone conversations with each engineer, to determine wages that qualify, will add up quickly when you take into account that the engineer could be continuing to conduct research instead, and the costs paid those conducting the interviews. When a company does extensive research and development and has multiple locations with multiple engineers, it adds up even faster.

The precision of an estimate calculated from a sample varies inversely with the square root of the sample size.²⁵ Therefore, in the example above, if ten engineers were originally interviewed, in order to double the precision the taxpayer would be required to interview forty engineers.²⁶ Similarly, to increase the precision of a sample by a factor of ten, it would require interviewing one hundred engineers.²⁷ Adding more numbers to this example, if a sample of ten determines that the mean percentage of time engineers spend doing qualified research is 60%, and you can be 95% sure that the mean of the population falls between 40% and 80%, to be 95% sure that this amount is between 50% and 70%, one would have to have to sample forty engineers.²⁸ To further increase precision so that you can be 95% sure that the percentage was between 59% and 61% would require interviewing four hundred engineers.²⁹

Although the “longstanding”³⁰ rule developed in *Cohan v. Commissioner* is that absolute certainty is not required and that close approximations are acceptable when calculating deductions,³¹ it would be difficult to argue that such a wide range would be acceptable. This would be especially true when it is possible to calculate a more precise number. Using a sample to claim a deduction or credit of \$60, that a taxpayer is 95% sure that is between \$40 and \$80, does not appear to be a close approximation. However, it would be easier to argue that if it was determined that the deduction or credit was \$60 with 95% certainty that that the deduction or credit was between \$59 and \$61, that \$60 is a close approximation. However, if it costs the taxpayer \$1 to determine that they are 95% sure the deduction or credit is between \$40 and \$80, and \$400 to determine that they are 95% sure the deduction or credit is between \$59 and \$61; it is not worth it for the tax payer to calculate the deduction or credit at all if such a high degree of precision is required.

²⁴ *Id.*

²⁵ Zeisel & Kaye, *supra* note 4.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *United States v. McFerrin*, 570 F.3d 672, 679 (5th Cir. 2009).

³¹ *Cohan v. Comm'r*, 39 F.2d 540, 544 (2d Cir. 1930).

IV. A COMPROMISE IS NEEDED TO MAKE STATISTICAL SAMPLING EFFECTIVE

When you have a range of how much tax liability exists, the IRS will always want the taxpayer to pay more and the taxpayer will always want to pay less. When precision is not very high, this difference may be large. Consider if instead of the example above that used tens of dollars, a credit of tens of millions was being calculated. In continuing to provide guidance to what extent statistical sampling is acceptable, the IRS should take into account how much can be saved by using statistical sampling. While they have a legitimate concern over requiring tax returns that are precise, the IRS should realize that the money saved could go elsewhere. Even if a deduction or credit fails to net as much revenue for the government, the presence of the deductions and credits encourage other activities for the benefit of the United States.³² If it costs the taxpayer more to collect the information needed to calculate a potential benefit, the taxpayer may not participate in the potentially beneficial activity at all.³³

V. CONCLUSION

Statistical sampling allows for substantial savings when making conclusions about populations. At the same time, there comes a point when asking for increased precision may cost more than it is worth to have this precision. Tax deductions and credits may be difficult to calculate, but rather than render them worthless to taxpayers or get rid of them completely, statistical sampling should be encouraged when calculations would otherwise be too difficult to calculate.

³² Gitell & Tebaldi, *supra* note 19.

³³ Mary Batcher, *supra* note 18.

WHO SHUT OFF THE A/C?: TURNING UP THE HEAT ON CORPORATE ATTORNEYS AND THE ATTORNEY CLIENT PRIVILEGE

JULIAN WATKINS

I. INTRODUCTION

The decision of Judge Jed Rakoff in the settlement agreement between Bank of America (“BofA”) and the Securities and Exchange Commission (“SEC”) is one that could strike fear in the hearts of corporate attorneys everywhere. On August 3, 2009, the SEC filed charges against the Bank of America Corporation for its lack of disclosure to its shareholders about bonuses paid to Merrill Lynch executives in the merger.¹

The Bank of America/Merrill Lynch merger is a complicated web of litigation and investigation that has become multifaceted as time goes on. As stated by Pennsylvania law professor David Skeel, “It’s like a multiplayer chess game where each party is making different moves from a different strategic position and each party has a huge amount at stake.”²

While the SEC is investigating the lack of disclosure to BofA shareholders regarding the bonuses paid out to Merrill Lynch executives, Congress’ Committee on Oversight and Government Reform (“COGR”) and New York attorney general Andrew Cuomo are also investigating the surprise losses incurred by Merrill Lynch in regards to receiving bailout money from the federal government.³ It has been noted by Edolphus Towns, chairman of the COGR that BofA is not allowed to rely on the attorney client privilege in dealing with Congress’ investigation.⁴ The legal principle of attorney client privilege is only protected to the extent that the information stays between client and attorney. As stated in *In re Grand Jury*, even though the attorney client privilege has been on utmost importance, it must

¹ Press Release, Securities and Exchange Commission, SEC Charges Bank of America for Failing to Disclose Merrill Lynch Bonus Payments, <http://sec.gov/news/press/2009/2009-177.htm> (Aug. 3, 2009).

² Louise Story, *Congress Aims to Force Bank of America to Give Details on Merrill*, N.Y. TIMES, Sept. 21, 2009, available at <http://www.nytimes.com/2009/09/21/business/21bank.html>.

³ *Id.*

⁴ *Id.*

be guarded cautiously or else the privilege would be waived.⁵ Would this mean that there would be a forced waiver of the attorney client privilege in regards to concurrent litigation and investigation by the SEC? If so, what does this mean for corporate lawyers?

II. BACKGROUND ON BOFA/MERRILL LYNCH MERGER

When forming the contract in a hasty manner, BofA and Merrill Lynch executives developed a joint proxy statement in order to obtain votes from shareholders regarding the merger.⁶ In this statement, BofA stated that Merrill Lynch executives would not receive year-end bonuses or other incentives without the consent of BofA and its shareholders.⁷ However, the two companies' Board of Directors had already come to an agreement that Merrill executives would receive up to \$5.8 billion in discretionary bonuses.⁸ These bonuses were going to be paid regardless of the fact that Merrill Lynch had lost \$27.6 billion that year.⁹ The schedule appended to the merger agreement stated that Merrill Lynch executives would be paid bonuses, but those bonuses could not exceed a total of \$5.8 billion.¹⁰ This was obviously contrary to the provision within the merger agreement that Merrill Lynch would not pay its executives bonuses without the permission of BofA and its shareholders. However, this appended Schedule was not disclosed to the shareholders for consideration before voting on the merger.¹¹

III. THE SETTLEMENT AND ITS DOWNFALL

On September 14, 2009, the SEC and BofA proposed a settlement

⁵ *In re Grand Jury*, 475 F.3d 1299 (D.C. Cir. 2007).

⁶ Plaintiff Compl., Sec. Exch. Comm'n v. Bank of America, No. Civ. 6829 (S.D.N.Y. Aug. 23, 2009), available at <http://www.sec.gov/litigation/complaints/2009/comp21164.pdf>.

⁷ Press Release, *supra* note 1.

⁸ *Id.*

⁹ Marcy Gordon, *Bank of America Trial With SEC Coming*, HUFFINGTON POST, Sept. 22, 2009, available at http://www.huffingtonpost.com/2009/09/22/bank-of-america-trial-wit_n_294437.html.

¹⁰ Plaintiff Compl., Sec. Exch. Comm'n v. Bank of America, No. Civ. 6829 (S.D.N.Y. Aug. 23, 2009), available at <http://www.sec.gov/litigation/complaints/2009/comp21164.pdf>.

¹¹ Press Release, *supra* note 1.

agreement for \$33 million which was subject to court approval.¹² However, court approval of this settlement was denied.¹³ In a decision by Judge Jed Rakoff, the settlement was rejected and set to move to trial in February 2010.¹⁴ The judge stated that this settlement was, “a contrivance designed to provide the SEC with the facade of enforcement and the management of the bank with a quick resolution to an embarrassing inquiry — all at the expense of the sole alleged victims, the shareholders.”¹⁵ Judge Rakoff scolded the SEC and Bank of America because its settlement would not impose liability upon those at fault for the lack of disclosure itself.¹⁶ The SEC, which usually does go after the executives who were responsible, stated that it was not able to do so in this case because the lawyers for BofA and Merrill were the drafters of the merger documents and made the decisions about disclosure and this information would be protected by the attorney client privilege.¹⁷

Judge Rakoff, in his order, made a statement that perked up the ears of corporate attorneys everywhere. He stated that, “. . .if that is the case, why are the penalties not then sought from the lawyers?”¹⁸ The rejection of this settlement could greatly influence the decisions of corporate attorneys when dealing with corporations.

IV. THE EFFECT OF THE BOFA/MERRILL LYNCH MERGER ON THE ATTORNEY CLIENT PRIVILEGE

The purpose of the attorney client privilege is to provide full, frank communication between attorney and client for complete and adequate legal

¹² Sec. Exch. Comm’n v. Bank of America, No. Civ. 6829 (S.D.N.Y. Sept. 14, 2009), available at <http://online.wsj.com/public/resources/documents/bofaorder914.pdf>.

¹³ Zachary A. Goldfarb, *Judge Says SEC Failed Investors*, Wash. Post, Sept. 15, 2009, available at <http://www.washingtonpost.com/wpdyn/content/article/2009/09/14/AR2009091401671.html>.

¹⁴ *Id.*

¹⁵ Loren Steffy, *Judge Speaks Justice to Wall Street*, HOUS. CHRONICLE, Sept. 18, 2009, available at <http://www.chron.com/disp/story.mpl/business/steffy/6626409.html>.

¹⁶ Sec. Exch. Comm’n v. Bank of America, No. Civ. 6829 (S.D.N.Y. Sept. 14, 2009), available at <http://online.wsj.com/public/resources/documents/bofaorder914.pdf>.

¹⁷ *Id.*

¹⁸ *Id.*

representation for the client.¹⁹ By forcing BofA to disregard the attorney client privilege, corporate lawyers could become defendants in this case or be investigated further to seek claims based on their professional ethics.²⁰ According to the Associations for Corporate Counsel, this would be an absurd precedent for other companies if BofA was forced to give up information regarding private legal advice.²¹

By setting such a precedent, corporate attorneys might be reluctant to have full, frank communication with their clients for fear that they will no longer be protected by the attorney client privilege if their company comes under investigation by Congress where the attorney client privilege will not hold up. In this case, BofA's disclosure of such information to Congress is based on the amount of losses incurred by Merrill Lynch during the past year with regards to the acceptance of federal bailout money, while the SEC's investigation is focused on whether shareholders were wronged by BofA's lack of disclosure of executive compensation.²² As stated before, in dealing with Congress, BofA's employees are not able to invoke the attorney client privilege and would be forced to share information regarding the legal advice given by its corporate counsel.²³ In response, BofA would be forced to supply information that would normally be sheltered by the attorney client privilege in investigations by the SEC and New York attorney general Andrew Cuomo. This is due to its disclosure of such information to Congress in its investigation.²⁴

In his order, Judge Rakoff states that the persons who really suffer from the settlement deal between the SEC and BofA would be the investors.²⁵ However, if allowed this precedent of forcing the company to disclose its private legal communications would also harm the shareholders. If corporate lawyers are

¹⁹ ABA Task Force Mission Statement, <http://www.abanet.org/buslaw/attorneyclient/home.shtml> (last visited Oct. 8, 2009).

²⁰ Nathan Koppel, *Ashby Jones, and Amir Efrati, Law Firms Put in an Unfamiliar Spot*, WALL ST. J., Sept. 16, 2009.

²¹ Story, *supra* note 2.

²² *Id.*

²³ Letter from Edolpus Towns, Chairman, House Committee on Oversight and Government Reform, to Kenneth Lewis, Chief Executive Officer and President, Bank of America Corporation (Sept. 18, 2009) http://www.huffingtonpost.com/2009/09/20/congress-aims-to-force-bo_n_292931.html.

²⁴ Story, *supra* note 2.

²⁵ Sec. Exch. Comm'n v. Bank of America, No. Civ. 6829 (S.D.N.Y. Sept. 14, 2009), *available at* <http://online.wsj.com/public/resources/documents/bofaorder914.pdf>.

not able to discuss private legal matters with its corporate clients for fear that they will be held liable for wrongdoing, the costs of corporate counsel will begin to skyrocket to account for the potential cost of litigation and settlements stemming from such conduct. This cost would be indirectly borne by the shareholders.

This would also cause corporate counsel to be fearful of providing legal assistance to a corporation regarding certain matters. Attorneys will fear that they will be held liable and would not be protected by the attorney client privilege. This would also be detrimental to the corporation and shareholders in that there would not be adequate legal representation based on full and accurate disclosure of all legal possibilities due to the lawyer's fear of liability. As stated by Susan Hackett, senior vice president and general counsel for the Association of Corporate Counsel, corporate lawyers would be unable to do their job effectively if they did not trust that the company will protect materials covered by the attorney client privilege.²⁶ This policy is one that we should adhere to the fullest in order to protect the investors, corporation and the field of corporate law itself.

V. CONCLUSION

While expanding liability to more individuals may seem to be in the spirit of the SEC, such an expansion would greatly hinder the ability of corporate lawyers to best defend their clients. By forcing a corporation to waive its attorney client privilege, shareholders and the corporation itself suffers as a result. While initially, it may be in the best interest of the shareholders of the specific corporation in general, this breakdown in the attorney client privilege would set bad precedent and lead to a slippery slope of corporate attorney liability which would, in effect, deny the corporation sufficient legal counsel. The shareholders would also bear the effects of this policy in the rising rates of corporate attorneys due to fear of liability if the attorney client privilege does not stand. The attorney client privilege has, in the past, been balanced with competing interests, however, the interests in adequate legal counsel and protecting the field of corporate law greatly trump the policies set forth by forced waiver of this privilege.²⁷

²⁶ Kimberly Atkins, *AG Michael Mukasey: Attorney-client privilege policy may change*, LAWYERS USA, Feb. 25, 2008, <http://www.allbusiness.com/government/government-bodies-offices/8896391-1.html>.

²⁷ ABA Task Force Mission Statement, *supra* note 19.

HAVE HOMEOWNERS ASSOCIATIONS CROSSED THE LINE?

