

THE ILLINOIS BUSINESS LAW JOURNAL

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



Volume 2009 – Issue 1

The Efficient Breach Hypothesis: Its Impact and Effect on the Penalty Clause as Defined under Colombian Law	<i>Juan P. Moreno</i>	4
Marvel and Disney: A Merger With Character	<i>Frederic Deraiche</i>	15
Plug the Leak: Employee Turnover – A Consequence of Discriminatory Behavior?	<i>Amanda Pintaro</i>	24
The Impact of the Financial Crisis on Nonprofits	<i>Zina Kiryakos</i>	30
The Skinny on Taxing Fatty Foods	<i>Henry Young</i>	35
Should Cheerleading Be a Sport?	<i>Helena Varnavas</i>	40
No Starts, No Stats, No Problem	<i>Paul Whitehair</i>	49
Can I Get a Piece of That? Policies on Sampling And How it Affects Creativity in Hip Hop	<i>Brittany Estell</i>	55
Protecting “The Progress of Science and Useful Arts”	<i>Warren Albert Wilke III</i>	61
Knock-off the Knockoffs: The Fight Against Trademark and Copyright Infringement	<i>Meghan Collins</i>	68

BOARD OF EDITORS
2009-2010

Editor-in-Chief
Marta M. Kowalczyk

Managing Editor
Samuel Rosenberg

Executive Editor
Gary Klinger

Staff Writers

Meghan Collins
Kevin Coffey
Frederic Deraiche
Brittany Estell
Carlos De La Paz
John Michael Ekblad
Ilya Gilman
Yuejiao Hou
Marianna Kiselev
Gustavo Morales Oliver

Maria Kuzmina
Juan P. Moreno
Zina Kiryakos
John Lee
Michael Lenhardt

Isabel Freitas Peres
Amanda Pintaro
Cari Silverman
Lu Sun
Helena Varnavas
Paul Whitehair
Sae Bom Yoon
Julian Watkins
Warren Wilke III
Henry Young

Faculty Advisor
Larry Ribstein

Research Advisor
Michael Robak

INFORMATION REGARDING *THE ILLINOIS BUSINESS LAW JOURNAL*

The Illinois Business Law Journal is a peer-reviewed, student publication of the University of Illinois at Urbana-Champaign, College of Law. The Journal is available online at <http://www.law.uiuc.edu/bljournal>.

Proper Citation: ILL. BUS. L.J.

The Journal accepts solicited and unsolicited articles. The author may elect to have the article posted online immediately after acceptance of the article. Articles should not exceed 8,000 words in length. Articles should conform to *The Bluebook* (18th ed.) for citations and to the University of Chicago *Manual of Style* (15th ed.). Articles will not be returned to the author. Articles can be submitted electronically at iblj@law.illinois.edu or by U.S. Mail to *The Illinois Business Law Journal*, University of Illinois at Urbana-Champaign, 68 Law Building, 504 East Pennsylvania Avenue, Champaign, IL 61820, USA.

The views expressed herein are attributed to their authors and are not to be attributed to the University of Illinois, the editors, or the journal.

THE EFFICIENT BREACH HYPOTHESIS: ITS IMPACT AND EFFECT ON THE PENALTY CLAUSE AS DEFINED UNDER COLOMBIAN LAW

JUAN P. MORENO

I. INTRODUCTION

Inspired by the close interaction of law and economics, common law scholars have applied an economic perspective to bear legal problems in the last decades. This scholastic effort has produced interesting results in the United States where the sophistication of the courts and its judges allow a pragmatic application of economic theories to actual controversies. Economists analyze legal rules in terms of efficiency.¹ Reallocating resources in a society is considered efficient only if that reallocation makes someone better without making some others worse off.²

Economic theory has been broadly applied in the United States, particularly in the area of contract law. At the heart of its application lies the *efficient breach hypothesis*, a milestone of contract law and the law and economics movement.³ Simply put, the hypothesis suggests that promisors should be permitted, if not encouraged, to breach a contract whenever the net gains resulting from said breach exceed the net gains of performance.⁴ Parties are therefore encouraged to complete the projects they consider efficient while abandoning any other contractual project that results in inefficiency or waste.⁵

In the United States, the efficient breach hypothesis has been repeatedly endorsed by notable legal personalities like Richard Posner who has openly welcomed the hypothesis both as a scholar and as a judge. In *Patton v. Mid-Continent Systems Inc.*, for example, Judge Posner stated that:

¹ See *Walgreen Co. v. Sara Creek Property Co.*, 966 F.2d 273 (7th Cir. 1992) (Posner, J., dissenting).

² Allan Farnsworth *et. al.* CONTRACTS CASES AND MATERIALS, 7 (Ed. Foundation Press, 2001) 1965.

³ Barry E. Adler, *Efficient Breach Theory Through the Looking Glass*, 83 N.Y.U. L.REV. 1679, 1688 (2008) (arguing that negative damages may promote efficient breach decisions ex post and efficient investment decisions ex ante).

⁴ Jody S. Kraus, *A Critique to the Efficient Performance Hypothesis*, YALE L.J. POCKET PART 568 (2006) (criticizing the efficient breach hypothesis while offering an alternative theory defined as the efficient performance hypothesis).

⁵ Adler, *supra* note 3, at 1681.

[N]ot all breaches are blameworthy. The promisor may simply have discovered that his performance is worth more to someone else. If so, efficiency is promoted by allowing him to break his promise, provided he makes good the promisee's actual losses. If he is forced to pay more than that, an efficient breach may be deterred, and the law does not want to bring about such a result.⁶

The close interaction between economics and law and the innovations that arise from this dualism is not present in civil law jurisdictions where, unfortunately, the literature in economic law is scarce. In Latin America and particularly Colombia, scholars and courts tend to focus on the *status quo* of the rule of law and limit their interpretation and analysis to a set of guidelines established in a code or a long-standing ruling. Innovative approaches to law tend to be minimalistic and rigid. As such, while the rule of law in common law jurisdictions tends to be dynamic and regularly adjusted through its case law; its civil counterpart tends to be static and immutable.

This difference however does not, by any means, indicate that civil law is inferior from common law, it is just different.⁷ Nonetheless, lawmakers and adjudicators must be conscious of this difference before transplanting innovative legal theories to well-entrenched civil law systems.

This paper explores the possibilities of transplanting the efficient breach hypothesis into Colombian law. The paper centers its analysis on the effect the efficient breach hypothesis would have on the penalty clause. Part II introduces a general overview of penalty clauses under Colombian law and highlights its multifaceted use in contract formation and enforceability. Part III stresses the role of penalty clauses as means of avoiding litigation and concludes that efficiency is best achieved by these clauses. Part IV presents a general conclusion.

⁶ See *Patton v. Mid-Continent Systems, Inc.*, 841 F.2d 742 (7th Cir. 1988) (discussing the efficient breach and the importance of remedies in the decision between performance and breach).

⁷ I disagree with Judge's Posner characterizing civil law as inferior from the standpoint of promoting commercial activity. See Richard A. Posner, *Let Us Never Blame A Contract Breaker*, 107 MICH. L. REV. 1349, 1352 (2009) (criticizing that the concepts of fault and blame, as understood of moral terms, as unlike components to the doctrine of contract law).

II. HARMONIZING THE EFFICIENT BREACH HYPOTHESIS WITH THE PENALTY CLAUSE

An issue that arises from applying the efficient breach hypothesis to Colombian contractual law is the effect the hypothesis has on penalty clauses. American courts generally refuse to enforce liquidated damages (i.e. anticipated damages agreed by the parties) if the liquidated damages substantially exceed the actual damages caused to the non-breaching party i.e. if such damages are grossly disproportionate.⁸ If the court finds the liquidated damages to be excessive, i.e. a penalty, the clause is usually, if not always, deemed unenforceable.⁹ In other words, under common law, penalty clauses are declared unenforceable because they hinder efficient breaches.¹⁰

The efficient breach hypothesis limits the enforceability of liquidated damages to very limited situations and upon the fulfillment of two conditions. First, the stipulated amount must be a reasonable estimate of just compensation in light of the harm anticipated by the parties.¹¹ Second, the anticipated damages that may arise from the breach must be uncertain and difficult to calculate.¹²

By contrast, in civil law jurisdictions, penalty clauses are generally enforceable.¹³ In classic Roman law, for example, the *stipulatio poenae* was used as a means of enforcing *natural obligations* that were not generally enforceable, such as obligations acquired by minors or the obligations arising from contracts that did not comply with legal formalities.¹⁴ Today most civil law jurisdictions continue to enforce penalty clauses, even those that may result in excessive money judgment vis-à-vis the actual damage caused to the non-breaching party.

⁸ See Metz v. Clay 101 Kan. 45 (1917); McGrath Co v. Wisner, 55 A.2d 793 (Md. 1947); City of Rye v. Public Serv. Mut. Ins. Co., 315 N.E. 2d 458 (N.Y. 1974).

⁹ Charles J. Goetz et.al., *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, COLUM. L. REV. 554, 555 (1977) (discussing the principles of just compensation and efficient breach).

¹⁰ Aristides N. Hatzis, *Having the Cake and Eating it Too: Efficient Penalty Clauses in Common and Civil Law Contract Law*, INT'L REV. L. & ECON. 381, 385-86 (2002) (discussing the different approaches of Common Law and Civil Law vis-à-vis liquidated damages).

¹¹ See RESTATEMENT (SECOND) OF CONTRACTS § 356 and U.C.C. § 2-718(1).

¹² *Id.*

¹³ *Id.*

¹⁴ Guillermo Ospina Fernández, RÉGIMEN GENERAL DE LAS OBLIGACIONES, 132 (Ed. Temis S.A. 1998) (1992).

However, most civil jurisdictions grant the courts the discretion to reduce the penalty clause to a reasonable amount, but only if the promisor requests it.¹⁵

In Colombia, parties to a contract are generally allowed to enforce liquidated damages clauses, even if such damages amount to a penalty. Unlike in common law, if the penalty clause is grossly disproportionate when compared to the actual damages, the penalty clause is not declared void *ab initio*, but instead, it is adjusted by the court at the request of the debtor, or by the court itself depending on whether the contract involves a determinable or indeterminable consideration.¹⁶

Moreover, under Colombian law, penalty clauses serve a variety of functions besides those generally associated with liquidated damages clauses in common law jurisdictions. This multifaceted role of the penalty clause and its active role under Colombian law will therefore be used as a starting point in the analysis.

Pursuant to Article 1592 of the Colombian Civil Code, a penalty clause is a contractual clause whereby one of the parties agrees to perform, as a penalty, an obligation to give, do or not do something.¹⁷ It is said that the penalty clause serves three main functions: (i) breach deterrent; (ii) guarantee and (iii) damage prognosticator.

A. The Penalty Clause as Breach Deterrent

Similarly to the *stipulatio poenae* in the classic Roman law and the old Spanish law, Article 1594 of the Colombian Civil Code allows a creditor to enforce both the underlying obligation and the penalty clause if the agreement entered by the parties so provides.¹⁸ In these cases, the damages arising from the penalty clause may be recovered along with the compensatory damages arising from the breach of the underlying obligation.¹⁹

Colombian Civil Code also allows parties to negotiate penalty clauses in favor of third parties, what was known under classic Roman law as the *rato manente pacto*.²⁰ In these cases, the penalty clause serves as a breach deterrent in

¹⁵ See for example the Spanish civil code (Art. 1154 of the Spanish Civil Code); the Italian civil code (Art. 1382-1384 of the Italian civil code).

¹⁶ See CÓD. CIV. Article 1601.

¹⁷ See CÓD. CIV. Article 1592.

¹⁸ See CÓD. CIV. Article 1600 generally prohibits the enforcement of the penalty clauses when damages have been requested. However, the penalty and the damages may be aggregated if the agreement so provides.

¹⁹ Ospina Fernández, *supra* note 14, at 142.

²⁰ See CÓD. CIV. Article 1502.

favor of third parties and not as a guarantee because generally a third party has no enforceable rights under an agreement. It is therefore said that the third party is entitled to enforce the penalty clause independently.²¹

Two examples may be instrumental in clarifying the foregoing. Assume that Parties A and B agree to sell/purchase widgets for 10,000. Both parties also agree on a penalty clause in favor of B. In this case, the penalty clause guarantees compliance of Party A with its obligations under the agreement.²² Party B will be able to enforce both the penalty and request damages only if the contract so provides. By contrast, assume that Parties A and B agree on the penalty clause, but this time in favor of Party D, so that D will be compensated if Party A breaches his portion of the agreement (e.g. if Party A does not deliver the widgets). If Party A breaches, Party D will not be affected by the breach (since he does not have anything at stake in the agreement). The only person affected by the breach is Party B who may request an indemnification for the breach or request Party A to perform (depending on the case). Although not affected by the breach, Party D may enforce the penalty clause agreed in his favor even if Party D does not have any rights in the underlying agreement.²³

Complicating things, let us take a pragmatic example commonly present in insurance contracts. Assume Party A enters into an insurance agreement with Party B (an insurance company). Under the terms of the contract, Party A insures certain widgets to be delivered to D. The insurance is made in favor of D, who, although not a party to the insurance agreement would have the ultimate right to enforce the insurance agreement. Indeed, under the theory of *estipulacion por otro*, third party beneficiaries are entitled to enforce certain obligations of an agreement executed by others. It is said that Party D is the third-party beneficiary of the insurance agreement celebrated between A and B.

Now, assume further that in addition to the right of D to enforce the insurance agreement, Parties A and B establish a penalty clause in favor of Party A, who has no rights to enforce the insurance agreement. Party A will then be entitled to enforce the penalty clause of the insurance agreement if B does not pay. The enforceability of A's right would therefore be independent of D's right. This explains why the penalty clause should be construed as a breach deterrent, rather than as a guarantee. Indeed, Party B will be compelled to comply with the agreement (deter from breaching) not because of a guarantee given to D, but instead because of the fear of paying a penalty to a party that has no legal rights in the insurance agreement.

²¹ See Cód. Civ. Article 1506.

²² See *infra* Part II B.

²³ See Cód. Civ. Article 1593.

*B. Penalty Clause as a Contractual Guarantee*²⁴

Similarly to a pledge or a mortgage, penalty clauses guarantee the compliance of the underlying obligation.²⁵ In Roman times, this function acquired special preponderance in cases where the underlying obligation was unenforceable, not because it was void or null but because it did not give rise to a legally enforceable obligation e.g. obligations acquired by insane people or by minors. This function stayed in most civil law jurisdictions giving the creditor the right to enforce the guarantee against the third-party guarantor.

Under Colombian law, this function is only operative when a third party guarantees the underlying obligation of a debtor,²⁶ for instance if Party D agrees to guarantee Party A's obligations arising from his agreement with Party B. In such cases, Party B (the creditor) has the possibility of either enforcing the underlying obligation against the debtor's assets (Party's A assets) or enforcing the penalty clause against the third-party guarantor (Party D).²⁷

This function departs from the role of penalty clause as a breach deterrent in that in the latter the penalty clause and the right to enforce the underlying agreement does not fall to the same person.²⁸ By contrast, when the penalty clause is used as a contractual guarantee, the right to enforce the agreement or the penalty clause falls on the same person (B in the example below). It is, therefore, said that the penalty clause and the right to enforce the agreement are not independent but alternative (in the sense that the creditor has the alternative to enforce the contract or the guarantee).

C. Penalty Clause as a Damages Prognosticator

The penalty clause also serves to anticipate the damages a non-breaching party may claim in the event of a breach.²⁹ This function is generally seen as the most important function of the penalty clause.³⁰

Similarly to liquidated damages clauses, penalty clauses are used in civil law jurisdictions to anticipate the damages a party may incur for the breach of the other party.³¹ Many scholars believe this to be the most efficient way to calculate

²⁴ See CÓD. CIV. Article 65.

²⁵ See CÓD. CIV. Article 1502.

²⁶ See CÓD. CIV. Article 1529.

²⁷ Ospina Fernández, *supra* note 14, at 144.

²⁸ *Id.*

²⁹ See CÓD. CIV. Article 1593.

³⁰ *Id.*

³¹ See CÓD. CIV. Article 1502.

damages, because parties, like no one else, are in the best position to estimate the scope of their damages.³²

Although this function is similar to the liquidated damages clauses regulated under the United States this function is broader in civil law jurisdictions because penalty clauses may be enforceable even if the underlying obligation is declared void.³³

Let us take the Colombian example. Assume for example that Party A agrees with Party B that Party D will deliver the widgets. Under Colombian law, Party D is not obligated to deliver the widgets if he does not ratify said obligation.³⁴ If Party D does not ratify, Party A will be in breach of a promise and Party B will be entitled to recover the damages caused. Since promising on behalf of another person (when the promisor has no authority to do so) is a reprehensible conduct under Colombian law, vane promises are usually prevented and discouraged by the use of penalty clauses.