HOMEOWNERS ASSOCIATIONS ARE QUICK TO PURSUE FORECLOSURE FOR UNPAID ASSESSMENTS

MARIANNA KISELEV

I. INTRODUCTION

Common Interest Communities have become a way of life for the American people. Millions of Americans reside in gated communities governed by homeowners associations.¹ These communities are growing in popularity for numerous reasons. One such reason is that families want to live and raise their children in an environment that fits their needs and desires.² Another reason is that people feel a sense of security and stability in a gated community.³

However, these communities have not escaped strong criticism for their burdensome restrictions, excessive regulation and aggressive enforcement. Critics argue that the disadvantage of living in such a community is that homeowners have to comply with a myriad of restrictions and covenants and failure to do so can result in fines.⁴ Critics also allege that the zealous homeowners associations often times abuse their powers when enforcing the rules and penalties.⁵

With the current economic crisis homeowners associations are faced with difficult choices of how to keep the community alive but also keep members in their homes. As the economy is getting worse homeowners are not only falling behind in their mortgage payments but they are also struggling to pay their

¹ Paula A. Franzese, *Privatization and Its Discontents: Common Interest Communities and the rise of Government for the Nice*, 37 URB. LAW 335, 335 (2005).

² *Id.*

³ *Id.*

⁴ *Id.* at 340.

⁵ *Id.*

monthly assessment fees.⁶ As more homeowners leave the area, those remaining have to take the burden of paying additional fees to maintain their communities.⁷ This is raising a myriad of issues concerning what should be done to keep these communities alive. In many states, associations are pursuing non-judicial foreclosure against homeowners who have not paid their assessment fees.⁸ Many homeowners are outraged because they may be on the verge of losing their primary residence and their largest investment.⁹ What can homeowners associations do to collect their unpaid fees? Should resorting to foreclosure be an option or is that an abuse of power? Should homeowners associations have to pursue other remedies to collect their debt before resorting to foreclosure? What are the limits on the power of homeowners associations? What can homeowners do to prevent foreclosures? What is the role of the courts and the legislature to put limits on the power of homeowners associations?

This article considers and criticizes the current laws that have been enacted in several states and proposes solutions to address these questions. Specifically, this article will focus on non-judicial foreclosures which accord less protection to the homeowners.¹⁰ Part II discusses the general structure and law governing common interest communities. Part III analyzes how various states have responded to the issue of homeowners associations pursuing non-judicial foreclosure on members who fail to pay their assessments. Finally, Part IV combines the various state approaches and creates a solution that attempts to address the concerns of the homeowners associations and the members.

II. THE STRUCTURE OF COMMON INTEREST COMMUNITIES

Common interest communities consist of properties that are burdened with restrictions controlling the use of the property, requiring homeowners to pay assessments for maintenance of the community property, and assessing fines for

⁶ Jeff Collins, *Homeowner Association Delinquencies on the Rise*, THE ORANGE COUNTY REGISTER, Sept. 28, 2008.

⁷ *Id.*

⁸ Jim Wasserman, *For Want of \$120, House was lost more Homeowners Association using Foreclosure as Tool to collect dues*, MILWAUKEE JOURNAL SENTINEL, Feb. 22, 2004.

⁹ *Id.*

¹⁰ BLACK'S LAW DICTIONARY 674 (8th ed. 2004) (defining "nonjudicial foreclosure", also called "power-of-sale", as "a foreclosure process by which ... property is sold at a nonjudicial public sale by a public official, the mortgagee, or a trustee, without the stringent notice requirements, procedural burdens, or delays of a judicial foreclosure").

violations.¹¹ The restrictions are imposed in the community's declaration of covenants, conditions, and restrictions, the bylaws, and the rules adopted by the board or the owners.¹²

Common interest communities are managed by a board of directors elected by the owners.¹³ The declaration outlines the power of the board of directors to collect assessments from individual homeowners for the maintenance of common areas and to take actions against owners that fail to pay their assessments, such as placing a lien on the property or pursuing foreclosure if the assessments are not paid.¹⁴ Furthermore, the board of directors can charge a late fee with interest for delinquent assessments.¹⁵

Common interest communities are typically incorporated as non-for-profit corporations and governed by a board of directors.¹⁶ Therefore, the principles of corporate law apply to the decisions of the board of directors.¹⁷ For instance, courts apply the business judgment rule when assessing the board's actions.¹⁸ Consequently, the court will not interfere with the board's decision unless it appears that there fraud, self-dealing, or unconscionable conduct.¹⁹ This gives the board of director substantial discretion to decide what type of method to use when collecting unpaid assessments.²⁰ With the current economic conditions, this is becoming a growing concern because there has been a substantial increase in the amount of homeowners being unable to pay their assessments.²¹ As a result, homeowners associations are increasingly foreclosing on property owners for

¹¹ RESTATEMENT (THIRD) OF PROPERTY (SERVITUDES) § 6.5 (Council Draft No. 8, 1997) [hereinafter RESTATEMENT].

¹² Susan F. French, *Making Common Interest Communities Work: The Next Step*, 37 URB. LAW. 359, 362 (2005).

¹³ *Id.*

¹⁴ *Id.*

¹⁵ Gemma Giantomasi, *A Balancing Act: The Foreclosure Power of Homeowners Associations*, 72 FORDHAM L. REV. 2503, 2515 (2004) (focusing on the law in various states regarding homeowners associations this article does not address the issue from a current economic and legal perspective and the solutions proposed are outdated).

¹⁶ Wayne S. Hyatt, *Common Interest Communities: Evolution and Reinvention*, 31 J. MARSHALL L. REV. 303, 342-343 (1998).

¹⁷ *Id.* at 343-44.

¹⁸ *Id.*

¹⁹ Paula A. Franzese, *Common Interest Communities: Standards of Review and Review of Standards*, 3 WASH. U. J.L. & POL'Y 663, 667 (2000).

²⁰ Giantomasi, *supra* note 15, at 2515.

²¹ Wasserman, *supra* note 8.

minor unpaid dues.²² Do homeowners associations have the power to foreclose on a member's property for failing to pay assessments?

In most states homeowners associations have the power to foreclose on property for unpaid assessments. The courts in various states have reasoned that the homeowner's association's lien on the property for unpaid assessments constitutes an interest in real estate to secure debt and therefore can be foreclosed upon.²³ Furthermore, most state statutes contain a provision allowing foreclosure for unpaid assessments.²⁴ With the current economic conditions, the homeowner's association's unregulated power to pursue foreclosure is becoming a growing concern because there has been a substantial increase in the amount of homeowners that are unable to pay their assessments.²⁵ This article will focus on whether the homeowners associations are abusing their power and resorting to foreclosure for low amounts of debt without exhausting other remedies. Many states have responded to this growing concern by enacting legislation restricting the association's power to foreclose on property.

III. PROPOSED LEGISLATION

The following is a brief survey and critique of three states that have enacted or attempted to enact legislation to deal with homeowners associations foreclosing on properties for unpaid assessments.

A. *Texas Legislation*

The Texas legislature has been consistently fighting over the past several years to restrict the powers of homeowner associations, especially with regards to foreclosure. Republican Senator Burt Solomons, who has been the lead proponent of the bills, stated that "things have gotten out of control with homeowners associations . . . it's amazing that the courts have allowed them to foreclose on homesteads for something as minor as getting behind on association

²² *Id.*

²³ Bd. of Dirs. of Olde Salem Homeowners Ass'n v. Secretary of Veterans Affairs, 226 Ill. App.3d 281, 288 (1992); Inwood N. Homeowners Ass'n Inc. v. Harris, 736 S.W.2d 632 (Tex. App. 1987).

²⁴ DONALD KUPERMAN, ASSESSMENT COLLECTION, IN CONDOMINIUM AND HOMEOWNERS ASSOCIATION LITIGATION: COMMUNITY ASSOCIATION LAW 259 (Wayne S. Hyatt & Phillip S. Downer eds., 1987).

²⁵ Wasserman, *supra* note 8, at 340.

dues ... we have to restore some balance." ²⁶ Senator Solomons, along with several other Texas state senators, proposed four bills significantly restricting homeowners' associations' rights to foreclose on property but only one has been enacted into law. ²⁷

The first proposed bill was designed to limit the homeowners' associations' powers to foreclose on properties by requiring them to take preliminary steps before resorting to foreclosure. ²⁸ For instance, the bill would require a homeowners association to "visit a board member before any foreclosure, stopping a foreclosure if a homeowner paid back dues or agreed to a payment plan, and extending the time a foreclosure owner could buy a home back." ²⁹ This bill was never signed into law. ³⁰

The second bill called for homeowners associations to reimburse a property owner if their home was sold for less than the most recent appraisal of the property. ³¹ The homeowners association would have to reimburse the owner the difference between the sale price and the appraisal value. ³² This bill was also not passed into law. ³³

The third bill which has been passed into law restricted the power of homeowners associations to pursue foreclosure for unpaid attorney's fees or overdue fines. ³⁴ The bill also allows home owners to redeem their property 180 days after the foreclosure sale. ³⁵

Finally, there has been another recently proposed bill that would drastically limit the power of homeowners associations. The proposal is to submit a "constitutional amendment to Texas voters that would prohibit foreclosures by associations on homesteads within their jurisdiction." ³⁶ The bill would still allow

²⁶ Eric Berger, *Homeowners Association Bill Gets OK/ Some More Stringent Requirements Unlikely to Survive Law Making Process*, HOUSTON CHRONICLE, May 16, 2001.

²⁷ Giantomasi, *supra* note 15, at 2532.

²⁸ *Id.*

²⁹ S.B. 699, 1999 Leg., 76th Reg. Sess., § 207.125(b) (Tex. 1999), available at <http://www.capitol.state.tx.us/tlo/76R/billtext/SB00699H.HTM>.

³⁰ *Id.*

³¹ S.B. 1834, 2001 Leg., 77th Reg. Sess., § 51.008(c) (Tex. 2001), available at <http://www.capitol.state.tx.us/tlo/77R/billtext/SB01834I.HTM>.

³² *Id.*

³³ *Id.*

³⁴ TEX. PROP. CODE § 209.009(1)(2) (West 2009).

³⁵ *Id.* at § 209.011(b).

³⁶ Terrence Stutz, *Texas Amendment Would Prohibit HOA Foreclosures*, DALLAS MORNING NEWS, Feb. 28, 2009.

the association to place a lien on the property for which they can receive payment once the owner decided to sell the house voluntarily.³⁷ This is expected to receive strong opposition and probably will not be passed into law.³⁸

Despite the active role of the Texas legislature in trying to reform the rights of homeowners little has actually been done. The most recent proposal, taking away the power of homeowners associations to foreclose, is an extreme solution and will not work for several reasons. First, this type of solution does not effectively deal with the problem of homeowners not paying their dues. Rather it gives homeowners a chance to take advantage of the system and avoid their obligations to the community. Second, this would nullify the power and authority of the board and threaten the existence of the association because the association will have no recourse against delinquent homeowners.³⁹ The current law gives homeowners more time to redeem their property but does not address the issue of foreclosing for unpaid assessments.

B. California Legislation

Similarly, in California homeowners associations were accused of abusing their powers and pursuing non-judicial foreclosures to collect relatively small debts. For instance, people were losing their homes in California for failing to pay a couple hundred in dues.⁴⁰ While these may be extreme examples the legislature in California noticed and decided to take action. Senator Denise Moreno Ducheny sponsored a bill that would require homeowners associations to use small claims court to collect unpaid assessment sums below \$2,500.⁴¹ Ducheny told the Senate Committee hearing for the bill that “often for less than \$200 people are losing their homes and being evicted without the due process rights given to tenants...we understand the need for everyone to pay their agreed-upon debts, but we also want to protect the equity of homeowners and their due process rights.”⁴²

³⁷ *Id.*

³⁸ *Id.*

³⁹ Niki Zupanic, *Keeping Homes off the Auction Block: California Limits Foreclosures by Homeowners Associations*, 37 MCGEORGE L. REV. 199, 200 (2006).

⁴⁰ *Id.*

⁴¹ Daniel Yi, *Homeowner Groups' Power to Foreclose Is Under Attack* *Lawmakers say boards have gone too far by seizing and selling units over minor disputes*, L.A. TIMES, June 7, 2004.

⁴² Jim Wasserman, *Bill Advances to Limit Power of Homeowner Groups to Take Houses*, DAILY BREEZE, Mar. 30, 2005.

The proposed bill was amended several times and became effective January 1, 2006.⁴³ Known as Chapter 452, the new law would greatly limit the power of homeowners associations to foreclose on properties. Under Chapter 452, homeowners association can pursue judicial and non-judicial foreclosure only if the assessment debt is \$1,800 or more and the debt must also be more than 12 months delinquent.⁴⁴ If these requirements are not met the homeowners association can file a civil action in small claims court to collect the debt.⁴⁵ Alternatively, the homeowners association can file a lien on the property upon which it can foreclose later after the \$1,800 or 12 month delinquency thresholds are met.⁴⁶

Chapter 452 also toughens foreclosures notices and provides procedures that the board of directors must follow when deciding whether to pursue foreclosure. For instance, the homeowners association's board of directors "must make a formal decision to foreclose upon a lien at an executive meeting of the board, by a majority vote, and at least 30 days prior to any foreclosure auction to sell the property."⁴⁷ The association must also send legal notification to the homeowner regarding the foreclosure and provide an itemized list of the delinquent assessments.⁴⁸ Finally, the law also provides that homeowners associations should participate in alternative dispute resolution to settle the disputes before resorting to litigation or foreclosure.⁴⁹ For instance, a homeowner has the right to seek a meeting to discuss the delinquent debts and try to figure out a way to pay back the assessments.⁵⁰ There are also options for a formal arbitration process where a neutral third party mediates the dispute.⁵¹

California's law is the best approach to dealing with the foreclosure issue but it also has its drawbacks. First, the law significantly restricts the homeowners' associations' power to foreclose on properties for unpaid assessments. This addresses the possibility of the board of directors abusing their power and makes them take preliminary steps before resorting to such a drastic measure. This approach strongly encourages alternative dispute resolution which is in the best interest of the property owners and the association because it saves costs and time. However, the law does not effectively address the issue of

⁴³ Zupanic, *supra* note 39, at 202.

⁴⁴ CAL. CIV. CODE § 1367.4 (b).

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.* at § 1367.4(c)(2).

⁵⁰ *Id.* at § 1367.1(c)(1).

⁵¹ *Id.*

transparency in the board's decision making process or the lack of communication between the board and the members.

C. Nevada

Finally, Nevada, among several other states, has proposed solutions focusing on alternative dispute resolution and increased transparency of the board's decision making. For instance, in Nevada the legislature passed a law in 1991 that was designed to increase the rights of homeowners in common interest communities. Specifically, the bill provides that members may attend and speak at all of the association's meetings.⁵² In addition, the bill provides homeowners with greater access to financial statements of the association.⁵³ For instance, the homeowners associations are required to send the members an annual statement of the association's budget.⁵⁴ Members shall have open access to all financial documents except those dealing with the individual owner's unit.⁵⁵ Furthermore, before any litigation the association must send a statement to the owners describing the potential costs of the litigation and an explanation of the benefits and risks.⁵⁶ In addition, the law restricts the power of homeowners associations to pursue foreclosure for unpaid fines and places a cap on fines which may not exceed \$100 per violation or a total of \$500, whichever is less.⁵⁷ Finally, an Office of the Ombudsman for Owners in Common Interest Communities was created which was designed to provide education to homeowners and board members to help them better understand their rights and obligations under the governing documents and state laws.⁵⁸

Even though Nevada's law may not be as comprehensive as the measures taken in California it provides a good idea of possible ways to increase the transparency of the board's decision making process. Providing greater access to financial statements and allowing members to attend and speak at board meeting

⁵² Frankie Sue Del Papa, *Rules for Homeowners Associations*, 9-MAY NEV. LAW. 10 (2001).