Going back to the same example, assume Party A promises Party B that Party D will deliver the widgets. Parties A and B additionally agree on a penalty clause to assure B that D will ratify. If D does not ratify (e.g. because he has given Party A no authority to negotiate), Party B may be entitled to recover the damages arising from the Party A's promise *plus* the penalty agreed. This function works both as a deterrent of reprehensible conduct and as a guarantee of Party A's promise. Note that since D did not ratify his obligation, no agreement was formed. This however, does not limit B's ability to enforce the penalty clause against A.

D. Putting the Findings in Perspective

Unlike liquidated damages clauses, penalty clauses serve a plurality of functions in Colombian law. As a result, the legal transplantation of the efficient breach hypothesis to Colombian law may create more discomfort in the commercial flow than benefit. However, an initial disruption of the legal order may be welcomed if said disruption is beneficial in the long run. The question that arises is therefore, whether the Colombian legal system should implement the efficient breach hypothesis as a means of promoting free and efficient commercial flow, or whether Colombian courts should disregard the efficient breach hypothesis. In other words, is the Colombian penalty clause legislation efficient?

³² Hatzis, *supra* note 10 at 390.

³³ See Cód. Civ. Article 1507.

³⁴ *Id.*

The main concern of the economists adhering to the efficient breach hypothesis is that the enforcement of penalty clauses deters efficient breaches.³⁵ This concern is both valid in the United States as well as in Colombia. Indeed, there is inefficiency when the anticipated damages are higher than the actual damages because, for example, a promisor would be compelled to perform even when the cost of performance exceeds the net benefits for each of the parties involved.³⁶

Also, it said that penalty clauses create a barrier of entry. Thus, the efficient breach hypothesis suggests that limiting the amount that may be recovered from a contractual breach enhances efficiency as said limit prevents the parties from over committing to a specific agreement.³⁷

Another concern arises from the fact that scholars in the United States tend to see penalty clauses as the result of either unfairness in the bargaining process (for instance, as the result of adhesion contracts) or as an objectionable *in terrorem* agreement entered to secure performance overcompensating the injured party and obstructing the free commercial flow.³⁸

In spite of these apparent problems, many scholars believe that limiting the amount of damages that can be recovered after a breach is not as efficient as initially thought.³⁹ Some critics even see anticipatory damages clause (e.g. liquidated damages or penalty clauses) as the most efficient way to calculate damages.⁴⁰

In the particular case of Colombia, where civil procedures are lengthy and where it is often hard to prove the actual damage caused, penalty clauses serve a threefold purpose.

First, creditors are released from the task of proving the damages caused since there is a legal presumption that the amount agreed by the parties in the penalty clause is enforceable *juris et jure*, so that the debtor cannot present any evidence to the contrary. Article 1599 of Colombia's civil code establishes this presumption by stating that the penalty may be enforced whenever it has been agreed upon by the parties without any kind of recourse by the debtor.⁴¹

Second, the penalty clause reduces the evidence stage of the procedure because, as stated above, the debtor is not entitled to prove that the damages caused were lower than originally anticipated. For example, if Party A causes a

³⁵ Patton v. Mid-Continent Systems, Inc., 841 F.2d 742 at 745.

³⁶ Hatzis, *supra* note 10, at 385.

³⁷ *Id.*

³⁸ Goetz, *supra* note 9, at 562.

³⁹ *Id.* at 561.

⁴⁰ Hatzis, *supra* note 10, at 390.

⁴¹ CÓD. CIV. Article 1601.

damage of 10,000 by not delivering the widgets but the penalty clause is set at 100,000, Party A will not be able to show that the actual damage was 10,000.

Lastly, the penalty clause may be automatically executed. Creditors enforcing a penalty clause are only required to show that the underlying obligation has been breached and that that a penalty clause is triggered as a result of such breach.⁴² Creditors are therefore not obliged to enter into a lengthy procedure to execute the guarantee but would be automatically paid if the court finds there is a breach. In this sense, the role of the penalty clause is more efficient than other sorts of guarantees like a pledge or a mortgage that require an additional process to be executed.⁴³

As seen, unlike the common law where liquidated damages play a limited role in the contractual relationship of two parties, the plurality of applications that penalty clauses have in a civil law jurisdiction implies a rejection of the efficient breach hypothesis. This, by no means, suggests that the contractual legal order of civil law jurisdictions is inefficient. On the contrary, it suggests the limited applicability of the hypothesis in countries where additional transactional costs, not common in common law jurisdictions, play a major role in the decision-making process.

III. AVOIDING COLOMBIAN LITIGATION: SEEKING EFFICIENCY ABOVE ALL

The efficient breach hypothesis rests on the presumption that parties are willing to go to court.⁴⁴ The hypothesis assumes that parties are influenced by the contractual remedies established in the agreement when deciding whether to breach or not the contract.⁴⁵ But this assumption is only valid if non-breaching parties are able to go to court and obtain the damages they are entitled in an efficient manner, i.e. if there are no transaction costs resulting from going to court.

If the court systems is clogged by lengthy procedures, the transactional cost of litigating a breach in order to obtain recovery may encourage a party to carefully negotiate anticipatory damages in the form of penalty clauses as a means of either securing a faster recovery, as in the case of Colombian law, or as a means of deterring the other party from breaching the contract.

⁴² CÓD. CIV. Article 1599.

⁴³ Ospina Fernández, *supra* note 14, at 146.

⁴⁴ Ni Zhu, *Case Study of Legal Transplant: The Possibility of Efficient Breach in China*, 36 GEO. J. INT'L L. 1145, 1146 (2005) (discussing the applicability of the efficient breach hypothesis in China).

⁴⁵ *Id.*

Based on the current status of Colombian procedural law, particularly its lengthy stages and its clogged tribunals,⁴⁶ it is suggested that an *ex-ante* calculation of damages *via* penalty clauses would tend to be more efficient for the parties than implementing the teachings of the efficient breach hypothesis. Indeed, the Colombian procedural system is often, if not always, lengthy and tedious.⁴⁷ In common parlance, it is said that the “life of a Colombian lawyer equals two complex litigations.” Establishing and negotiating penalty clauses in a contract is therefore an excellent mechanism to reduce the length of the process since the creditor is not obligated to show the actual damages caused, but simply, to show that there was a breach of the contract and that the penalty clause was triggered with said breach.⁴⁸

On the other hand, penalty clauses can be used as a sort of “insurance” to secure performance. Proponents of the insurance theory argue that in the absence of unfairness or other bargaining abnormalities, efficiency is maximized by the enforcement of the agreed allocation of risks embodied in a liquidated damages clause.⁴⁹ This theory suggests that liquidated damages secure transaction costs because the cost of negotiating a liquidated damages clause (or a penalty clause) are less than the costs of litigation.

The theory is also expressed by Hatzis in the following terms: when one of the parties is risk-averse and/or places high subjective valuation on the performance of the contract, and the other party is the best possible insurer against his loss, then it is logical to ensure performance by establishing a penalty (“insurance”).⁵⁰ On this perspective, penalty clauses are preferable than an insurance contract in various grounds:

- (i) They are less costly, both economically as in terms of opportunity costs;
- (ii) They facilitate the calculation of risks since they eliminate uncertainty in the future as to the amount that will be recovered at the same time;
- (iii) They promote contract planning as parties know with certainty what they would recover/pay in the event of a breach;

⁴⁶ See Omar Beabentos *et. al*, DERECHO PROCESAL, CIVIL Y COMERCIAL, 137 (Ed. Juris, 2004).

⁴⁷ Francisco Leal Buitrago, EN LA ENCRUCIJADA: COLOMBIA EN EL SIGLO XXI, 459 (Ed. Norma, 2006).

⁴⁸ Similarly, the threat of a subsequent review increases the costs of negotiating the damages clauses.

⁴⁹ Goetz, *supra* note 9, at 578.

⁵⁰ Hatzis, *supra* note at 10, at 391.

- (iv) Insurance compensation generally does not contemplate the recovery of non-pecuniary damages, as it is sometimes done with penalty clauses; and
- (v) Subjective valuation can be expressed in the penalty clause (e.g. in the form of a greater penalty), which is not often the case in insurance agreements absent a greater premium.⁵¹

Thus, absent abnormalities in the negotiation process it is suggested that the use of penalty clauses under Colombian law would achieve higher levels of efficiency by imposing anti-breaching mechanisms that guarantee performance of the agreement.

IV. CONCLUSION

Analyzing law through the eyes of economists usually brings innovative solutions and new perspectives to recurrent legal problems. Yet, said analysis must take into consideration the realities of the law and its formalisms. While in some cases it would be possible to permeate the law with innovative economic perspectives, in others, the economic perspectives have to give way to legal traditions, which although not economically viable, if analyzed alone, allow the legal system to function efficiently when analyzed in conjunction with other institutions.

Although innovative, the applicability of the efficient breach hypothesis to Colombian law is limited. Not only does it conflict with important institutions of Colombian law like the penalty clause, but also disregards pragmatic problems related to the current state of Colombian legal proceedings.

Despite the limit applicability of the efficient breach hypothesis, it is the hope of this author, that some of the teachings of economic analysis be borrowed by Colombian scholars and that this paper becomes a tool to foster a new wave of thinking outside the box, that will not only strengthen Colombia's legal institutions, but also enrich and modernize the way law is analyzed, viewed and practiced there.

⁵¹ *Id.*

MARVEL AND DISNEY: A MERGER WITH CHARACTER

FREDERIC DERAICHE

I. INTRODUCTION

On August 31, 2009, The Walt Disney Company (“Disney”) and Marvel Entertainment, Inc. (“Marvel”) entered into a merger agreement in which Disney would acquire Marvel.¹ At this time, it is up to debate whether the acquisition is a horizontal, vertical, or conglomerate/lateral transaction. Both Disney and Marvel are involved in a very broad range of products and services, but both companies center their business models on intangibles, particularly characters. As a result, much of Disney and Marvel’s business revolves around intellectual property. Unlike the products of technological and software companies, the intellectual property rights created by Disney and Marvel are less concrete but more versatile, and decidedly harder to enforce. As such, this article will consider the nature of characters as property rights, particularly those of Disney and Marvel, as they relate to the Department of Justice (“DoJ”) and Federal Trade Commission (“FTC”) Merger Guidelines and suggest areas of consideration that will require more study for a full antitrust analysis of the merger.

II. BACKGROUND

Disney was formed in 1923² and has grown to very significant size in the time since then. Disney owns many varied assets in several different industries. Several are of interest for this merger. The Disney family of companies contains a motion picture arm that owns and operates film studios, and produces films based both on Disney intellectual property as well as the worlds and characters of other creators.³ Furthermore, Disney controls a publishing company that is involved both in traditional books as well as comic book and magazine

¹ Marvel Entertainment, Inc., General statement of acquisition of beneficial ownership (Schedule 13D/A) (Sept 10, 2009).

² The Walt Disney Company, The Walt Disney Company and Affiliated Companies - Company Overview, <http://corporate.disney.go.com/corporate/overview.html> (Last visited Sept. 20, 2009)

³ The Walt Disney Company, *2008 Annual Report* (2009), available at http://amedia.disney.go.com/investorrelations/annual_reports/WDC-AR-2008.pdf.

publications.⁴ Finally, Disney relies a great deal on merchandising and licensing opportunities that arise out of their intellectual properties, especially characters.⁵

Marvel was founded in 1933 and exists mainly as a character-based entertainment and licensing business. Marvel owns and then licenses its intellectual properties, existing in the form of characters, and describes itself as a character-based entertainment company.⁶ Marvel further owns and operates Marvel Publishing, Inc, which acts as the publishing arm of Marvel, with a focus on comic books.⁷ Furthermore, Marvel owns and operates a film production office, known as MLV Productions, Inc.⁸ Marvel does not, however, create films in-house and does not own or operate any movie studios.⁹

Under the terms of the agreement of the merger, Disney is acquiring Marvel so that each share of common stock in Marvel will be converted into a receivership right to either \$30 in cash, or 0.7452 shares of Disney common stock.¹⁰ Furthermore, the agreement provides that Marvel Characters licensing and publishing offices will continue to be based in their original home cities.¹¹

III. ANALYSIS

The merger guidelines of the DoJ and FTC make a distinction between horizontal and non-horizontal mergers.¹² Each requires different analysis, but both treat efficiencies similarly. Because the Disney-Marvel merger has characteristics of both horizontal and non-horizontal mergers, each will be addressed separately, and then the concept of efficiencies, which the guidelines treat in the exact same way,¹³ will be addressed last.

⁴ *See id.* at 29.

⁵ *See id.* at 28, 63.

⁶ Marvel Entertainment, Inc., *Annual Report for the Year Ended December 31, 2008* (2009), available at http://marvel.com/company/pdfs/2008_annual_report.pdf.

⁷ *Id.* at 7.

⁸ *Id.* at 9.

⁹ *Id.*

¹⁰ Marvel Entertainment, Inc., General Statement of Acquisition of Beneficial Ownership (Schedule 13D/A) (Sept 10, 2009).

¹¹ Marvel Entertainment, Inc., Policies for the Management of the Marvel Business (Form 425, EX-99.1) (Sept 4, 2009).

¹² U.S. DEP'T OF JUSTICE, U.S. DEP'T OF JUSTICE MERGER GUIDELINES (1984) available at <http://www.usdoj.gov/atr/public/guidelines/2614.htm> [hereinafter 1984 MERGER GUIDELINES].

¹³ *Id.*

A. Horizontal

Many analysts have speculated on the horizontal nature of the merger. Their approach centers on the idea that Marvel and Disney intellectual properties, especially characters, compete for the attention of the same market.¹⁴ Several of these analysts point out that Disney has repeatedly tried and failed to capture the young male market share with their characters, especially in the television and film realms, but succeeded with young women.¹⁵ These analysts point to Marvel's strong hold on young males and weakness towards female in the comic book realm as indication that the two companies have synergistic competition and could significantly benefit from a merger.¹⁶

The merger guidelines provide that the first step in analyzing a merger that is considered to be horizontal is to define the markets in question, both geographically and in terms of product.¹⁷ Disney and Marvel both operate as national corporations and make their products available across the United States, so the geographic market is clearly national. However, it is more problematic to try and identify the exact product market.

For two goods to be in the same market, they must be at least general substitutes.¹⁸ If the price of Disney properties were to go up, or if they were to become unavailable, their customers would have to substitute with Marvel properties for the two to be competitors. It is questionable what portion of either customer base would substitute from one to the other. The nature of the products alone raises questions as to whether the two companies operate in a single market.

¹⁴ Brooks Barnes & Michael Cieply, *Disney Swoops into Action, Buying Marvel for \$4 Billion*, N.Y. TIMES, Aug. 31, 2009, available at <http://www.nytimes.com/2009/09/01/business/media/01disney.html>; Sarah Jaffe, *Can Marvel-Disney Help Close the Comic Book Gender Gap?*, <http://www.newsarama.com/comics/090902-Disney-Marvel-Girls.html> (last visited Sept. 14, 2009).

¹⁵ Barnes & Cieply, *supra* note 14.

¹⁶ Jaffe, *supra* note 14.

¹⁷ U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, U.S. DEPARTMENT OF JUSTICE AND THE FEDERAL TRADE COMMISSION HORIZONTAL MERGER GUIDELINES §1.1 (1992, revised 1997) available at http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmg1.html [hereinafter 1997 MERGER GUIDELINES].

¹⁸ Michael E. Porter, *The Five Competitive Forces that Shape Strategy*, HBR 79 (January 2008).

Marvel has generally produced character properties in the realm of superhero, detective, and horror story characters. Disney, on the other hand, has a vast realm of fairies, princesses, dashing princes, and anthropomorphic critters. Furthermore, Marvel's properties typically skew towards older customers whereas Disney properties typically skew towards the younger, family-appropriate crowds.

More specifically, the merger guidelines call for the identification of markets using the small-but-significant price increase method.¹⁹ This method calls for the assumption of a monopolist, and then considering the effect of a price increase by said monopolist with all other prices held constant.²⁰ If Disney is considered a monopolist, and it increases the price of its character properties by five percent, would consumers shift towards Marvel?

The Guidelines' method seems to fail at this juncture. Is the price of an intellectual property as versatile as a character? There is no simple answer. Characters and the worlds that have been built around them can be sold for use in movies, television programs, books, advertisements, etc. There are few, if any, real limits to their use. Furthermore, Disney and Marvel generally create their own products based on their characters. Perhaps the price of a character property should be one that the end consumer pays. A new issue arises with this approach in that we must determine what media to consider. We must further question whether the traditionally movie-based characters of Disney can be compared alongside the generally comic book-based characters of Marvel fairly in any single media, and whether it is wise to compare across media.

Existing data regarding the competition between Disney and Marvel at the intellectual property level is scarce and would serve no purpose in this instance. Historically, Marvel properties have been focused in a comic book format whereas Disney properties have been focused on animated and film media. As a result, it is hard to examine whether the properties can compete with each other when their current preferred formats do not. It may well be impossible to ascertain whether Mickey Mouse and Wolverine are competing properties at this time. It will be critical for the regulators, however, to approximate date in this field so as to get a clearer picture of this character market. Doing so will be critical in determining whether concerns in this market should affect the agencies' stance on the overarching merger.