⁵³ *Id.*

⁵⁴ *Id.* at 11.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.* See also Michelle Crouch, *New Law to Limit Power of Neighbors: Rules would make foreclosure more difficult, limit some fees*, CHARLOTTE OBSERVER, Aug. 22, 2005. North Carolina legislature passed a similar bill that would reduce the maximum fines assessed by associations from \$150 to \$100 a day and will cap late fees for association dues unless the rules state otherwise. *Id.*

⁵⁸ *Id.* at 11-12.

provides members with the ability to get involved in the decision making process. It also gives homeowners a chance to evaluate the financial condition of the community and determine whether foreclosure is necessary. Foreclosures have the tendency to bring down the value of homes in the neighborhood and also increase the assessment fees for other members.⁵⁹ Therefore, giving members a chance to participate in the decision making process the rate of foreclosure may decrease. Also, creating an office which provides information to the board members and homeowners is a great way to ensure that the decisions are as a result of an informed board and homeowners are aware of the risks and disadvantages of their actions.

While this bill increases transparency and communication among board members and property owners it does not address the issue of foreclosing on property owners for unpaid assessments. More limits are necessary on homeowners' associations' power to pursue foreclosure because there is a possibility of abuse.⁶⁰

IV. SOLUTION

An effective solution to this problem is going to take a balanced approach to the issue. There needs to be a balance between the individual homeowner's interest in preserving their equity and the association's interests in preserving the community.

A. *Minimum Threshold Required Before Pursuing Foreclosure*

The California approach has put reasonable limits on the homeowners association but can still use improvement. First, creating a minimum debt that the homeowner must accumulate before foreclosure is pursued is a good way to approach the problem. Homeowners associations should not be foreclosing on people for owing just a couple hundred in debt when their house has greater.⁶¹ Therefore, placing a limit will prevent the abuse of power and will give the homeowner a chance to remedy the problem before foreclosure is pursued.⁶² The legislature should consider increasing the limit from \$1,800 to provide greater protection for homeowners. The reason greater protection is necessary is because "a home is one of the most valuable assets a person may ever own."⁶³ In addition

⁵⁹ Collins, *supra* note 6.

⁶⁰ Giantomasi, *supra* note 15, at 2540.

⁶¹ Zupanic, *supra* note 34, at 204.

⁶² *Id.*

⁶³ *Id.*

to the minimum threshold, requiring the homeowners associations to take the delinquent property owner to small claims court to recover the unpaid assessments is a good way to make the associations pursue other remedies before resorting to foreclosure.

B. More Transparency in the Board's Decision Making

Creating transparency in the board's decision making process will prevent the abuse of power and will make it easier to hold the board accountable when there has been wrongdoing. Transparency makes the decision making process look legitimate and makes it easier for the homeowners and the court to evaluate whether there has been wrongdoing. Some possible ways to accomplish transparency is by making the board members provide written financial statements of the homeowners' delinquent fees, providing notice when there are delinquencies, and meeting with the homeowners to discuss a possible solution to the problem.⁶⁴ Furthermore, providing the time and place of all the board's meetings and making all the information available to all parties is necessary to increase transparency.

C. Increased Communication between Members and Homeowners Associations

Increasing communication between the members and the homeowners association will help solve this problem. Many homeowners do not have a positive opinion of the board of directors.⁶⁵ While this may be a natural reaction because the board is required to enforce the restrictions, impose fines, and take other unfavorable measures against members this does not have to be a cruel and hostile process. By increasing communication this can increase the feeling of community and understanding among the members and the homeowners association. First, the homeowners association should let the members express their opinions and provide insight into what is happening in the community.⁶⁶ For instance, when a member is facing foreclosure the homeowners association should let all the members provide insight at the meeting and try to propose solutions. This will help the members feel that they also have a say in what is happening in their community and will encourage creative solutions to solve the financial difficulties. After all, the attraction of common interest communities is

⁶⁴ Giantomasi, *supra* note 15, at 2537.

⁶⁵ Franzese, *supra* note 1, at 336.

⁶⁶ Frankie Sue Del Papa, *supra* note 52, at 10.

that they are environments where people work together not against each other to live comfortably.

D. Flexibility of Homeowners Associations

Homeowners associations need to be flexible, especially in this struggling economy. Flexibility allows for good relations between the board and the members. That can be accomplished by providing a grace period for owners that cannot afford to pay their fees for a couple months and stopping the accumulation of fees until the homeowners have caught up in making payments. Another possibility is creating a payment plan that can help delinquent homeowners pay back their debts in smaller monthly payments rather than one large sum.⁶⁷ This will increase the likelihood that homeowners facing financial difficulties will be able to pay back their debts.

V. CONCLUSION

The legislature needs to balance the interests of the homeowners associations and the individual members. The new law needs to ensure mechanisms so that homeowners do not take advantage of the system and avoid paying their fees. The law also needs to ensure that homeowners associations are not abusing their powers and pursuing foreclosures when other steps can be taken to cure the debt. These communities constitute a large part of the housing market and truly provide a value to many peoples' lifestyles. Therefore, the solution is not to abolish these communities completely or to enact laws that effectively get rid of their power to function but rather to create a greater sense of community and support by stressing transparency, communication, and flexibility. This type of solution will foster good relations which will improve the value that homeowners place on their community and will give them a desire to remain there in the future.

⁶⁷ CAL. CIV. CODE § 1367.1(c)(1).

SHOULD SECTION 10(B) RULE 10B-5 OF THE SECURITIES ACTS BE AMENDED TO ALLOW PRIVATE RIGHT OF ACTION FOR AIDING AND ABETTING?

KEVIN COFFEY

I. INTRODUCTION

The Securities Act of 1933 and the Securities Exchange Act of 1934 were enacted in response to the Stock Market Crash of 1929 that ushered in the Great Depression.¹ In passing the Acts, Congress' intention was to implement regulations that would govern the ways securities were bought and sold in the United States and to protect individual consumers from securities fraud. Specifically, Section 10(b) of the 1933 Act and Rule 10b-5 of the 1934 Act regulate fraud in connection with the purchase or sale of a security.² To obtain a conviction under these provisions, it must be proved that:

- (1) (a) the defendant engaged in a fraudulent scheme, or
(b) made a material misstatement, or
(c) omitted material information to one to whom the defendant owed a duty;
- (2) the scheme, misstatement, or omission occurred in connection with the purchase or sale of a security; and
- (3) the defendant acted "willfully."³

From the time Congress passed the laws in the early 1930's, there has been debate over exactly who could be held liable for securities fraud under Section 10(b) and Rule 10b-5. For the most part, courts have understood the antifraud provisions to extend liability to "primary violators," those who actually

¹ DONNA M. NAGY, RICHARD W. PAINTER, MARGARET V. SACHES, *SECURITIES LITIGATION AND ENFORCEMENT: CASES AND MATERIALS* (2nd ed. 2003).

² *Id.*

³ J. KELLY STRADER & SANDRA D. JORDAN, *WHITE COLLAR CRIME: CASES, MATERIALS, AND PROBLEMS* (2d ed. 2009).

make material misstatements or omissions or commit a manipulative act or acts. In *Central Bank of Denver v. First Interstate Bank of Denver*⁴ and again in *Stoneridge Investment Partners, LLC v. Scientific Atlanta, Inc.*,⁵ the United States Supreme Court considered the issue of whether to adopt a theory of “scheme” or “aider and abettor” liability. According to the holdings in those cases, shareholders can only sue parties directly involved in a fraud, and not third parties who indirectly aid or abet the fraud.⁶ As the Court put it, the issue before it was “whether private civil liability under Section 10(b) extends as well to those who do not engage in the manipulative or deceptive practice, but who aid and abet the violation.”⁷ In both cases, the Court held that “because the text of Section 10(b) does not prohibit aiding and abetting ... a private plaintiff may not maintain an aiding and abetting suit under 10(b).”⁸ In *Central*, the court explained that its decision was guided by statutory interpretation, noting that “[i]f ... Congress intended to impose aiding and abetting liability, we presume it would have used the words ‘aid’ and ‘abet’ in the statutory text. But it did not.”⁹

II. NEW LEGISLATION: S.1551, THE LIABILITY FOR AIDING AND ABETTING SECURITIES VIOLATIONS ACT OF 2009

A year after the Court defended this interpretation of Section 10(b) in *Stoneridge*, as if responding to its “Congressional intent” argument posed by the majority in that case, Senator Arlen Specter (D-PA) introduced S.1551, the Liability for Aiding and Abetting Securities Violations Act of 2009.¹⁰ The bill, introduced in July 2009 and co-sponsored by Senators Edward E. Kaufman (D-DE), Jack Reed (D-RI) and Sheldon Whitehouse (D-RI), would repeal the Supreme Court’s decisions in *Central* and *Stoneridge* by amending the securities laws to allow private litigation against a person that provides “substantial assistance” in a violation of the securities laws. The language of the proposed bill states:

⁴ 511 U.S. 164 (1994).

⁵ 128 U.S. 761 (2008).

⁶ *Id.*; *Cent. Bank of Denver*, 511 U.S. 164.

⁷ *Cent. Bank of Denver*, 511 U.S. at 167.

⁸ *Id.* at 191.

⁹ *Id.* at 177.

¹⁰ S.1551, 111th Cong. (2009).

For purposes of any private civil action implied under this title, any person that knowingly or recklessly provides substantial assistance to another person in violation of this title, or of any rule or regulation issued under this title, shall be deemed to be in violation of this title to the same extent as the person to whom such assistance is provided.¹¹

In effect, the bill would permit private civil actions against aiders and abettors, including accountants and attorneys. The aider and abettor liability proposed by Sen. Specter reflects the “substantial participation approach” advocated by the plaintiffs in *Wright v. Ernst & Young LLP*.¹² There, plaintiffs claimed that Ernst & Young violated the antifraud provisions of the 1933 and ’34 Acts by orally approving materially false and misleading financial statements made by the company which it was auditing.¹³ In turn, that company disseminated that information to the public in a press release.¹⁴ As a basis for liability, the plaintiffs argued that the Court of Appeals for the Second Circuit should adopt a “substantial participation approach,” under which third-party defendants, like Ernst & Young, would be held primarily liable for statements made by others in which the defendant had significant participation.¹⁵ The Court in that case declined to adopt such a rule and refused to extend liability to those who did not actually make fraudulent or misleading statements to the public.¹⁶ Instead, the Court utilized a “bright-line approach,” under which a third party’s review and approval of documents containing fraudulent statements is not actionable under Section 10(b) because one must make the material misstatement or omission in order to be a primary violator.¹⁷ In other words, the Court refused to extend liability to a defendant who did not actually make the misleading statement or omission. If Sen. Specter’s bill is passed, the “substantial participation approach” would essentially replace the “bright line approach” used

¹¹ *Id.*

¹² 152 F.3d 169 (2d Cir. 1998).

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

by the Supreme Court in *Central* and *Stoneridge*. The question remains, should this bill be adopted?

III. THE DEBATE: SHOULD THE BILL BE PASSED?

On September 17, 2009, the bill had its first committee hearing at a session of the Subcommittee on Crime and Drugs of the United States Senate Committee on the Judiciary (“Subcommittee”). During that hearing, the Subcommittee heard testimony from University of Michigan Law Professor Adam Pritchard, who outwardly opposes the bill. Among Professor Pritchard’s many concerns over the bill, he states that its enactment would essentially “tear down the safeguards instituted in *Central* and *Stoneridge* and create the potential for the securities laws to be injected in a wide range of ordinary commercial transactions.”¹⁸ Pritchard is most concerned over the prospect of increased “strike suits” filed against deep-pocket, third-party defendants.¹⁹ The professor suggests that litigation aimed at “aiders and abettors” will be detrimental to the economic strength of the United States and significantly raise the cost of capital.²⁰ In his testimony before the Subcommittee on September 17, Professor Pritchard articulated the potential negative effects of the proposed legislation:

Giving the plaintiffs’ bar aiding-and-abetting authority would offer class action lawyers one more weapon with which to shake down settlements. Here the obvious targets would be available deep pockets with some contractual connection to the corporation, such as accountants, lawyers, and banks ... Aside from the threat of bankruptcy, shifting liability from the corporation to these third parties only puts an additional link in the chain of the pocket shifting problem. Professionals providing services to public

¹⁸ *Evaluating S. 1551: The Liability for Aiding and Abetting Securities Violations Act of 2009, Before the S. Comm. on the Judiciary, Subcomm. on Crime and Drugs*, 111th Cong. (2009) [hereinafter *Evaluating S. 1551*] (statement of Adam C. Pritchard).

¹⁹ Leslie A. Platt & Kimberly M. Melvin, Senate Subcommittee Takes up Repeal of *Stoneridge*, Sept. 18, 2009, <http://www.wileyrein.com/publications.cfm?sp=articles&newsletter=1&id=5530>.

²⁰ *Id.*

corporations will demand compensation for bearing the risks of liability. Moreover, these advisors will begin more aggressively monitoring statements in order to protect themselves from litigation risk. The additional time spent on monitoring will not only duplicate the corporation's efforts to ensure accuracy; it will also be redundant across the multiple advisors working on a common document. Shareholders will bear those costs; securities class actions are not a free lunch.²¹

In essence, Pritchard believes that the bill will hurt the competitiveness of U.S. capital markets and financial centers and expand the potential liability and litigation expense for innocent third parties. Professor Pritchard is not the only one having trouble seeing the potential benefits of this bill. Professor William Jacobson, director of the securities law clinic at Cornell University Law School, has reservations about extending liability for securities fraud to a third-party defendant who did not make a fraudulent statement. "The person who assists in the sham transaction isn't the person making the public statement or the public filing," said Jacobson.²² Along with Pritchard and other experts in the field of securities law, Professor Jacobson is worried that the bill will benefit plaintiffs' attorneys more than shareholders. "Whether it actually helps investors, it's hard to say," he said. "But it's certainly going to help investors' lawyers – there's no question about that."²³

On the other hand, there are many who believe that the bill is necessary to provide relief for investors who have fallen victim to securities fraud aided by third-party actors. Columbia Law Professor John Coffee testified before the Subcommittee in support of the bill, stating that civil aiding and abetting liability is necessary to provide compensation for defrauded investors and to deter third-party actors, like accountants and lawyers, from intentionally or recklessly assisting a corporation in defrauding shareholders.²⁴ Sitting before the Subcommittee on September 17, Coffee rebuked claims by opponents of

²¹ Pritchard, *supra* note 18.

²² Suzanne Barlyn, *Update: Compliance Watch: Bill Would Fuel More Investor Fraud Suits*, WALL ST. J., Aug. 5, 2009, <http://online.wsj.com/article/BT-CO-20090805-715386.html>.

²³ *Id.*

²⁴ Kevin M. LaCroix, *Specter's "Aiding and Abetting" Bill: Why it Could Pass and Why it Matters*, D&O DIARY, Sept. 21, 2009, <http://www.dandodiary.com/2009/09/articles/securities-litigation/specters-aiding-and-abetting-bill-why-it-could-pass-and-why-it-matters/>.

Specter's proposed legislation that, if passed, the bill would have a negative effect on capital markets:

[P]rivate liability for aiding and abetting violations makes sense because (1) the critical gatekeepers of the capital markets – accountants, investment banks, securities analysts, credit rating agencies, and sometimes law firms – will not otherwise face liability and will remain underdeterred in most instances, and (2) these gatekeepers can be more easily deterred than the primary violator because they do not stand to receive the same gain as the primary violator. In contrast, the primary violator may be essentially undeterrable by civil penalties.²⁵

Coffee's support for the bill, it seems, rests on an assumption that by threatening the gatekeepers with aider and abettor liability, securities fraud will be prevented more frequently. However, Coffee does not assess the risk of increased "strike suits" against third-party defendants. Even assuming that the bill will have the deterring effect cited by its proponents, it is unclear whether the benefit of decreased fraud will outweigh the costs of increased strike-suits against deep-pocketed gatekeeper companies.

IV. CONCLUSION

While it appears that the bill has an equal amount of support and opposition within Congress, it is becoming increasingly clear that it will probably not reach the Senate floor for debate by the end of the year, as the legislative calendar is quite full with issues concerning health care reform. While the timeline for this bill is not certain, shareholders can rest assured that this debate will not go away indefinitely. As the United States remains in the midst of a serious recession, voices for stricter regulation in regard to the purchase and sale of securities are growing louder and more insistent.

²⁵ *Evaluating S. 1551, supra* note 18 (statement of John C. Coffee, Jr.).

IT'S SHORT OUT THERE

CARLOS DE LA PAZ

I. INTRODUCTION

I was in the third grade on Christmas morning when I received my first investment security, a portable shoeshine kit. I asked my father, “Why a shoeshine kit?” He answered back with sound investment advice. He told me to take that shoeshine kit (which probably cost him twenty dollars) and make it into fifty dollars. A couple of days later my father found me on the floor of the garage, covered in sweat, shining a wagon full of our neighbors’ shoes.

As I look back, instead of putting in all that work shining those shoes, what I should have done was even simpler. Instead of receiving that shoeshine kit as a gift, I should have just borrowed that shoeshine kit, promised to return it to my father, sell that kit to an unsuspecting third party, and wait for the value of that kit to decrease over time. Once the kit had decreased in value, I should have then bought the kit back at the discounted value. Give the shoeshine kit back to my father, and pocket the difference. Simply put, I should have shorted my investment.

Initially, this short sell is very much legitimate.¹ I may have done my homework and come to the conclusion that the shoeshine kit was overvalued. I then sold it to someone who was willing to pay the overvalued price, and then buy it back from someone that was willing to sell it at the decreased value. I even paid off my debt by giving the shoeshine kit back to my father. But what happens if I initiated the decrease in the value of the shoeshine kit by my own actions? For example, I started a rumor that shoeshine kits are not worth a dime. Is my short sell still legitimate? If not, then more importantly, who is going to stop me?

To make an adequate conclusion on whether shorting should be regulated, and to what extent, it is important to analyze the benefits and costs of shorting. Once these costs are identified, it will be necessary to take a closer look at some possible prevented measures. The “alternative uptick rule” is an adequate measure that can help prevent these costs from incurring.

¹ Richard Geist, *New Short Selling Regulations*, BULL & BEAR FIN. REPORT, available at <http://www.thebullandbear.com/articles/2004/0304-geist.html>.

II. ANALYSIS OF THE BENEFITS AND COSTS OF SHORTING

There isn't anything inherently wrong with shorting in the marketplace.² In fact, short selling can potentially result in better pricing efficiency and a more liquid market.³ Basically, if a security "gets ahead of itself;" in other words, the market price of the company is overinflated, shorting will help correct the value of that security.⁴ Also, if a company is worthless, shorting will ensure the destruction of that company's equity.⁵ A modern day example is found in the case of Enron. Short sellers were among the first to discover problems in Enron.⁶ Short selling then helped Enron's stock reflect its true value, nothing.⁷

Shorting doesn't come without its fair share of problems. As most economists realize, capitalistic economies are controlled by individual incentives.⁸ Individuals react a certain way that will maximize their own utility, even if it creates a burden on the economy.⁹ The short seller has an incentive to short a stock to maximize his own utility by this transaction. This short sell, however, can be perverse for the economy. The short seller will "kick the sector when it's already down, making a hefty profit in the process."¹⁰ This practice, mostly done by hedge funds, artificially lowers the value of companies stock, which will inevitably lower available capital.¹¹ The end result is that these companies, although solvent, will be traded as if they were insolvent.¹²

² *Id.*

³ Ekkehart Boehmer and Julie Wu, *Short Selling and the Informational Efficiency of Prices* (Working Paper, 2009) available at <http://ssrn.com/abstract=972620>.

⁴ Harlan D. Pratt, *A Fuller Theory of Short Selling* (Northeastern U. Bus., Working Paper No. 2002 02 20, 2002) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=301321.

⁵ *Id.*

⁶ Claire Suddath, *A Brief History Of Short Selling*, TIME, Sept. 22, 2008, available at <http://www.time.com/time/business/article/0,8599,1843255,00.html>.

⁷ *Id.*

⁸ CHARLES WHEELAN, *NAKED ECONOMICS UNDRRESSING THE DISMAL SCIENCE* 6 (W.W. Norton & Company, Inc.) (2003).

⁹ *Id.* at 30.

¹⁰ *Mad Money: Cramer's Outrage* (CNBC television broadcast Mar. 6, 2009).

¹¹ *Id.*

¹² *Id.*

Many argue that shorting is what helped bring down Bear Stearns and Lehman Brothers in 2008.¹³ A rumor leaked out, which was eventually traced back to two hedge funds and a Bear Stearns competitor, that Bear Stearns had a liquidity problem.¹⁴ In reality, Bear Stearns was not having a liquidity problem.¹⁵ They had eighteen billion in their cash reserves to cover trading when the week began.¹⁶ However, this rumor proved too monstrous to contain, and eventually short selling destroyed Bear Stearns.¹⁷ This very example exemplifies a major cost to short selling: the perverse incentive to start disastrous rumors and cash in on the widespread panic.

III. REGULATION AS A DEVICE TO COMBAT ABUSIVE SHORTSELLING

Regulations are great devices that would be able to reach abusive short selling. Under title 15 of the United States Code, it is unlawful for a person to engage in short selling that is “in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”¹⁸ Obviously the spreading of false destructive rumors in anticipation of shorting would constitute fraud, but the inquiry doesn’t end there. For starters, what are the best interests of the public or investors?

The SEC has partially answered this inquiry by reinstating the “uptick rule.” This rule was adopted in the 1930’s to combat the manipulative effect short sales had on the already down market.¹⁹ The gist of this rule is that “short sales may only be made at a price higher than the next preceding different price.”²⁰ “For example, if there were two successive sales of a stock at a price of \$100 on an exchange, you may sell short at \$100 only if the third preceding sale was at a price less than \$100.”²¹ The SEC eventually abolished the “uptick rule” in July

¹³ Gerry Shih, *SEC May Reinstate Rules for Short-Selling Stocks*, N.Y. TIMES, July 3, 2009, available at <http://www.cnbc.com/id/31719408/site/14081545>.

¹⁴ Bryan Burrough, *Bringing Down Bear Stearns*, VANITY FAIR, Aug., 2008, available at http://www.vanityfair.com/politics/features/2008/08/bear_stearns200808.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ 15 U.S.C.A § 78j(a)(1) (2006).

¹⁹ Short Sales, Exchange Act Release No. 34-42037 (Oct. 20, 1999).

²⁰ U.S. v. Mandel, 296 F.Supp. 1038, 1039 (S.D.N.Y 1969).

²¹ *Id.*

2007,²² but the SEC is currently considering reinstating the rule with some modifications.²³

IV. THE “UPTICK RULE” IS IN THE BEST INTERESTS OF THE PUBLIC

Currently the SEC is holding round table discussions on the reinstatement of the “uptick rule.” These roundtable discussions have not gone on unnoticed. Both sides of the aisle are expressing their concerns on whether they believe this regulation will actually be effective against abusive shortselling.

To address a few concerns of the “uptick rule;” first, it is too costly to implement.²⁴ The “uptick rule” requires a constant stream of cash flow. Given the volatility in the market place, who is going to monitor the securities to determine the lowest value a security can be traded? This constant monitoring activity would be expensive to maintain. Second, the “uptick rule” inhibits efficient pricing on securities. If a security is worthless or overvalued, the “uptick rule” might inhibit that security from reflecting its true value.

The SEC has addressed the first concern with a proposed “alternative uptick rule.”²⁵ This “alternative uptick rule” would refer to the national best bid when determining the allowable bid price for short sales, which is less extensive than the previous approach.²⁶ This is different than the previous approach, which requires a more constant monitoring of a security, to determine the appropriate last sale price.²⁷ Also, because of this new approach for determining the bid price, it would be easier to program into trading and surveillance systems.²⁸

V. RECOMMENDATION

In regard to the second concern, I propose that the “alternative uptick rule” actually pushes a better pricing efficiency into the market place than without it. The implementation of this rule will help clean up the market place from fraudulent activities. This rule might even have saved Bear Stearns from becoming highly devalued after the destructive rumors started flying around. The

²² 69 AM. JUR. 2D *Securities Regulation* § 415 (2009).

²³ Amendments to Regulation SHO, Exchange Act Release No.34-60509 (Aug. 17, 2009).

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

“uptick rule” was not implemented back during the Great Depression as means to inhibit trading; they were put into place to control abusive human behavior.²⁹

VI. CONCLUSION

In conclusion, the prevention of abusive shorting and the prevention of the widespread panic like we saw in 2008 are reasons why the “alternative uptick rule” is in the best interests of the public. As noted earlier, short selling can be an efficient tool for keeping the market in check; however, this powerful tool needs parameters in order to keep the manipulators from ruining it for the general public. The law should not pursue these manipulators unless going after them will actually do some good.³⁰ Although the “alternative uptick rule” may not be the complete solution to abusive short selling, it is a step in the right direction that will actually do some good. It is easier to spread fear and panic than it is to spread feelings of calmness.³¹ The “alternative uptick rule” will help dampen the panic in times of recession. In conclusion, the prevention of abusive shorting and the prevention of the widespread panic like we saw in 2008 are reasons why the “alternative uptick rule” is in the best interests of the public.

²⁹ *Mad Money: Cramer’s Outrage*, *supra* note 10.

³⁰ Steve Thel, *\$850,000 In Six Minutes--The Mechanisms of Securities Manipulation*, 79 CORNELL L. REV. 219, 223 (1994) (discussing the effects manipulators in the market place).

³¹ *Mad Money: Cramer’s Outrage*, *supra* note 10.

FREE TRADE VERSUS PROTECTIONISM: A TAXING DEBATE

YUEJIAO HOU

I. INTRODUCTION

President Obama's September 11th decision to restrict imports of Chinese tires has sparked a taxing debate both domestically and abroad. On top of the preexisting four percent tariff on all tire imports, the president determined to impose additional ad valorem duties upon certain passenger vehicle and light truck tires from China, designed to taper down from 35 to 30 to 25 percent over three years.¹ China responded within days by raising a World Trade Organization ("WTO") challenge to the safeguard, alleging that Obama's actions are inconsistent with existing international laws.² Meanwhile, the proclamation has incited both criticism and praise from a variety of domestic and foreign interests. This article will assess the legality, consequences, and judiciousness of implementing such a tariff and conclude with a word on the free trade versus protectionism debate.

II. BACKGROUND

The tire tariffs are in response to a United Steelworkers complaint about the impact of cheap Chinese tire imports on the United States economy. The union brought the action to the International Trade Commission ("ITC") in April, citing that from 2004 to 2008, imports of cheap consumer tires from China increased 215 percent, boosting Chinese market shares of tires in the United States from 4.7 percent to 17.3 percent while domestic production declined by roughly 25 percent.³ As a result, United Steelworkers allege that over 5,000

¹ Presidential Determination No. 2009-28 (Sep. 11, 2009), *available at* <http://www.thefederalregister.com/d.p/2009-09-16-E9-22409>.

² WORLD TRADE ORG., REQUEST FOR CONSULTATIONS BY CHINA, UNITED STATES – MEASURES EFFECTING THE IMPORTS OF CERTAIN PASSENGER VEHICLE AND LIGHT TRUCK TYRES FROM CHINA REQUEST FOR CONSULTATIONS BY CHINA (2009), *available at* [http://www.worldtradelaw.net/cr/ds399-1\(cr\).pdf](http://www.worldtradelaw.net/cr/ds399-1(cr).pdf).

³ Testimony of Scott N. Paul, United States Representative Hearing: Certain Passenger Vehicle and Light Truck Tires from China, Docket No. USTR-

American tire workers have lost their jobs and four tire plants have closed about the nation, with three more to close this year.⁴

The ITC, a bi-partisan, quasi-judicial agency created by the United States to provide guidance to Congress and to the president on trade matters, returned a recommendation of stepped tariffs over three years in amounts of 55 percent, 45 percent, and 35 percent, respectively.⁵ President Obama heeded the recommendation, but enforced the tariffs at somewhat lower rates in order to reduce but not to prohibit Chinese tires in the United States market.⁶

III. LEGALITY

China's WTO challenge is based on the premise that the U.S. tire tariff is inconsistent with Article I:1 of the General Agreement on Tariffs and Trade ("GATT") of 1994.⁷ The GATT, the treaty that is the predecessor to the WTO and the foundation from which the WTO was born, was created to facilitate the reduction of barriers to international trade.⁸ Article I establishes one of the GATT's most fundamental rules, the "most favored nation" principal, a non-discrimination regulation which states that conditions pertaining to the most favored trading nation must apply to all member-states of the WTO.⁹ Although China's assertion that the tire tariffs violate the GATT because they apply solely to China is sound, there are several exceptions to Article I that the WTO will take into account.

2009-0017 (Aug. 7, 2009), *available at* <http://www.americanmanufacturing.org/wordpress/wp-content/uploads/2009/08/testimony-421-tires-aug-7-09.pdf>.

⁴ *Id.*

⁵ Warren Mass, *China Calls for WTO to Settle Trade Dispute*, NEW AM., Sept. 15, 2009, *available at* <http://www.thenewamerican.com/index.php/world-mainmenu-26/asia-mainmenu-33/1888-china-calls-for-wto-to-settle-trade-dispute>.