B. Non-Horizontal

Disney does not solely create and own intellectual properties. They also publish books and comic books, produce movies and television shows, and create

¹⁹ 1997 MERGER GUIDELINES, *supra* note 17, at §1.11.

²⁰ *Id.*

amusement parks, all of which use the properties as a base for the product.²¹ As a result, Disney is a significant consumer of intellectual properties as well a producer thereof. Marvel, on the other hand, publishes comic books, but does not own movie or television studios and does not operate any theme parks. As a result, Marvel could be considered to be a supplier for Disney if Disney were to use Marvel properties in creating such products as movies and television shows. Disney perhaps acquired Marvel for its intellectual properties as an act of vertical integration, to save itself the costs of acquiring such properties for use in their other ventures.

This approach has been suggested by several analysts.²² However, some are quick to point out that, on the vertical level, this merger would be a less than favorable deal for Disney.²³ Marvel properties are already embroiled in license agreements that are set to last for several more years and, as a result, the merger may only work to Disney's favor in a longer time horizon.²⁴ As a result, the non-horizontal effects of the merger on the markets are hard to fully quantify as there are both present and future effects.

The non-horizontal merger guidelines call for an examination of effects of the merger on barriers to entry.²⁵ They further call for an analysis centering on whether Disney owning both Marvel and its own character-property producing facilities raises the barriers to entry in Disney's primary market.²⁶ However, the issue is further confused by the difficulty in ascertaining, as mentioned above, whether Disney and Marvel characters, and therefore any products based on such characters, are in the same market.

Finally, the greatest question that arises is whether there could ever be barriers of entry in an industry that require only imagination to create a product. Characters can be created by anyone, at any time, simply by imagining the character, and then publishing its characteristics to the world in some way. This raises a question as to whether barriers to entry can exist at all. No matter how big Disney and Marvel get, they cannot physically stop individuals from

²¹ See The Walt Disney Company, 2008 Annual Report, *supra* note 3.

²² See Steven Zeitchik, *Analysis: Disney-Marvel Deal Brings Changes*, ADWEEK, Sept 1, 2009, available at http://www.adweek.com/aw/content_display/news/media/e3i76e7bfe15f67e9f1832a6af63f7c353c; Alex Dobuzinskis, *ANALYSIS - Disney-Marvel benefits come with time lag, risks*, REUTERS, <http://in.reuters.com/article/businessNews/idINIndia-42170020090902> (last visited Sept 14, 2009).

²³ Dobuzinskis, *supra* note 22.

²⁴ *Id.*

²⁵ 1984 MERGER GUIDELINES, *supra* note 12, at §4.2

²⁶ *Id.*

imagining characters and cannot stop individuals from consuming those characters in some way, whether it be through formalized media like television, or through an informal media, such as stories posted on a blog on the internet. As such, it seems that the non-horizontal merger guidelines are either not equipped to consider a merger where one of the primary products is non-technical intellectual property, or not interested in regulating a merger in such an industry.

C. Efficiencies

The legal world surrounding intellectual properties such as those produced by Disney and Marvel is complicated and murky. Multiple legal debates have arisen, and much of legal framework seems inefficient. Characters have long been established as copyrightable separate of their originating work.²⁷ A test was first created in *Nichols v. Universal Picture Corp.* for the copyright protection of characters, but it is considered unclear and generally inconclusive.²⁸ In *Nichols*, the court explained that “the less developed the characters, the less they can be copyrighted” and further stated that identifying characteristics were critical for the copyrighting of characters, but did not elaborate a strict test.²⁹

The tests that have since emerged continue to leave much to the imagination of lawyers and judges. Names cannot be copyrighted, but characters cannot be copyrighted without a name.³⁰ Stock characters, characters who are generic and generally only identifiable by their general purpose, such as two lovers who are “loving and fertile [and] that is really all that can be said of them,” are not copyrightable, as Judge Learned Hand recognized in *Nichols*,³¹ but at what point does a character exit the stock and become delineated? According to author Gregory Schienke, the answer remains unclear and requires further clarification to this day.³²

This background creates a complicated legal landscape in which character-based entertainment companies such as Marvel or Disney must operate. This is further complicated by the ways in which characters can be infringed, and the decisions that must be made as to which infringements must be stopped and

²⁷ *Nichols v Universal Pictures Corp.*, 45 F.2d 119 (2d Cir. 1930).

²⁸ Gregory S. Schienke, *The Spawn of Learned Hand – A Reexamination of Copyright Protection and Fictional Characters: How Distinctly Delineated Must the Story be Told?*, 9 MARQ. INTELL. PROP. L. REV. 63, 70 (2005).

²⁹ *Nichols*, 45 F.2d at 121.

³⁰ Schienke, *supra* note 28, at 81.

³¹ *Nichols*, 45 F.2d at 121-22 (1930).

³² Schienke, *supra* note 28, at 83.

which should be allowed as fostering fan dedication and appreciation (the “fandom” as some refer to it).³³

Disney derives a great deal of its market share and market power from copyright and its ability to control its intellectual properties.³⁴ However, the intangible nature of copyright infringement as well as the relatively loose and vague judicial guidelines discussed above mean that Disney may be accruing a great deal of costs in enforcing its rights with regards to these properties. The emergence of a significant international intellectual property issue further complicates this problem and acerbates the costs involved.³⁵

Marvel has had a myriad of intellectual property issues of its own. The Superhero genre that Marvel operates in has been particularly prone to infringement from varied sources.³⁶ Only recently, a significant case arose from the video game industry, *Marvel v. NCSoft*, which considered whether the operator of an online game had a duty to prevent users from replicating Marvel characters and whether the game operators and designers had made it too easy to replicate such characters.³⁷ The case, though ultimately settled, relied heavily on the question of what constitutes the character and whether appearance or name was enough to be infringement.³⁸ The legal problem arises out of the difficulty of defining exactly what a character and what he or she represents.³⁹ Author Michael Price, in an article titled *When Phone Booths are Inadequate Protection: Copyright and Trademark Infringement of Superheroes*, points to the importance of flexibility in copyright protections in acknowledgment that a character is more than a name and appearance.⁴⁰ As a result, litigation arising out of these concepts is evidence-intensive and likely expensive to pursue.

A merger by Disney and Marvel may well operate to combine the legal aspects of the character-based business and afford the two companies a greater

³³ Britton Payne, *Super-Grokster: Untangling Secondary Liability, Comic Book Heroes, and the DMCA, and a Filtering Solution for Infringing Digital Creations*, 16 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 939, 955 (2006).

³⁴ Michael J. Meurer, *Copyright Law and Price Discrimination*, 23 CARDOZO L. REV. 55, 83 (2001).

³⁵ See Marshall A. Leaffer, *Protecting United States Intellectual Property Abroad: Toward a New Multilateralism*, 76 IOWA L. REV. 273 (1991).

³⁶ Michael T. Price, *When Phone Booths are Inadequate Protection: Copyright and Trademark Infringement of Superheroes*, 43 WAYNE L. REV. 321, 321-22(1996).

³⁷ See Payne, *supra* note 33, at 958.

³⁸ *Id.*

³⁹ Price, *supra* note 36, at 323.

⁴⁰ *Id.*

economy of scales in policing and enforcing their intellectual property rights. As a result, it would be critical for antitrust authorities to consider the exact ramifications of such efficiencies when considering the merger. Efficiency is typically recognized as a significant positive in a merger and may serve to convince antitrust authorities that a merger may be positive for the economic landscape.⁴¹

IV. RECOMMENDATION

When two companies merge, antitrust authorities must regulate the merger and determine, based on the economic data before them, whether it will result in too great a reduction in competition. In this case, however, the two companies have a significant level of involvement in creating intangible products: characters. The only thing that can be clearly ascertained are the efficiencies gained by a merger of two such character-producing entities. As such, it becomes critical for the regulatory agencies to closely consider the exact ramifications of the merger, as the negative effects on competition are hard to quantify, and the positive effects are much clearer. However, it appears most likely that the approach delineated in the merger guidelines will not be sufficient to fully appraise this merger. This is a likely sign that the guidelines are not yet flexible enough to approach every type of industry and may require further revision.

V. CONCLUSION

The nature of intellectual property does not meld well with that of merger regulation. One requires a flexible approach that allows for close consideration of the facts in each case; the other approaches the world with an inflexible viewpoint that requires hard facts. Any time the two meet, difficulties arise. However, the specific realm of intellectual property focusing on multimedia, creative properties leads to even greater difficulties in analysis. Unlike technological intellectual property such as software, or technical plans, or other such products, characters have nearly limitless use. Furthermore, the markets are hard to define, because these characters can base themselves in a number of media that do not directly compete for the same end consumer. Characters further cannot be clearly defined,

⁴¹ See Alan A. Fisher & Robert H. Lande, *Efficiency Considerations in Merger Enforcement*, 71 CALIF. L. REV. 1582, 1582 (1983); 1984 MERGER GUIDELINES, *supra* note 12, at §4.24; 1997 MERGER GUIDELINES, *supra* note 17, at §4.

and the boundaries between copyrighted character and similar but legally-acceptable character are extremely blurry. These characteristics lead to an awkward fit between such a merger and the “ideal” merger implied by the merger guidelines. As a result, these transactions will undoubtedly be hard to regulate, and may well push for a revision of the guidelines to a more flexible approach.

PLUG THE LEAK: EMPLOYEE TURNOVER – A CONSEQUENCE OF DISCRIMINATORY BEHAVIOR?

AMANDA PINTARO

I. INTRODUCTION

What does employee turnover look like these days? Well, much like pouring liquid into a sieve, employees are passing through a company much too rapidly. According to the Bureau of Labor Statistics, which collects and compiles monthly data on a sampling of business establishments, the total number of employees who left their jobs exceeded those being hired from July 2008 through June 2009.¹ “Over the 12 months ending in June, hires totaled 51.8 million and separations totaled 57.1 million, yielding a net employment loss of 5.3 million.”² The increasing problem of employee turnover seems to revolve around two vital issues. Companies do not fully understand what causes employee turnover, and they do not know how to go about correcting the problem. This article will discuss: 1) the costs and causes of employee turnover; 2) the methods by which different companies have approached the problem; and 3) how excessive employee turnover can be a direct result of conscious or unconscious discriminatory behavior by employers.

II. FINANCIAL IMPACT OF EMPLOYEE TURNOVER

John McConnell, author of *Hunting Heads, How to Find and Keep the Best People*, describes employee turnover as the number of employees a company loses each year, whether they are asked to leave or not.³ Despite popular belief, employee turnover is not always negative.⁴ It tends to purge an organization of the inadequately skilled, less productive, and objectionable employees.⁵ In

¹ Press Release, BUREAU LAB. STAT., Job Openings and Labor Turnover Survey (Sept. 9, 2009) (on file with the U.S. DEP’T. LAB.) *available at* <http://www.bls.gov/news.release/jolts.htm>.

² *Id.*

³ JOHN H. MCCONNELL, HUNTING HEADS, HOW TO FIND AND KEEP THE BEST PEOPLE 20-23 (Kiplinger Washington Editors) (2000).

⁴ Not All Employee Turnover Is Bad- Celebrate “Losing the Losers,” <http://www.ere.net/2009/04/06/not-all-employee-turnover-is-bad-celebrate-losing-the-losers/> (last visited Sept. 18, 2009).

⁵ *Id.*

contrast, a company exhausts valuable time and resources in recruiting, interviewing, hiring, processing, orienting, and training new employees.⁶ A major study of the employee turnover dilemma within the supermarket industry estimated that the total cost of replacing a supermarket cashier earning \$6.50 per hour was a minimum of \$3,637.⁷ Consider the negative impact on the overall business profit for a supermarket having to replace several cashiers in any given fiscal period. In an attempt to address these concerns, many theories have been developed to analyze why employees leave.

III. CAUSES OF EMPLOYEE TURNOVER

According to Aubrey C. Daniels, Ph.D., an internationally recognized author, speaker and expert on management and human performance issues, “surveys consistently show that more than 40% of people who quit do so because they feel that they weren’t appreciated for their contributions.”⁸ More specifically, there are five important factors that can contribute to employees leaving their jobs. These factors consist of 1) incompetent managers, 2) lack of employee recognition, 3) scarcity of employee advancement and growth opportunities, 4) problems with employees balancing work and life issues, and the 5) erosion of trust between company, management, and employees.⁹ In response to these rationales, companies have employed a variety of methods to retain a greater percentage of employees.

IV. HOW COMPANIES HAVE MANAGED EMPLOYEE TURNOVER

Applebee’s International Incorporated has recently endeavored to deal with its employee turnover problem by instating a system in which managers play

⁶ Rod Hawkes, *Retaining Good Employees is Smart Marketing*, VEGETABLE PRODUCTION & MARKETING NEWS, Jan. 2001, available at <http://aggie-horticulture.tamu.edu/extension/newsletters/vpmnews/apr01/art3apr.html>.

⁷ *Id.*

⁸ Aubrey C. Daniels, *How to Prevent Employee Turnover*, ENTREPRENEUR, Apr. 7, 2003, <http://www.entrepreneur.com/humanresources/employeemanagementcolumnistdavidjavitch/article60740.html>.

⁹ Employee Retention: 5 Reasons That People Quit Their Jobs, <http://www.examiner.com/x-13521-SF-Workplace-Communication-Examiner~y2009m9d2-Employee-retention-5-reasons-people-quit-their-jobs> (last visited Sept. 18, 2009).

a significant role in reducing employee turnover.¹⁰ Applebee's managers have an opportunity to earn merit raises and bonuses based upon their successful contributions to employee retention.¹¹ This has inspired the restaurant managers to devise creative motivational techniques including point systems, prizes, and even ice cream desserts to encourage employee attendance.¹² Applebee's credits their system with successfully reducing employee turnover by nearly fifty percent within four years.¹³ This approach has alleviated the turnover crisis with monetary solutions and short term incentives. However, at some point, the novelty of receiving prizes and ice cream will eventually subside for those employees who have more important concerns.

In another unique approach, McDonald's Corporation is attempting to reduce their employee turnover by offering employees health care incentives and other employee benefits.¹⁴ After calculating that experienced employees and proficient managers could accrete as much as \$100,000 in additional annual sales and could potentially save \$10,000 in annual overhead costs, McDonald's restaurants began training their managers to tactically interview employees to determine what they value most about their jobs and suggestions they might have to improve them.¹⁵ Since health insurance coverage is considered so essential by job applicants, McDonald's restaurants across America are now offering employees' health insurance benefits at group rates, along with "computerized English-language classes and other life-enhancing skills that can be learned during breaks or after shifts," says Rich Floersch, the company's chief human-resources officer.¹⁶

Amongst all employment sectors, the government appears to manage employee turnover most efficiently. According to the Bureau of Labor Statistics, federal, state and local governments were the only sectors besides health care services that have seen more employee hires than employee separations from July 2008 to July 2009.¹⁷ This could be an ancillary consequence of the recent high unemployment rate and overall depressed economy or it may be attributed to the

¹⁰ Erin White, Editorial, *Theory & Practice: How to Reduce Turnover - Restaurant Chain Retains Workers Using Rankings and Rewards*, WALL ST. J., Nov. 21, 2005, at B5.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ Richard Gibson, Editorial, *Building Pride Into a "McJob,"* WALL ST. J., May 7, 2008, at B3C.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Press Release, BUREAU LAB. STAT., *supra* note 1.

way in which governments treat their employees. Governments acting as a role model have a foremost objective to respect their employees through compliance with the law. For example, the "Federal Retirement Thrift Investment Board" has established statutes to provide stock bonuses, pensions, and profit-sharing plans exclusively for those employed in government positions.¹⁸ Perhaps the government recognizes the importance employees place on such laws.

V. ROLE OF DISCRIMINATORY BEHAVIOR BY EMPLOYERS

Whether companies realize it or not, a significant portion of their employee turnover is, in all probability, a direct result of the conscious or unconscious discriminatory behavior by employers.¹⁹ In evidence of this, "every fiscal year since 2001, the Equal Employment Opportunity Commission (EEOC) has received more than 22,000 retaliation charges" says Donald Names, director of special staff services in the EEOC's Office of Federal Operations.²⁰ To make matters worse, this statistic is not comprehensive and does not incorporate all forms of discriminatory charges that the EEOC receives annually.

There are many forms of discriminatory behavior in the workplace that federal statutes are designed to curtail.²¹ Employees are protected in regards to the following characteristics: race or color, national origin, ancestry, sex and gender, sexual orientation, marital status, pregnancy, age, physical or mental disability, medical condition, and religion or military status.²² Some statutes protecting these aspects from discrimination include Title VII of the Civil Rights Act of 1964, Age Discriminating in Employment Act (ADEA) of 1967, Americans with Disabilities Act (ADA) of 1990, the Rehabilitation Act of 1973, and the Equal Pay Act (EPA) of 1963.²³ The EPA which bans wage discrimination between males and females performing the same job became the

¹⁸ See 26 U.S.C. § 401 (2000).