⁶ Dr. Eliot J. Feldman, *Trade War?*, CHINA-U.S. TRADE LAW BLOG, Oct. 2, 2009, *available at* <http://www.chinaustradelawblog.com/2009/10/articles/trade-disputes/trade-war-eaeaei>.

⁷ WORLD TRADE ORG., *supra* note 2.

⁸ About the WTO – a statement by the Director-General, http://www.wto.org/english/thewto_e/whatis_e/wto_dg_stat_e.htm (last visited Oct. 5, 2009).

⁹ INT'L INST. FOR SUSTAINABLE DEV. & UNITED NATIONS ENV'T PROGRAMME, ENVIRONMENT AND TRADE A HANDBOOK (2001), *available at* <http://www.iisd.org/TRADE/handbook/default.htm>.

The first relevant exception is the Agreement on Safeguards of Article XIX of the GATT 1994 and Section 201 of the Trade Act of 1974. Article XIX allows a nation to implement temporary safeguard measures when imports are found to cause or to threaten serious injury to a domestic industry.¹⁰ However, as the Agreement on Safeguards requires adherence to strict substantive and procedural regulations, including that safeguards be applied on a non-selective basis,¹¹ the exception is not likely to apply in the present case.

The exception in contention is contained in the Protocol on the Accession of the People's Republic of China and in section 421 of the Trade Act of 1974.¹² When China joined the WTO in 2001, it signed an Accession Protocol whereby it agreed to allow other WTO members the right to impose safeguard relief on goods from China when imports of the goods are in such increased quantities as to cause market disruption to the acting country's domestic industries.¹³ Under section 421, safeguard relief can be granted on a lower standard than in section 201 – a standard of “material injury” instead of “serious injury” to the competing domestic industry.¹⁴ As the objective of the Accession Protocol is to allow the other WTO members a period of adjustment, the China-specific protocol was determined to last for twelve years and is to terminate in 2013.¹⁵ The United Steelworkers filed their complaint pursuant to section 421 of the Trade Act, and upon investigation the ITC found the required material disruption to the U.S. domestic tire industry.¹⁶ The president responded by implementing the ITC's recommendation, effectively exercising his option to utilize the existing trade laws. As a result, China is unlikely to succeed on its WTO challenge.

IV. DEBATE

The benefits of the tire tariffs are contentious. Obama's decision drew a fair amount of praise, but more commonly criticism both from within the nation

¹⁰ Agreement on Safeguards, http://www.wto.org/english/tratop_e/safeg_e/safeint.htm (last visited Oct. 5, 2009).

¹¹ *Id.*

¹² WORLD TRADE ORG., *supra* note 2.

¹³ Leo W. Gerard, *Enforcing the Rule of Trade Law*, THE HILL, Sept. 25, 2009, available at <http://thehill.com/blogs/congress-blog/economy-a-budget/60359-enforcing-the-rule-of-trade-law>.

¹⁴ Ronald A. Cass, *Chinese Tires*, FORBES, Sept. 14, 2009, available at <http://www.forbes.com/2009/09/14/chinese-tires-trade-opinions-contributors-ronald-a-cass.html>.

¹⁵ *Id.*

¹⁶ Gerard, *supra* note 13.

and abroad. Both sides are adamant in their positions.

Acclaim for Obama's actions rang loudly from The United Steelworkers. Although the union had originally sought quotas from the ITC, it was receptive to the idea that the tariffs will provide effective economic relief domestically.¹⁷ The United Steelworkers remain optimistic despite analyst opinions that should the price of Chinese-made tires increase, domestic businesses will simply shift to other low-cost producers to obtain cheap tires.¹⁸ The union states that alternative low-cost sources are few and have limited capacity to supply the U.S. market.¹⁹

Advocates of the tariff cite that China itself is in violation of international trade law through its labor and business policies.²⁰ Proponents of protectionism cite moral grounds for enforcing trade barriers against China, including the Chinese government's own questionable business practices and its brutal labor policies in violation of safety conditions and of its own national minimum wage.²¹

Free trade advocates maintain several arguments against the tariffs. First, they state that the tariffs will not benefit American domestic industry and are even harmful to advancing domestic and global interests – the comparatively higher cost to produce the tires in the United States renders the business uncompetitive, and raising tariffs will do little to remedy this in the long run.²² As a protectionist policy can only impede growth, the focus should not be on protecting businesses that will inevitably be phased out, but on otherwise regenerating growth at home and abroad.²³

Critics are also afraid that the tire tariff can set a dangerous precedent that may spark a trade war between the United States and China.²⁴ Riding on the

¹⁷ *Steelworkers laud Obama decision to enforce trade laws against China*, WORKDAY MINN., Sep. 16, 2009, available at http://www.workdayminnesota.org/index.php?news_6_4168.

¹⁸ *Tired Protectionism*, N. Y. TIMES, Sept. 19, 2009, available at http://www.nytimes.com/2009/09/19/opinion/19sat1.html?_r=4&scp=1&sq=tired%20protectionism.

¹⁹ USW Backgrounder, Advisory for Monday, June 29, 2009, http://assets.usw.org/China_Trade_Tires/s421_backgrounder-china-tire-myths_usw062909.pdf (last visited Oct. 5, 2009).

²⁰ *Steelworkers laud Obama decision to enforce trade laws against China*, *supra* note 17.

²¹ *Id.*

²² *Tired Protectionism*, *supra* note 18.

²³ *Id.*

²⁴ Mark Drajem, *China Warns of 'Dangerous Precedent' From Obama's Tire Tariffs*, BLOOMBERG, Sept. 17, 2009, available at <http://www.bloomberg.com/apps/news?pid=20601087&sid=aiU3Ejff.Phg>.

victory of the tire tariffs, United Steelworkers, in conjunction with three paper manufacturers, have filed a new trade case against Chinese imports of coated paper.²⁵ Many fear that protectionist tariffs will heighten bilateral tensions and cause a China-United States trade war as textile and steel producers start to follow suit.²⁶ Within 24 hours of Obama's proclamation, China announced antidumping trade investigations into U.S. poultry and automobile parts²⁷, an action that observers were quick to label as retaliation.²⁸

A trade war would be disastrous for both parties as bilateral trade accounted for more than \$400 billion dollars in 2008, and China-United States trade accounts for around 12 percent of the total U.S. trade and 13 percent of total Chinese trade.²⁹ A trade war between the United States and China could lead to severe ramifications for already contracting global trade.³⁰ With China at the forefront of the battle for global economic recovery,³¹ a deterioration of the Chinese economy would be disastrous for all international actors.

Finally, some fear that China could pressure the United States by refusing to purchase U.S. Treasuries.³² In September of this year, China became the largest holder of U.S. government debt, holding over \$585 billion dollars.³³ Volatile China-United States relations could affect United States interest rates and lead to unnecessary volatility in the domestic money market, cascading yet again into injurious consequences for global economic recovery.³⁴

V. ANALYSIS

While the China tire tariffs may be legally sound, its principle and

²⁵ Gerard, *supra* note 13.

²⁶ Finfacts Team, *China-US: Protectionism on the rise - how likely is a trade war?*, FINFACTS IR., Sept. 24, 2009, available at http://www.finfacts.ie/irishfinancenews/article_1017968.shtml.

²⁷ Feldman, *supra* note 6.

²⁸ Mass, *supra* note 5.

²⁹ *Id.*

³⁰ *Id.*

³¹ John Lee, *Looking East: The Road to Recovery*, Ill. Bus. L. J., Sept. 21, 2009, available at <http://www.law.uiuc.edu/bljournal/post/2009/09/21/Looking-East-The-Road-to-Recovery.aspx>.

³² Finfacts Team, *supra* note 26.

³³ *China becomes largest holder of U.S. government debt*, PEOPLE'S DAILY ONLINE, Sep. 19, 2009, available at <http://english.people.com.cn/90001/90776/90884/6536616.html>.

³⁴ Finfacts Team, *supra* note 26.

application are in conflict with the very purpose of the WTO, which was created to promote and advance the prospect of free trade. China has been a member of the WTO for eight years, and China-United States trade relations existed long prior to China's accession into the WTO.³⁵ The current action seems to arise not out of a need for an "adjustment period" but rather out of the standard consequences of free trade. Absent the Accession Doctrine, the China-specific safeguard falls short legally as it directly contradicts the most favored nation principal as well as the key tenant of the WTO that safeguard measures must be applied on a nondiscriminatory basis. Despite falling within the word of the law, the tire safeguard is at odds with the spirit of progressing international law.

However, while economics agree that a policy of free trade is preferable to a policy of protectionism by margins of up to 100 to 1,³⁶ no industrialized country has ever adhered strictly and indefinitely to a policy of free trade.³⁷ In a free trade system, there are always losers as well as winners, but the net gain is said to offset the loss.³⁸ What happens when one nation is continuously the loser? One can say that a government has a duty to its own people over those not within its constituency, and therefore one cannot expect any government to ignore the immediate welfare and morale of its people. Consequently, the occasional protectionist policies will and should occur despite not being the most beneficial ones on a global economic scale.

While balance in a system of interdependent states is often seen as precarious, the economics of self-interest will demand that each state looks out for itself by carefully heeding its relationships with each other state. As a result, the framework that ties each actor together may be stronger than observers believe.

Many analysts believe that the tire tariffs will in reality have minimal impact.³⁹ Chinese tire exports constitute less than 1 percent of China's total exports to the United States, an amount that is insignificant in view of China's total export volume.⁴⁰ The Automotive Trade Policy Council calculated that at

³⁵ U.S.-China Trade Timeline: 1784-2008, http://www.stratfor.com/memberships/106695/analysis/u_s_china_trade_timeline_1784_2008 (last visited Oct. 5, 2009).

³⁶ *Benefits of offshoring jobs exaggerated: Experts*, INDIA TIMES, Mar. 19, 2004, available at <http://infotech.indiatimes.com/articleshow/569739.cms>.

³⁷ Center for Trade Policy Studies, *The Truth about Trade in History*, <http://www.freetrade.org/pubs/freetotrade/chap2.html> (last visited Oct. 5, 2009).

³⁸ GREGORY N. MANKIW, *MACROECONOMICS* (5th ed., Worth Publishers 2002).

³⁹ Finfacts Team, *supra* note 26.

⁴⁰ *Id.*

the tariff rates implemented by Obama, the additional cost per tire would amount to less than \$3.50.⁴¹

Because of heavily intertwined economic interest between both nations, a major escalation is unlikely.⁴²

President Obama announced on September 15th that the tire tariffs will not spark a trade war and is in fact a step toward expanding trade in the long run,⁴³ alluding to the notion that he recognizes that open markets are a fundamental catalyst of economic recovery.⁴⁴ His imposition of a lesser tariff than originally recommended by the ITC also lends to this recognition as well as to his desire not to grievously injure China-United States relations. He is unlikely to entertain further protectionist demands in light of the severe detriments a trade war can cause, and likewise, while China must act tough to quell resentment and to promote public image, the Chinese government will tolerate much to avoid social discontent in the form of lost jobs.⁴⁵ It is also unlikely that China will respond by halting its purchase of U.S. Treasuries, as doing so would slash the value of its own foreign reserves.⁴⁶

While many fear China's announcement of antidumping investigations as a retaliatory response to the tire tariffs, there is a substantial argument that it is a coincidence or a setup; a large bureaucracy such as China is unlikely to be able to announce such investigations in less than twenty-four hours response time, and the poultry dispute had previously existed between China and the United States⁴⁷ Dr. Elliot J. Feldman proposes that instead of viewing China's actions through a lens of retaliatory fear, China's actions actually signify its maturation as a major world power willing to accept the legitimacy of international institutions and their disciplines.⁴⁸

China's increasing acceptance of international law further promotes the notion that China will not retaliate illegitimately without the approval of the WTO.

⁴¹ *Steelworkers laud Obama decision to enforce trade laws against China*, *supra* note 17.

⁴² Finfacts Team, *supra* note 26.

⁴³ Drajem, *supra* note 24.

⁴⁴ Simon Lester, *The Implication of the Chinese Tires Decision*, Int'l Econ. L. & Policy Blog, <http://worldtradelaw.typepad.com/ielpblog/2009/09/the-implications-of-the-china-tires-decisions.html> (Sept. 13, 2009, 7:37A.M.).

⁴⁵ Finfacts Team, *supra* note 26.

⁴⁶ *Tired Protectionism*, *supra* note 18.

⁴⁷ Feldman, *supra* note 6.

⁴⁸ *Id.*

VI. CONCLUSION

Normally an avid advocate of free trade, the United States employs selective protectionism that is contrary to the spirit of progressive globalization and to the goals of the WTO. Nonetheless, occasional protectionist policies employed by member-states are natural and to be expected; in light of the legality of the tire tariffs and their low economic impact, major consequences are unlikely.

The tariffs can be seen as a wise move, as domestically they aim to effectively please labor unions, to raise industry morale, and to give the president political clout. Internationally, there remains much to be considered outside of economics; the president must be careful not to injure foreign relations and to upset the balance that the global economy rests upon, a contention that he is undoubtedly aware of. While the occasional tariff like this one will ultimately pass without dire consequence, continued protectionist policies may trigger the very trade wars that critics fear. However, as long as each state looks out for itself by regarding the reactions of each other, entwined economic interests will ensure that the occasional exclusively self-serving measure will not destroy the equilibrium.

INTELLECTUAL PROPERTY RIGHTS: THE LAST BARRIER TO INTERNATIONAL FREE TRADE

LU SUN

I. INTRODUCTION

The world today is highly technologically advanced in that works of art, literature, designs and other goods are highly digitalized.¹ Whereas in previous generations, trade agreements dealt in hard goods that could be accounted for and of which value was readily determined, the commodities of today are digital and informational.² These intangible goods are harder to track and almost impossible to value. As such, the goal of international free trade is being impeded by the reluctance of certain companies to invest overseas either directly in new upcoming firms or through trading of patented information.³ Some nations are reluctant to stringently enforce, or even create, laws for the protection of intellectual property rights. These nations argue that protection of intellectual property rights through patents and copyrights would raise market prices to a level near a monopolistic environment.⁴ The belief is that an innovative foreign company will not pay royalties for the imported product while the domestic company has to do so, thus resulting in the product being more expensive in the importing country.⁵ This is the big problem when it comes to trying to break down the remaining barriers of international free trade. Overall, the traditional Northern, or more developed countries have been accused of taking advantage of the poorer, underdeveloped Southern countries for many years. This is reflected in the fact that most of the intellectual property patents are held by individuals residing in these countries.⁶ United States business representatives and politicians have four primary complaints about foreign copyright system: (1) the failure of

¹ What Is Intellectual Property?, <http://www.wipo.int/about-ip/en/> (last visited Sept. 27, 2009).