¹⁹ Hr411.com, Unconscious Discrimination: Could you be Guilty?, https://www.hr411.com/hr-tip/Unconscious-Discrimination-Could-you-be-Guilty%3F_68800 (last visited Sept. 15, 2009).

²⁰ David L. Hudson Jr. & Lawrence D. Rosenthal, Editorial, *Targeted at Work*, 31 LEGAL TIMES 7, Feb. 18, 2008.

²¹ Diskinlawfirm.com, Grounds by Which an Employer Discriminates, http://deskinlawfirm.com/grounds_by_which_an_employer_discriminates (last visited Sept. 18, 2009).

²² Hr411.com, *supra* note 19.

²³ Mike Scarcella, Editorial, *Size Matters in Wal-Mart Discrimination Case*, 32 LEGAL TIMES 13, Mar. 30, 2009.

subject of one of the largest discrimination lawsuits in United State's history, *Dukes v. Wal-Mart Stores*.²⁴

In the class action case filed in mid-2004 against Wal-Mart, 1.5 million current and former female Wal-Mart employees claimed that they suffered discrimination under the Equal Pay Act of 1963.²⁵ This employee class was sending a clear message that they felt less appreciated by their employer, one of the main reasons why employees leave a company, as previously suggested.²⁶

With massive amounts of EEOC claims flooding the courts, employers have to be particularly careful that they are not overlooking the rights of their employees.²⁷ Arkady Itkin, a California attorney specializing in employment law suggests there are five common, subtle and "circumstantial" ways in which employers engage in discrimination against employees.²⁸ They include: 1) applying the rules of discipline unequally, 2) stating untrue reasons for termination, 3) asking or reminding older employees about retirement plans, 4) not investigating complaints or allegations prior to terminating the accused employee, and 5) terminating an employee shortly after he has exercised his legal rights.²⁹ Whether intentional or not, these discriminatory behaviors could be contributing to employee turnover by causing employees to leave a company at or against their will.

Employment policies and practices are the foundation to creating an efficient company with "a productive and satisfied workforce."³⁰ There are an abundance of laws at federal, state and local levels that employers can utilize to their advantage not only to boost employee morale, but also to maintain legal compliance.³¹ For example, employers should actively review employee backgrounds to assess whether workers are eligible for insurance premiums and other benefits from programs such as ERISA, HIPAA, or COBRA.³² Companies can also educate their staff about discrimination and develop systematic policies

²⁴ *Id.*

²⁵ *Id.*

²⁶ Employee Retention: 5 Reasons That People Quit Their Jobs, *supra* note 9.

²⁷ Unconscious Discrimination: Could you be Guilty?, *supra* note 19.

²⁸ Posting of Arkady Itkin to Employment Law Firm Blog, http://www.sanfranciscoemploymentlawfirm.com/2009/07/how_employers_discriminate_and.html (July 15, 2009).

²⁹ *Id.*

³⁰ Hr411.com, *supra* note 19.

³¹ *Id.*

³² *Id.*

to address discipline and termination procedures.³³ The legal solutions are endless.

VI. CONCLUSION

The government provides the prototype to legal compliance and employee satisfaction within the workplace. Companies will continue to struggle with high employee turnover and other negative repercussions if they do not approach their employee needs from all perspectives, including the law. If companies fully understand the underpinnings of discrimination in the workplace and how they can alleviate this misdeed, perhaps, one day, companies will eventually plug the leak that drains from their organization their most valuable asset, their valued employees.

³³ *Id.*

THE IMPACT OF THE FINANCIAL CRISIS ON NONPROFITS

ZINA KIRYAKOS

I. INTRODUCTION

Nonprofits play an important role in the American economy, accounting for 5.2% of the domestic GDP and 8.3% of US wages and salaries.¹ At a time when most sectors of the American economy feel the pinch of the recession, the nonprofit sector's financial struggles should raise additional concerns for the US government, because of the increasing amount of Americans seeking assistance from the nonprofits. This article will detail some of the statistics regarding the financial struggles of the nonprofits during the current recession. Additionally this article offers insight into advice from the legal community regarding counseling such nonprofits. Finally, this article provides a recommendation and conclusion as to the steps that nonprofits should keep in mind while coping through the recession.

II. BACKGROUND

Nonprofits provide a variety of widely needed benefits in our communities, such as serving the needs of low-income neighborhoods, children, and providing additional educational resources. Several articles and surveys have discussed the impact of the financial crisis on the nonprofit sector.² One concern for nonprofits has come from the decline in donations from bank executives and other corporate executives.³ In 2007, banks were the second largest corporate

¹ Bonnie Erbe, *Nonprofits Escape Economic Slowdown*, U.S. NEWS & WORLD REP., Jan. 28, 2008, <http://www.usnews.com/blogs/erbe/2008/01/28/nonprofits-escape-economic-slowdown.html>.

² See Stephanie Strom, *Financial Safety Net of Nonprofit Organizations Is Fraying, Survey Finds*, N.Y. TIMES, Mar. 25, 2009, at A17, available at <http://www.nytimes.com/2009/03/26/us/26charity.html>; Dianne Walker, *5 Effects on Nonprofit Funding Due to Tough Economic Times*, EXAMINER, June 30, 2009, <http://www.examiner.com/x-12811-DC-Nonprofit-Business-Examiner~y2009m6d30-5-effects-on-nonprofit-funding-due-to-tough-economic-times>; GUIDESTAR USA, THE EFFECT OF THE ECONOMY ON THE NONPROFIT SECTOR (2009), <http://www2.guidestar.org/ViewCmsFile.aspx?ContentID=2319>.

³ Aili McConnon, *Wall Street's Financial Crisis Rocks Nonprofits*, BUSINESSWEEK, Sept. 25, 2008, available at <http://www.businessweek.com/>

donator to nonprofits.⁴ Now, since the recession, bank executives and corporate executives have contributed less resulting in fewer resources for the nonprofits.⁵ Adding further to the problem, the Nonprofit Finance Fund reported earlier in the year that out of 1,100 nonprofits surveyed on the effects of the economy to their organization, 93% of the organizations that provide essential services expected a 2009 increase in demand while 31% did not have more than a month's operating cash on hand.⁶

The National Council of Nonprofits reported similar results in a survey of 2,279 nonprofits.⁷ The survey indicated that while demand for services is increasing, nonprofits are facing escalating operating costs and decreasing revenues.⁸ The report highlighted the decrease in revenues from the five traditional sources of funding for nonprofits, specifically corporate donations, reduction in fees for services, the shrinking of the nonprofits' assets, the governments delay or nonpayment for services provided by the nonprofits, and the decline in individual contributions.⁹

The Johns Hopkins University compiled the *Listening Post Project*, a report of the recession's impact on 363 nonprofit organizations with a focus on the period of September 2008 thru March 2009.¹⁰ The report found that about 40% of the nonprofits surveyed as well as a third or more of child-serving and elderly-serving nonprofits indicated their fiscal stress to be "severe or very severe."¹¹ The majority of nonprofits facing the most difficulties are mid-sized organizations with revenues between \$500,000 and \$3 million.¹² However, the

magazine/content/08_40/b4102042668936.htm?chan=magazine+channel_news.

⁴ *Id.*

⁵ *Id.*

⁶ *Nonprofit Finance Fund Survey: America's Nonprofits in Danger*, NONPROFIT FIN. FUND, Apr. 2009, <http://www.nonprofitfinancefund.org/content.php?autoID=166>.

⁷ *Id.*

⁸ National Council of Nonprofits, *A Respectful Warning Call To Our Partners In Government: The Economic Crisis Is Unraveling The Social Safety Net Faster Than Most Realize* (2009), <http://www.councilofnonprofits.org/?q=specialreport8>.

⁹ *Id.* at 2.

¹⁰ JOHNS HOPKINS UNIVERSITY CENTER FOR CIVIL SOCIETY STUDIES LISTENING POST PROJECT, COMMUNIQUÉ NO. 14 IMPACT OF THE 2007-2009 ECONOMIC RECESSION ON NONPROFIT ORGANIZATIONS (2009), http://www.ccss.jhu.edu/pdfs/LP_Communiques/LP_Communique_14.pdf.

¹¹ *Id.* at 1.