² *Id.*

³ EU firms wary of China over IP insecurity, http://www.theregister.co.uk/2009/09/10/eu_china/ (last visited Sept. 26, 2009).

⁴ Eliane Engeler, *US filed the most international patents in 2008 but latest figures show meltdown's impact*, WASH. EXAMINER, Sept. 18, 2009, available at http://www.washingtonexaminer.com/economy/ap/us_filed_the_most_international_patents_in_2008_but_latest_figures_show_meltdowns_impact-59725687.html.

⁵ *Id.*

⁶ *Id.*

foreign copyright law itself to meet U.S. standards of adequate copyright protection for copyright holders; (2) the lack of strict sanctions to deter potential violators; (3) the lack of government efforts to enforce the law; and (4) the lack of judges and lawyers who have experience with intellectual property issues.⁷ This paper will argue that despite the fact that the trend is beginning to change, countries such as China and Brazil have seen increases in applications for patents, this problem will never be solved unless the underdeveloped countries fundamentally change their views on intellectual property laws.

II. DISCUSSION

Although the World Trade Organization (“WTO”) and World Intellectual Property Organization (“WIPO”) currently help dictate multilateral trade agreements, the fact of the matter is that enforcement and general respect to these agreements still widely varies from country to country.⁸ The source of these differing attitudes towards intellectual property law can be seen in the history of the countries. For example, in China, a country whose history has been primarily communist, traditionally believes that intellectual property should not be protected as strictly as the United States. Magistrates in the Tang Dynasty in early China were also eager to avoid the formal legal system and so encouraged parties to resolve disputes amicably between themselves.⁹ In contrast, the United States patent law can be seen in the case of *Twentieth Century Music Corp. v. Aiken*, in which the Court states:

[T]he creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and other arts. The immediate effect of our copyright law is to secure a fair return for an “author's” [or artist's] creative labor. But the ultimate aim is... to stimulate artistic creativity for the public good. The sole interest of the United States and the primary object in conferring the monopoly lie in the general benefits derived by the public from the labors of authors and artists.¹⁰

⁷ June Cohan Lazar, *Protecting Ideas and Ideals: Copyright Law in the People's Republic of China*, 27 LAW & POL'Y INT'L BUS. 4 (1996).

⁸ What Is Intellectual Property?, *supra* note 1.

⁹ Katie Lula, *Neither Here Nor There But Fair: Finding an International Copyright Legal System Between East and West, Past and Present*, ASIAN-PAC. L. & POL'Y J. (2006).

¹⁰ *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975).

Enforcement in China is lax especially when put into context of the Chinese legal system in which many of the most minor crimes are punished more severely than in Western countries.¹¹ It is this lack of enforcement that is troubling. The National Intellectual Property Law Enforcement Coordination Council was established in 1999 and is charged with coordinating domestic and international intellectual property law enforcement among federal and foreign entities.¹² However, the problem lies not in coordinating domestic and international property law; the problem is in the valuation and subsequent enforcement of these laws.

This lack of enforcement or respect of intellectual property rights could be seen in the famous Nelfinavir scandal in 2001 in which Brazil “became the first country to break an international patent when it began producing the generic drug ‘Nelfinavir’ in order to address its huge AIDS problems.”¹³ According to Brazilian national law, one can bypass a patent if the holder is abusing his position as a monopolist.¹⁴

The holder of the Nelfinavir patent, a Swiss pharmaceutical company named Roche, argued that they had conceded to give the Brazilian government a discount of 13% on the drug following extensive talks between the two parties.¹⁵ The true fact of the matter was that Brazil spends over \$300m per year on Nelfinavir alone because the country has the highest number of AIDS infected patients in South-America.¹⁶ In bypassing the international patent for Nelfinavir and thus producing a similar drug domestically, Brazil cut its spending by nearly 40%.¹⁷

Attempts to punish Brazil in the WTO negotiations were subsequently dropped in June 2001 due to the public outrage over the case.¹⁸ This sets a daunting precedent in that it shows so-called “public good” is allowed to override established international law.

¹¹ John Boudreau, *Fake iPhones are cheap and Popular in China*, MERCURY NEWS, Sep. 16, 2009, http://www.mercurynews.com/breaking-news/ci_13350141?nclick_check=1.

¹² U.S. Trademark Act, 15 U.S.C.A. § 1128 (2006).

¹³ *Brazil to Break Aids Patent*, BBC NEWS, Aug. 23, 2001, http://news.bbc.co.uk/1/hi/english/business/newsid_1505000/1505163.stm.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

III. ANALYSIS

Problems arise when considering the integration of two phenomena: the explosive growth of digital technology, and the movement toward a uniform international copyright legal system.¹⁹ First, these trends make it difficult to create a system of intellectual property rights that is compatible with all nations, cultures, and societies.²⁰ Second, traditional Western copyright concepts, which are predominant in international copyright concepts, are incompatible with the burgeoning culture of digital information, where physically intangible works are made, copied, transferred, viewed, and modified through copious mediums across the world in seconds for little to no cost.²¹ In order to attempt to solve this problem, the WIPO and WTO should model the so-called uniform international intellectual property rights law after taking into consideration the customs of each nation.²²

The first step to changing the state of affairs in international intellectual property rights lies in the misguided view that intellectual property rights are only for the developed countries to make profit. Some argue that protection of intellectual property rights can be good for poorer countries as well. For example, it has become increasingly difficult for musicians in Mexico to get recording deals with record companies due to the fact that two thirds of all the cassettes and CDs sold in Mexico are counterfeit.²³ India is another example, due to the country's nearly non-existent intellectual property rights legislation many pharmaceutical companies choose not sell their products there for fear of copycats.²⁴ Underdeveloped countries need to realize that stringent enforcement of intellectual property rights benefits them domestically just as much as it would internationally. When countries develop more advanced states of intellectual property right protection, they would attract more foreign investment. This foreign investment would lead to a stimulation of the local economy which results in benefits for both the importing country as well as the exporting country.

The problem that exists now is not in establishing uniform intellectual property law across differing continents or establishing an agreed upon law

¹⁹ Lula, *supra* note 9.

²⁰ *Id.*

²¹ *Id.*

²² BURNS WESTON, INTERNATIONAL LAW AND WORLD ORDER (4th ed., Thomson West 2006).

²³ Stefania Scandizzo, *Intellectual Property Rights and International R&D Competition* (Int'l Monetary Fund, Working Paper No. 01/81, 2001), available at <http://www.imf.org/external/pubs/cat/longres.cfm?sk=15146.0>.

²⁴ *Id.* at 5.

through systems like the WTO or WIPO, but rather less developed nations should re-evaluate their basic beliefs of intellectual property rights. The less developed nations need to move into the economic environment of the present rather than maintaining outdated beliefs and practices. There needs to be a re-education of these countries that currently do not value intellectual property rights as they should. This could occur through sending representatives from the WIPO and WTO to talk with legislators or leaders of these countries so as to explain to them the importance of valuing intellectual property rights. Seen from this point of view, protection of intellectual property rights encourages the domestic industry, secures foreign investment and creates incentives for the creation and use of new technology. Proof of this strategy working is China.

In the past decade, as trade with China increased, more and more pressure was put on China through the sending of government representatives by the United States and Japan to try and change China's intellectual property rights laws so that they are more compatible on the global scale.²⁵ The result of this is that patent applications have been increasing consistently despite the global economic crisis. If this result can be repeated with other trading nations and subsequently reflected in multilateral trading agreements, international intellectual property rights would no longer be a barrier to international free trade.

IV. CONCLUSION

Although the cultures and attitudes regarding intellectual property rights differ between Eastern and Western, Northern and Southern, we must learn to compromise and educate in order to overcome the barriers posed by these differences and achieve a world where international free trade is possible. Currently the ball has been set in motion in that these underdeveloped or beginning industrialized nations have begun changing their ways; however this change is largely motivated by external pressures from highly industrialized trading partners. The barrier that intellectual property rights poses to international free trade will never be fully broken down until these countries realize on their own what benefits can be reaped when they change their ways.

²⁵ *Patent Applications Continue Rising in China*, CHINA DAILY, Sept. 19, 2009, http://www.chinadaily.com.cn/bizchina/2009-09/19/content_8711892.htm (last visited Sept. 25, 2009).

WHY LAWYERS SHOULD KNOW MORE ABOUT ANTITRUST REGULATIONS

ISABEL FREITAS PERES

I. INTRODUCTION

Antitrust law is usually understood as applying to companies and their products. The incentives for assuring competition among companies have not limited the function of antitrust law. Antitrust law has developed its application to beyond those players in the market. Now, lawyers and bar associations also have to watch out for antitrust regulation. The American Bar Association has been under pressure to lighten up several of its rules in order to allow multidisciplinary firms to evolve.¹

The application of antitrust law to lawyers will be discussed in this article. Part I discusses if the definition of “trade” applies to professional services for the purpose of antitrust regulation. Is the discussion of regulation related to horizontal agreements or legislation? If it is legislation (for example, laws establishing bar associations), it is out of the scope of antitrust law. Part II brings the European and also an economic approach to this matter giving more light to the discussion of what are the consequences of the direct application of antitrust law to lawyers. Part III recommends that lawyers should not be exempt from antitrust regulation. The formation of collusion and price fixing exists among this profession as well as in other areas and should be regulated. However, the existence of an exam to evaluate the quality of lawyers is not an anticompetitive behavior limiting entrance on the market, but it is a correction of the market that should exist to inform prospective clients. Part IV provides concluding thoughts on the regulation of attorneys.

II. THE CONCEPT OF PROFESSIONALS FOR ANTITRUST PURPOSES

The status of “professionals” raises uncertainty in the antitrust context, but the implied antitrust exemption for professional’s collective behavior has come

¹ American Antitrust Institute, AAI Says Legal Profession's Recommendations on Multidisciplinary Practices May Violate Antitrust Laws, <http://www.antitrustinstitute.org/Archives/52.ashx> (last visited Nov. 19, 2009).

under increasing analysis.² For example, in most European countries the legal system does not have a general definition of professionals, but rather there are multiple distinct concepts.³ The reality is that many of these professionals engage in concerning behavior that would otherwise be unlawful under antitrust laws,⁴ like fixing price and boycotts.⁵

American courts have three periods that can be identified for the professional antitrust exemption debate.⁶ At first, early judicial inquiries rigidly differentiated the learned professionals from “trade” or “commerce.”⁷ Then, Courts analyzed whether the professionals enjoyed an exemption from antitrust law and the Supreme Court explicitly held that professionals are subject to antitrust law in *Goldfarb v. Virginia State Bar* (“Goldfarb”).⁸ The issue presented in *Goldfarb* was whether a minimum fee schedule for lawyers published by a county bar association violates the Sherman Act.⁹ The bar association affirmed that the activities of lawyers belong to a “learned profession,” which indicates that competition is inconsistent with their practice.¹⁰ Antitrust, therefore could not reach their activities.¹¹ However, the Supreme Court rejected this argument, stating that in the present market it cannot be denied that the activities of lawyers play an important role in commercial interaction and that anticompetitive activities by lawyers may exert a restraint on commerce within the meaning of antitrust laws.¹² Nonetheless, the Supreme Court mitigated the impact of the above statement, alleging in the same case that it would not be realistic to understand the practice of professions as interchangeable with any other business

² See Christopher J. Gawley, *Protecting Professionals from Competition: the Necessity of a Limited Antitrust Exemption for Professionals*, 47 S.D. L. REV. 233 (2002).

³ See Daniel Vazquez Albert, *Competition Law and Professional Practice*, 11 ILSA J. INT’L & COMP. L. 555 (2005).

⁴ *Id.*

⁵ *Id.* According to the author, collective price fixing and the prohibition of certain forms of advertising by a professional association may constitute a restriction of competition under the meaning of Article 81(1) of the European Community Treaty.

⁶ 421 U.S. 773 (1975).

⁷ See Gawley, *supra* note 2.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² See David Shapiro, *Cost Containment In The Health Care Field And The Antitrust Laws*, 7 AM. J. L. & MED. 425 (1982).

activities and to automatically apply to the professions anti-trust concepts that were created in other areas.¹³ A final understanding regarding this issue, therefore, was not reach by the Court.

Currently, *California Dental Association v. Federal Trade Commission* (“California Dental Association”) is the precedent for the treatment of professionals under antitrust law.¹⁴ In *California Dental Association* the Court deals with advertisements regarding quality and price of professionals.¹⁵ The Federal Trade Commission asked for a per se treatment of such behavior.¹⁶ The Supreme Court, however, held the advertisement as pro competitive.¹⁷ The Court also elaborated on the difference between professionals and other typical market participants and affirmed the existence of important challenges to informed decision-making by customers for professional services.¹⁸ The Supreme Court brought an important economic issue behind the discussion, the lack of information among consumers regarding legal services available in the market.

As stated above, the definition and characteristics of the term professional for professional services matter for the treatment and for the application of the antitrust rules. According to supporters of applying antitrust law onto this category, professionals have values and attitudes, which distinguish them from the persons in other occupations, and this justifies self regulation, freedom of government intervention and application of the antitrust laws.¹⁹ Despite the fact that self regulation ensures that poorly informed consumers will be able to maximize their welfare by purchasing professional services of satisfactory quality at a reasonable cost, these professionals believe in the existence of their goals in addition to the maximization of individual gain.²⁰ At the same time, an additional discussion concerns the bar associations and the instrument for its creation.

III. THE ECONOMIC IMPLICATIONS OF THIS ANALYSIS: DIFFERENCES FROM AN EUROPEAN APPROACH

Apart from a legal point of view, an economic examination of this subject points out a strong asymmetry of information. For example, the function of the

¹³ *Id.*

¹⁴ 526 U.S. 756 (1604).

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ See American Antitrust Institute, *supra* note 1.

¹⁹ See Philip C. Kissam, *Antitrust Law and Professional Behavior*, 62 TEX. L. REV. 1 (1983).

²⁰ *Id.*

bar association is to provide information.²¹ Since most people do not have the appropriate skills to assess the services of a lawyer, passing the bar exam can evaluate the quality of the attorney and correct this market failure for the prospective clients. However, it should be pointed out that professionals are not immune from making use of typical antitrust concerns, such as price fixing, boycotts and joint ventures that can be employed by these professionals and other industries.²²

The antitrust interpretation of the legal market has changed since the 1940s when the law firms tended to be too small to alert the antitrust authorities.²³ Even so the application of the antitrust laws should be under a rule of reason, and never under a per se rule. Under the rule of reason analysis, courts look at the full context to determine whether the anticompetitive effects pose an "unreasonable" restraint on trade.²⁴ On the other hand, in a per se analysis, courts are to presume the illegality of activities.²⁵ The courts should move away from this rigid application because lawyers are not easily exchangeable merchandise (but rather a true "learned profession"). The facts and circumstances of the case presented to Courts must then be carefully analyzed.

The European Commission has adopted two reports and commissioned two independent studies on the competitiveness of some particular professions, including the market and activities of lawyers.²⁶ The report aimed to clarify why antitrust action was needed but also acted pro-actively to set out a plan of action to promote the abolition of unjustified restrictions.²⁷ This discussion was brought

²¹ See Michelle Behnke, *A Fresh Look at an Old Friend: The American Bar Association Partnership with the Alabama Legal Community*, 70 ALA. LAW. 63 (2009).

²² *Id.*

²³ See Thomas D. Morgan, *The Impact of Antitrust Law on the Legal Profession*, 67 FORDHAM L. REV. 415 (1998).

²⁴ See Meghan K. Woodsome and Katherine S. Dumouchel, *Antitrust Violations*, 46 AM. CRIM. L. REV. 275 (2009).

²⁵ *Id.*

²⁶ See Mary Catherine Lucey, *European Union Antitrust Law and Professional Associations: the Strategic Choices of "Soft" Weapons by the European Commission*, 16 TULSA J. COMP. & INT'L L. 87 (2008).

²⁷ *Id.* In Spain, for instance, mandatory fee schedules have been prohibited and advertising and marketing activities by professionals are now permitted as well as geographical restrictions to the practice of professionals have also been repealed. See Francisco Marcos, *A New Age In Spanish Antitrust Law: Fighting Against Restrictions To Competition In The Professional Services Market* (Nov. 6, 2001), (unpublished article, <http://ssrn.com/abstract=282491>).

in front of the Court of Justice in the European Union in *Wouter et Cie*.²⁸ The main issue in *Wouter et Cie* was the extent to which the Netherlands Bar Association is a horizontal agreement that violates the Articles 101(1) or (3) of the European Union Regulation.²⁹ If a regulation limits the lawyers ability to price their services, publicize their services, etc, there is a clear restraint in competition, and thus antitrust/competition law should be applied.

Also in Europe, the examples of Sweden and Finland bring interesting insights. In these countries, lawyers do not have to be certified by the bar association to provide legal services, but instead the quality of this profession is reflected by the market.³⁰ For example, hiring someone with a law degree is more expensive than hiring a young person without a law degree for legal advice. The market, in this case, is said to control the problem of asymmetry, in which you pay more for getting a better quality service. However, such a system does not work in all the countries, and in most of them there is a bar association exercising the main function of controlling the quality of the lawyers in the market.

In contrast, a certifying body that does not have a clearly articulated relevant criteria applied on a consistent basis runs the risks of being accused of boycott, even though the practical impact of antitrust exposure in the law market has been low.³¹ Also, the idea of the exemption of professionals is also related to the fact that there is less potential for actual agreement among professionals to knowingly engage in anticompetitive activity.³² The bar association may consequently serve in this case as a potential instrument for anticompetitive behavior.

IV. CONCLUSION

The fact that legal services involve the sale of personal services, rather than commodities³³ does not take it out of the category of “trade” and lawyers can certainly give cause to anticompetitive behavior. However, the antitrust rules if applied shall be cautiously used, especially when the analysis is properly based on a rule of reason approach rather than a per se approach. Standards which are useful to individual decision-making in markets should be protected under the

²⁸ See ELEANOR M. FOX, *THE COMPETITION LAW OF THE EUROPEAN UNION IN COMPARATIVE PERSPECTIVE* (2009).

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² See Albert, *supra* note 3.

³³ See Geoffrey C. Hazard, *Why Lawyers Should be Allowed to Advertise: A Market Analysis of Legal Services*, 58 N.Y. U. L. REV. 1084 (1983).

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rule of reason.³⁴ The second problem, the asymmetry of information, should be carefully analyzed and legislators and courts should always look to the welfare of consumers. A special and specific approach should be developed for professional services. Otherwise, because of the above stressed points, the traditional antitrust law would not be suitable for these special markets of “intellectual trade.”

The Courts nonetheless tend to get away from this problem and there are a number of reasons of why they do so. On the one hand, the Court may not think it is appropriate to set up rules governing this issue because it can bring unexpected consequences. On the other hand, the Courts may just have some notion of the specificity of the professions such as lawyers but are unable to articulate the difference. Despite the prejudices and the peculiarity of the discussion, an answer should be articulated either by the courts or the legislative bodies. Otherwise, silence may give incentives for anticompetitive behavior.

³⁴ See Gawley, *supra* note 2.

R.I.P. VANILLA DREAMS, YOU WILL BE MISSED

SAE BOM YOON

I. INTRODUCTION

In smoke-filled rooms, Big Tobacco executives are patting themselves on their backs while local smoke shops and flavored-cigarette aficionados are increasingly disgruntled by the loss of their Djarum cloves, Cherry Jubilee and Vanilla Dreams. The ban was introduced by the U.S. Food and Drug Administration (FDA) as an important step in curbing cigarette use among teenagers, branding flavored cigarettes as a “gateway for many children and young adults to become regular smokers.”¹ However, as the ban approaches its second week of implementation, gaping loopholes within the prohibition has left the ban to open attack by others.² This paper will attempt to cast doubt on the effectiveness of the recent ban on teenage smoking cessation efforts, showing that the tobacco products favored by teenagers are not affected by the ban. Consequently, this paper will argue that the ban will mainly profit major U.S. cigarette producers, Phillip Morris USA, Lorillard and Reynolds American Inc., allowing them to further monopolize the tobacco market under the guise of federal regulation.

II. BACKGROUND: THE FAMILY SMOKING PREVENTION AND TOBACCO CONTROL ACT

On March 21, 2000, the Supreme Court was tasked with determining whether the FDA had the authority to regulate tobacco products under the Food, Drug, and Cosmetic Act (FDCA).³ The Court held that, reading the FDCA as a whole, Congress never intended to give the FDA jurisdiction over tobacco

¹ Press Release, U.S. Food and Drug Administration, Transcript for FDA's Media Briefing on Ban on Cigarettes with Certain Characterizing Flavors (Sept. 22, 2009) (on file with author).

² Sarah Torribio, *Flavor Cigarette Ban Curbs Freedom, Helps Big Tobacco Keep Selling*, EXAMINER, Aug. 23, 2009, <http://www.examiner.com/x-10873-LA-Health-and-Bauty-Examiner~y2009m8d23-Flavor-cigarette-ban-curbs-freedom-helps-big-tobacco-keep-selling>.

³ FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120 (2000); Food, Drug, and Cosmetic Act, 21 U.S.C. § 301 et seq. (1938).

products and invalidated FDA regulations in question.⁴ In the ongoing battle of tobacco-related litigation, the Court effectively confirmed the fact that tobacco products have largely escaped regulation by federal health and safety laws for decades.

As a result, the Family Smoking Prevention and Tobacco Control Act (the Act) was signed into law on June 22, 2009, amending the FDCA and allowing the FDA to regulate the manufacturing, marketing, and sale of tobacco products for the first time.⁵ The Act does not allow the FDA to place a complete ban on conventional tobacco products, including cigarettes or smokeless tobacco products, or on nicotine levels within these devices.⁶ However, the FDA may now directly implement FDCA provisions that will, among other things, restrict tobacco advertising, prohibit the use of terms such as “light” or “mild” on tobacco product packages, strengthen warning labels on existing and new tobacco products, and herald federal efforts to stop tobacco smoking among minors.⁷

Interestingly, the Act also directly prohibits the manufacture or sale of all cigarettes that have a “characterizing flavor,” other than tobacco or menthol.⁸ The relevant provision of the statute states:

A cigarette or any of its component parts (including the tobacco, filter, or paper) shall not contain, as a constituent (including a smoke constituent) or additive, an artificial or natural flavor (other than tobacco or menthol) or an herb or spice, including strawberry, grape, orange, clove, cinnamon, pineapple, vanilla, coconut, licorice, cocoa, chocolate, cherry, or coffee, that is a characterizing flavor of the tobacco product or tobacco smoke.⁹

In effect, the production and sale of fruit, candy, or clove-flavored cigarettes have been banned in the United States as of Sept. 22, 2009.¹⁰ The ban

⁴ *Id.*, at 161.

⁵ Family Smoking Prevention and Tobacco Control Act, Pub. L. No. 111-31, § 907, 123 Stat. 1775 (2009).

⁶ TOBACCO CONTROL LEGAL CONSORTIUM, FEDERAL REGULATION OF TOBACCO PRODUCTS: A SUMMARY (2009), *available at* <http://www.wmitchell.edu/documents/federal-regulation-tobacco-summary.pdf>.

⁷ *Id.*

⁸ § 907, 123 Stat. at 1800.

⁹ *Id.*

¹⁰ *See* TOBACCO CONTROL LEGAL CONSORTIUM, *supra* note 6.

plainly excludes menthol-flavored cigarettes, which the FDA has singled out to examine its options regarding the product's regulation.¹¹

III. CASTING DOUBT ON THE ACT: BRAND PREFERENCES AND THE CURRENT STATE OF THE U.S. TOBACCO INDUSTRY

In announcing the ban on flavored cigarettes, the FDA placed particular emphasis on the special appeal that characterizing flavors such as fruit, candy, or cloves have on children, and how they would “allure kids into addiction.”¹² Another highly quoted figure in support of the ban comes from the Roswell Park Cancer institute, which claims that the use of flavored cigarettes is more likely among 17 year olds vis-à-vis 20 to 26 year olds.¹³ Teens are more prone to use flavored cigarettes because they prefer “high-impact” flavors, while their adult counterparts prefer “mild and natural flavors.”¹⁴

Despite such bold statements, recent statistics would argue otherwise. According to a survey conducted by the Centers for Disease Control and Prevention (CDC), out of 54,301 established smokers between the ages of 12 and 17, 52 percent of high school students preferred Marlboro, 21 percent favored Newport, while 13 percent smoke Camel cigarettes.¹⁵ Similar figures are shown among middle school students, with 43 percent, 26 percent, and 9 percent favoring each brand, respectively.¹⁶ A different study by the American Lung Association shows that among regular high school smokers, only 6.8 percent smoked clove cigarettes while 1.7 percent smoked candy-flavored cigarettes.¹⁷ In fact, figures from the CDC 2007 National Study on Drug Use and Health show

¹¹ *Id.*

¹² *See* Torribio, *supra* note 2.

¹³ KATHLEEN DACHILLE, TOBACCO CONTROL LEGAL CONSORTIUM, PICK YOUR POISON: RESPONSES TO THE MARKETING AND SALE OF FLAVORED TOBACCO PRODUCTS (2009), available at <http://tobaccolawcenter.org/documents/flavored-tobacco.pdf>.

¹⁴ *Id.*

¹⁵ Associated Press, *U.S. Teen Smokers Prefer Marlboro, Report Says*, MSNBC.COM, Feb. 12, 2009, <http://today.msnbc.msn.com/id/29167717/ns/health-addictions>.

¹⁶ *Id.*

¹⁷ *See* Sarah Torribio, *Flavor Cigarette Ban Curbs Freedom, Helps Big Tobacco Keep Selling*, EXAMINER, Aug. 23, 2009, <http://www.examiner.com/x-10873-LA-Health-and-Beauty-Examiner~y2009m8d23-Flavor-cigarette-ban-curbs-freedom-helps-big-tobacco-keep-selling>.

that teen preferences mirror that of adults, finding that the most popular brands among adults were also Marlboro, Newport and Camel, respectively.¹⁸

In other words, both teens and adults appear to favor tobacco and menthol-flavored cigarettes – both which the Act explicitly excludes from the ban. This begs the question as to why such a gaping loophole has been written into the Act if Congress and the FDA truly purport to ensure the health and safety of teenagers, and undercut “the most preventable cause of premature death in our society.”¹⁹

Furthermore, a breakdown on the national tobacco market supports the futile nature of banning flavored, as defined by the Act, but not tobacco or menthol-flavored cigarettes. The U.S. Tobacco industry currently operates under the iron fist of “Big Tobacco,” referring to the three big tobacco manufacturers that have dominated the \$70 billion national market (2007 figures)²⁰ – Phillip Morris USA (Altria), Reynolds American (RJR), and Lorillard, Inc.²¹ Phillip Morris owns the Marlboro brand, which accounts for 40 percent of national retail sales in cigarettes,²² and has just launched a new menthol brand, Marlboro Blend No. 54, this June.²³ Meanwhile, Lorillard owns Newport, which continues to be the best-selling menthol cigarette,²⁴ and Reynolds American holds the Camel brand and its menthol line Camel Crush.²⁵ These companies would hardly be adversely affected by the ban. In fact, Phillip Morris doesn’t even produce cigarettes that would trigger the ban.²⁶

¹⁸ See Associated Press, *U.S. Teen Smokers Prefer Marlboro, Report Says*, MSNBC.COM, Feb 12, 2009, <http://today.msnbc.msn.com/id/29167717/ns/health-addictions>.

¹⁹ American Cancer Society, *Prevention and Early Detection*, http://www.cancer.org/docroot/PED/content/PED_10_2X_Cigarette_Smoking.asp (last visited Oct. 2, 2009).

²⁰ Phillip Morris USA, Financial Information, http://www.philipmorrisusa.com/en/cms/Company/Financial_Information (last visited Oct. 2, 2009).

²¹ Torribio, *supra* note 2.

²² Yahoo! Finance, Phillip Morris USA Inc. Company Profile, <http://biz.yahoo.com/ic/55/55933.html> (last visited Oct. 2, 2009).

²³ Torribio, *supra* note 2.

²⁴ Yahoo! Finance, Lorillard, Inc. Company Profile, <http://biz.yahoo.com/ic/55/55993.html> (last visited Oct. 2, 2009).

²⁵ Yahoo! Finance, Reynolds American Inc. Company Profile, <http://biz.yahoo.com/ic/55/55935.html> (last visited Oct. 2, 2009).

²⁶ Torribio, *supra* note 2.

On the other hand, clove cigarettes represent .09 percent of all cigarettes purchased in the United States and the figures are far slimmer for flavored cigarettes,²⁷ while menthols account for an overwhelming 28 percent.²⁸ Here's an interesting twist – 99 percent of all cloves sold in the United States are imported from Indonesia, sparking a potential trade skirmish if Indonesia were to bring a protectionist complaint to the World Trade Organization.²⁹ No wonder Big Tobacco supports the ban – they have nothing to lose.³⁰ The ban, in effect, allows Big Tobacco to hold on to further monopolize the United States tobacco industry by doing away from what competition they faced from cloves and flavored cigarettes.

IV. WHAT'S THE NEXT STEP?

The absence of a logical explanation for banning cigarettes with “characterizing flavors” but not tobacco or menthol-flavored cigarettes undermines the purpose of the ban in the first place. This is not to say that the rest of the Act will not work to hinder children and young adults from smoking, or will not protect the general health of the nation as a whole. Other provisions of the Act have yet to come into effect: the terms “light,” “low,” and “mild” will be banned from use on tobacco products by July 2010; warning labels for smokeless tobacco products will be revised by July 2010; warning labels for cigarettes will be revised by Oct. 2012, to include larger warning signs and pictures depicting the harmful effects of cigarettes.³¹ Given the recent enactment of the Act, much of its consequences are of a wait-and-see scenario.

However, one thing is for sure – the FDA still has a long way to go before they can envision a world without smokers and cigarettes. Moreover, the commercialization of various non-traditional tobacco products, such as tobacco candies and e-cigarettes, will provide for new and particularized challenges to regulating tobacco products that the FDA has yet to encounter. As for right now,

²⁷ Paul Smalera, *Cool, Refreshing Legislation for Philip Morris*, SLATE, June 8, 2009, <http://www.thebigmoney.com/articles/judgments/2009/06/08/cool-refreshing-legislation-philip-morris>.

²⁸ Al Harris, *Altria Backs Ban on Flavored Cigarettes*, RICHMOND BIZSENSE, May 19, 2009, <http://www.richmondbizsense.com/2009/05/19/altria-backs-ban-on-flavored-cigarettes>.

²⁹ Smalera, *supra* note 27.

³⁰ *Id.*

³¹ FDA Flavored Cigarette Ban: What's Covered and What's Next? FINDLAW'S COMMON LAW, <http://commonlaw.findlaw.com/2009/09/fda-flavored-cigarette-ban-whats-covered-and-whats-next.html> (Sept. 22, 2009).

the FDA should stop hiding behind the ban of certain flavored cigarettes and come up with a legitimate answer to explain why we have lost our cloves and flavored cigarettes.

V. CONCLUSION

The Family Smoking Prevention and Tobacco Control Act may have given the FDA some teeth to reduce the prevalence of tobacco-related illnesses within the United States. Yet, the Act has yet to manifest any concrete results regarding smoking cessation among teenagers, or in challenging the long-standing, monopolistic power that Big Tobacco companies have enjoyed before the enactment of the Act. The ban on cigarettes with certain “characterizing flavors” has done little to help the FDA’s cause. Today, the ban stands strong, with little rationale supporting its binding nature. Therefore, we bid adieu. R.I.P. Vanilla Dreams, you will be missed.

RENEWABLE ENERGY: LOOKING TOWARD THE FUTURE

MICHAEL LENHARDT

I. INTRODUCTION

Rising gas prices and an increasing awareness of the environmental consequences associated with the use of fossil fuels have spurred the development of the biofuel industry. “From being merely an interest of marginal innovators, it has become a multi-million dollar business – transforming economies – thanks to rising attention and support from governments and the public.”¹ With the United States consuming nearly 20.8 billion barrels of oil per day, and with OPEC officials claiming they will not be able to meet the projected Western oil demands in 10 to 15 years, the prospect of meeting our energy needs through homegrown and renewable resources is becoming more appealing.² But this seemingly cut and dry solution to the US dependency on fossil fuels is not as simple as it appears. The actual economic and environmental benefits realized by relying more heavily on biofuels is hotly debated, and due to the fluid nature and unpredictability of the world market, concrete answers are hard to come by. Before considering the impact of a switch to biofuels, it is important to understand the true costs of our current oil dependency.

II. THE TRUE COSTS OF OIL DEPENDENCY

Through 1970 to 2005, US dependence on foreign oil has cost the US economy nearly \$8 trillion.³ The costs associated with oil dependency are not limited to the price of a gallon of gas, but also “they are the transfer of wealth from the United States to oil producing countries, the loss of economic potential

¹ UNITED NATIONS UN-ENERGY DIVISION, SUSTAINABLE BIOENERGY: A FRAMEWORK FOR DECISION MAKERS, 2007, <http://esa.un.org/un-energy/pdf/susdev.Biofuels.FAO.pdf>.

² Energy Statistics: Oil Consumption, http://www.nationmaster.com/graph/ene_oil_con-energy-oil-consumption (last visited Oct. 11, 2009).

³ FinFacts.com, *Saudis Say OPEC Will Not Meet Projected Oil Demand in 10-15 Years*, July 6, 2005, http://www.finfacts.com/irelandbusinessnews/publish/article_10002504.shtml; Institute for the Analysis of Global Security, *How Much Are We Paying for a Gallon of Gas*, <http://www.iags.org/costofoil.html> (last visited Oct. 11, 2009).

due to oil prices elevated above competitive market levels, and disruption costs caused by sudden and large oil price movements.”⁴ “Recent studies estimate that every \$1 billion of trade deficit costs America 27,000 jobs.”⁵ “Oil imports account for almost one-third of the total U.S. deficit and, hence, are a major contributor to unemployment.”⁶ Furthermore, it is estimated that \$50 billion is spent each year securing our access to oil in the Middle East.⁷ The cost of oil dependence is not limited to imports versus exports, oil dependency seeps into a wide swath of the U.S. economy. Also, the environmental costs associated with the production and use of oil, including the damage done by oil spills, drilling and extraction, and the emissions produced from the burning of fossil fuels, needs to be taken into consideration.

As you can see, the cost of oil dependence is not merely limited to the amount the average American pays per gallon at the pump. With demand for oil on rise, and the crude oil production expected to peak in 2037, an in-depth analysis of the pros and cons of biofuels is needed.⁸

III. THE SWITCH TO BIOFUELS AND ITS ECONOMIC IMPACT

A study done on the U.S. Renewable Fuel Standard, which provides for the amount of renewable fuels which must be blended with gasoline starting in 2006 and going through 2022, concluded that “direct job creation from advanced biofuel production could reach 29,000 jobs by 2012, rising to 94,000 jobs by 2016, and 190,000 jobs by 2022.”⁹ Total job creation, accounting for economic multiplier effects, could reach 123,000 jobs in 2012, 383,000 in 2016, and 807,000 by 2022.”¹⁰ Also, economic output from the biofuels industry, including capital investment and research and development “is estimated to rise to \$5.5 billion in 2012, reaching \$17.4 billion in 2016, and \$37 billion by 2022.”¹¹

⁴ *Id.*

⁵ John H. Wood, Gary R. Long, and David F. Morehouse, *Long-Term World Oil Supply Scenarios*, U.S. ENERGY INFORMATION ADMINISTRATION, Aug. 18, 2004, http://www.eia.doe.gov/pub/oil_gas/petroleum/feature_articles/2004/worldoilsupply/oilsupply04.html.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ BIO ECONOMIC RESEARCH ASSOCIATES, U.S. ECONOMIC IMPACT OF ADVANCED BIOFUELS PRODUCTION: PERSPECTIVES TO 2030 (2009), *available at* http://www.bio.org/ind/Economic_ImpactAdvancedBiofuels.pdf.

¹⁰ *Id.*

¹¹ *Id.*

“Taking into consideration the indirect and induced economic effects resulting from direct expenditures in advanced biofuels production, the total economic output effect for the U.S. economy is estimated to be \$20.2 billion in 2012, \$64.2 billion in 2016, and \$148.7 billion in 2022.”¹² The production and use of biofuels not only reduces the costs associated with our dependence on foreign oil, it further stimulates the economy by introducing a new domestic energy industry, by providing jobs to people, and by providing lower production costs to businesses.

IV. PROBLEMS WITH THE USE OF BIOFUELS

The production of biofuels itself requires energy, from the use farm machinery, to producing fertilizer, to transportation of the finished product. “To be a viable substitute for a fossil fuel, an alternative fuel should not only have superior environmental benefits over the fossil fuel it displaces, be economically competitive with it, and be producible in sufficient quantities to make a meaningful impact on energy demands, but it should also provide a net energy gain over the energy sources used to produce it.”¹³ A positive net energy benefit is achieved when biofuel energy content exceeds fossil energy input.¹⁴ While the net energy benefit of corn based ethanol is 25% over gasoline, wholesale costs of gasoline in 2005 were \$0.44/liter, the production costs alone of the energy equivalent liter of ethanol (EEL) were \$0.46/EEL. Also, the production cost of soybean diesel is \$0.55 per diesel EEL, while the wholesale price of diesel is \$0.46/liter.¹⁵ These numbers prove that without government subsidies, steadily increasing petroleum costs, and environmental concerns, biofuels would simply not be economically viable or competitive in the global energy market. Also, increased demand and production of biofuels around the world has led to deforestation, negating possible environmental benefits from the use of biofuels.¹⁶ “A 2006 study done by the research group LMC International found that increasing biofuel production to a point where it provided 5% of global fuel needs by 2015 would require expanding the acreage of all cultivated land

¹² *Id.*

¹³ Jason Hill, Erik Nelson, David Tilman, Stephen Polasky & Douglas Tiffany, *Environmental, Economic, and Energetic Costs and Benefits of Biodiesel and Ethanol Biofuels*, PNAS, June 2, 2006, available at <http://www.salmone.org/wp-content/uploads/2008/09/biofuel-pnas-july-06.pdf>.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Michael Grunwald, *The Clean Energy Scam*, TIME, Mar. 27, 2008, <http://www.time.com/time/magazine/article/0,9171,1725975,00.html>.

worldwide by 15%.”¹⁷ Dedicating all U.S. corn and soybean production to biofuels will meet only 12% of gasoline demand and 6% of diesel demand.¹⁸ Deforestation accounts for 20% of all current carbon emissions, and the destruction of forests, wetlands, and grasslands, for the purpose of growing crops to produce biofuel, is destroying the environmental benefits of using biofuels in the first place.¹⁹

Finally, switching land from food production to fuel production has increased food prices around the world. A study done by the IMF in 2007 found that, “One country's policy to promote biofuels while protecting its farmers could increase another (likely poorer) country's import bills for food and pose additional risks to inflation or growth.”²⁰ The expansion of biofuel production could affect food security through four major dimensions: availability, access, stability, and utilization.²¹ Availability and access to food will be affected because food production will suffer with producers favoring biofuel production.²² Stability may be affected because a switch to biofuel production may make food prices more volatile.²³ Utilization refers to the health concerns associated with diverting time and resources away from having cheap and healthy food.²⁴ On the other hand, technology is advancing constantly, and research on non-food based biofuels, such as cellulosic ethanol, can be produced with far less inputs and on marginally efficient land.²⁵ Research in the area of advanced biofuel is creating hope for new sources of biofuel that will reduce the drag on food supplies, while at the same time produce a less costly and more efficient source of energy.

V. IMPORTANT BIOFUEL LEGISLATION

In 2005, Congress passed the Energy Policy Act of 2005. The Act provided \$14 billion to the Department of Energy, and authorized the Department to partner with industrial and academic institutions in order to conduct research and develop advanced biofuels that are cost competitive with gasoline and

¹⁷ *IMF Warns About Impact of Biofuels on Food Prices*, FORBES, Oct. 17, 2007, <http://www.forbes.com/feeds/afx/2007/10/17/afx4229623.html>.

¹⁸ See Hill, Nelson, Tilman, Polasky, and Tiffany, *supra* note 13.

¹⁹ Grunwald, *supra* note 16.

²⁰ *IMF Warns About Impact of Biofuels on Food Prices*, *supra* note 17.

²¹ UNITED NATIONS UN-ENERGY DIVISION, *supra* note 1.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ See Hill, Nelson, Tilman, Polasky & Tiffany, *supra* note 13.

diesel.²⁶ Because it was aimed at combating one of the major problems associated with biofuels, its cost competitiveness, it was an important piece of biofuel legislation.

The Energy Independence and Security Act of 2007 was also a milestone in the history of the biofuel industry because it created a more aggressive Renewable Fuel Standard, calling for the production of 36 billion gallons of renewable fuel, 21 of which from advanced biofuels, by the year 2022.²⁷ Also, it requires automakers to increase the average mileage of new vehicles to 35 miles per gallon by 2020.²⁸ Finally, the Act created incentives for research and development in the area of advanced biofuels by allocating \$500 million for awards for grant programs that propose biofuels and technology that have the greatest reduction in life cycle emissions as compared to comparable motor vehicle lifecycle emissions.²⁹ This Act was important because it set goals for the future and took an active part in directing and funding vital research.

More current legislation, like the American Recovery and Reinvestment Act of 2009, appropriated \$786.5 million to the U.S. Department of Energy's Biomass Program.³⁰ Most of the funding will be aimed at the production of new biorefineries, with awards incentivizing the refineries that can be built and operational in the shortest amount of time. Most of the remaining funds are to be spent accelerating and expediting the construction of refineries already in the initial construction stages.³¹ One of the most recent pieces of biofuel related legislation is an amendment to a Senate appropriations bill for Interior Department funding, and is still currently under consideration.³² One of the

²⁶U.S. Department of Energy Office of Science, *Biofuels Policy and Legislation*, Dec. 8, 2009 <http://genomicsgtl.energy.gov/biofuels/legislation.shtml>.

²⁷ U.S. Department of Energy: Biomass Program, *Federal Biomass Policy: The Energy Independence and Security Act of 2007*, May 28, 2009, http://www1.eere.energy.gov/biomass/federal_biomass.html.

²⁸ Forrest Laws, *President Signs Legislation Promoting Biofuels, Reducing Consumption*, Dec. 19, 2007, <http://deltafarmpress.com/biofuels/071219-energy-bill/>.

²⁹ See U.S. Department of Energy: Biomass Program, *supra* note 27.

³⁰ T.J. Heibel, *Nearly \$800 Million from Recovery Act to Accelerate Biofuels Research and Commercialization*, BIOMASS RESEARCH & DEV., <http://www.brdisolutions.com/default.aspx> (last visited Oct. 11, 2009).

³¹ *Id.*

³² Margery A. Gibbs, *Nebraska Sen. Nelson Backing Biofuel Legislation*, FORBES, Sept. 24, 2009, http://www.forbes.com/feeds/ap/2009/09/24/business-financial-impact-us-nelson-biofuels_6925601.html.

proposed measures would direct the Environmental Protection Agency (EPA) to allow gasoline to contain up to 15% ethanol blend, 5% more than the maximum of 10% currently allowed by law.³³ Another measure in this amendment calls for the delay of the adoption of a rule proposed by the EPA that would penalize biofuel producers for environmentally-damaging land use.³⁴ It is still unclear if vehicles can run efficiently on 15% blends, or if the penalty is necessary to curb deforestation and land clearing activities.³⁵

VI. CONCLUSION

While our dependency on oil has cost the U.S. trillions of dollars and has done immeasurable damage to the environment, renewable sources of energy are also riddled with drawbacks. Even though the benefits of biofuels may be exaggerated and their costs downplayed by some, there is no doubt that biofuels are the lesser of two evils when compared with oil. It does not matter whether new technology will make hidden oil reserves available or more cost efficient to extract, oil is simply a finite resource. Even if oil can still be extracted for years to come, the rise in demand and the fall in supply of oil will make it increasingly expensive and inefficient. Thankfully, government agencies have recognized this and have passed legislation aimed at the research and development of biofuels, building biofuel refineries, and increasing the consumption of biofuels across the country and the world. The science of renewable energy is developing all the time, and even though many questions still need to be answered with regards to the feasibility and sustainability of biofuels, it is safe to say that biofuels will be one, if not the main source of energy for the future.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*