¹² *Id.* at 4.

report also found that due to the steps the nonprofits were taking to reduce the financial impact on their organizations, a substantial portion of them indicated a good financial performance even after months of the recession.¹³ Another sign of the nonprofits' resilience appears in the Midwest as Michigan nonprofits, although facing a heavier stress of financial difficulties than other nonprofits surveyed, were able to cope and increase their services to their patrons to a larger measure than their counterparts.¹⁴

Overall, the statistics indicate that the ever-growing requests for services from their patronage are weighing heavily on the nonprofits resources, which are further exacerbated by the reduction in donations and government spending.

III. ANALYSIS

In this section, I will analyze some of the methods nonprofits are using in order to cope with the recession, as well as review the advice that attorneys are recommending for nonprofit clients that are on the brink of closing their doors.

The practices of reducing staff and cutting programs are typically the most common way of cost saving initiatives.¹⁵ Nonprofits are creatively finding new ways to cope with the financial crisis, such as partnering with other nonprofits, and attracting new individual donors.¹⁶ The National Council of Nonprofits provided several additional tips in a report released August 10, 2009.¹⁷ The tips include "staying close to funders."¹⁸ In essence the nonprofits need to make their donors aware of their financial situation and the steps they are taking to manage the issues.¹⁹ Additionally, the National Council of Nonprofits recommends reducing travel and professional development costs while exploring new ways to develop the training of the nonprofits' staff in a more cost effective manner.²⁰

Many of the larger nonprofits have an array of attorneys to consult with them as to the legal ramifications of failing to meet their obligations to creditors or their employees or which paths to take considering the state of their balance

¹³ *Id.* at 22.

¹⁴ *Id.* at 11-12.

¹⁵ NATIONAL COUNCIL OF NONPROFITS, STRATEGIES BEING USED BY NONPROFIT LEADERS TO COPE WITH THE NATION'S ECONOMIC CRISIS (2009), <http://www.councilofnonprofits.org/?q=specialreport9>

¹⁶ *Id.* at 2.

¹⁷ *Id.* at 2-5.

¹⁸ *Id.* at 2.

¹⁹ *Id.*

²⁰ *Id.* at 4.

sheet.²¹ However, many attorneys are faced with counseling the smaller nonprofits that already have a tight budget and not much access to legal counseling.²² Usually for smaller nonprofits, that will avoid the legal costs of counsel, they seek advice when they are on the brink of closing their doors.²³

According to *Business Law Today*, attorneys should make sure the nonprofits are aware of the consequences of filing for bankruptcy petition as well as fully understand the nonprofits' financial position to determine if filing the petition is the best path.²⁴ As with any other type of commercial counseling, the attorney needs to understand the many facets of the nonprofits' organization in order to provide a thorough legal opinion.²⁵ Further steps in counseling a nonprofit include determining what the assets and liabilities of the nonprofit are and the outlook for future donations.²⁶ These determinations allow the attorney to make the necessary recommendations as to bankruptcy or selling assets of the nonprofit or various alternative measures in order to keep the nonprofits' doors open.²⁷ Additionally for many nonprofits no further additional legal steps may be necessary past an initial counseling session with an attorney, which should relieve some stress on their budgets.²⁸

IV. RECOMMENDATION

Nonprofits as with other struggling sectors of the economy need to reassess where they can best reduce costs while serving the community's needs with the same mindset and business ingenuity of a "for profit" corporation. Taking steps such as merging with other nonprofits or creatively outreaching towards individual donors may be the best way to ensure the doors stay open and the people are served.

In regard to legal counseling, nonprofits should have a good idea of their financial position and think about the possible options for recovery prior to seeking counsel. Nonprofits should keep an open-mind regarding the options that they are provided by the attorney, and try to seek out attorneys that are willing to counsel them on a pro bono basis.

²¹ Shelly Crocker, *Counseling the Nonprofit Debtor in Financial Stress*, BUS. L. TODAY, Aug. 18, 2009, at 21.

²² *Id.*

²³ *Id.*

²⁴ *Id.* at 22-23.

²⁵ *Id.* at 23.

²⁶ *Id.*

²⁷ *Id.* at 22.

²⁸ *Id.* at 24.

V. CONCLUSION

As with all aspects of the economy the nonprofit sector has been impacted by the current financial crisis. The key to surviving the challenging times will require a focus on keeping the needs of the patronage in mind and creating new ways to cope with the financial stress. In sum, the difficulties facing the nonprofit sector has led to another area of the law in which legal assistance is required to assist our economy in rebounding from the financial crisis.

THE SKINNY ON TAXING FATTY FOODS

HENRY YOUNG

I. INTRODUCTION

In case you have not read a newspaper, surfed the internet, or been outside your home recently, there is an obesity epidemic in the United States.¹ Search Google News for “obesity epidemic” and one will find about seven hundred stories in the last month.² Not to dwell on the prevalence of obesity, but according to the Centers for Disease Control and Prevention (CDC) in 2005-2006 “more than one-third of adults, or seventy-two million people [in the United States] were obese;” a number which had “doubled among adults from 1980 to 2004” and which has not decreased since.³

They say the first step to solving a problem is admitting one has one; America we have a problem. But simply admitting a problem exists does not necessarily mean it should be the government’s job to alleviate the problem. Even if it was the government’s job to alleviate the problem, taxing unhealthy foods⁴ may not be a possible or preferable solution. To understand the situation it

¹ The Centers for Disease Control and Prevention define overweight as adults with Body Mass Index between 25.0-29.9 and obese as a BMI 30.0 and over. For example, a man who is 5’9” tall would be in the “healthy weight” range if he weighed 125-168, “overweight” if he weighed 169-202, and “obese” if he weighed more than 202 lbs. See Centers for Disease Control and Prevention, *Defining Overweight and Obesity*, Aug. 19, 2009, <http://www.cdc.gov/obesity/defining.html>.

² Google News, www.google.com (last visited Sept. 9, 2009) (using search term “obesity epidemic”). The term “obesity” returned 10,946 results. *Id.*

³ CENTERS FOR DISEASE CONTROL AND PREVENTION, *OBESITY AMONG ADULTS IN THE UNITED STATES – NO STATISTICALLY SIGNIFICANT CHANGE SINCE 2003-2004* (2007), <http://www.cdc.gov/nchs/data/databriefs/db01.pdf>.

⁴ What constitutes “unhealthy foods” is beyond the scope of this article. However, a number of policy proposals have been made including only taxing sugared drinks. See Peter Moore, *President Obama has a Health Plan for America*, MEN’S HEALTH, Sept. 2009, available at <http://www.menshealth.com/cda/article.do?site=MensHealth&channel=health&category=doctors.hospitals&conitem=72387ea369683210VgnVCM10000030281ea>; see Heather Knight, *Newsom Wants to Charge Stores that Sell Soda*, SAN FRANCISCO CHRONICLE, Sept. 18, 2009, available at <http://www.sfgate.com/cgi->

is helpful to briefly look at the history of “Pigouvian” taxes, that is, taxes levied to correct an oversupply of a good or service that has negative externalities, and then examine whether obesity is a good candidate to be attacked with such a tax.

II. PIGOUVIAN TAXES

Pigouvian taxes are used to correct markets when the consumer of a good does not pay the true cost of the good, which is to say, externalities exist. An externality is simply a consequence of one’s economic activity that causes “another to benefit with our paying or suffer without compensation.”⁵

In the case of unhealthy food, the consumer pays for the good, its packaging, its marketing and many other things, but he does not pay for the additional health care costs that eating such foods levy on other tax payers, through publicly funded health insurance, or his coworkers, through increased insurance premiums.

III. HAVE PIGOUVIAN TAXES BEEN EFFECTIVE IN THE PAST?

The most common example of a successful Pigouvian tax is cigarettes. In 1965 42.5 percent of Americans smoked but by 2007 only 19.8 percent did.⁶ To be sure, Americans in 2000 have a better understanding of the health consequences of smoking. As well, other public policies, such as banning smoking in public places and limiting advertising, make it impossible to say how much tax policy affected the decrease in smoking and how much other public policies did. However, most people are comfortable saying that taxing cigarettes, at the very least, contributed to the decline in the number of people who smoke and how often the average smoker lights up.

bin/article.cgi?f=/c/a/2009/09/17/MNF619OSF4.DTL. A second option would be taxing foods which are below a certain level on the Rayner Scale – a model which balances a food’s nutritionally risk elements such as calories, fat, and sugar with its beneficial elements. See CAROLYN L. ENGLEHARD ET AL., REDUCING OBESITY: POLICY STRATEGIES FROM THE TOBACCO WAR 13 (Urban Institute 2009), available at http://www.urban.org/UploadedPDF/411926_reducing_obesity.pdf. A third option would be using a something akin to the Rayner model, but not the Rayner model. *Id.*

⁵ BLACK’S LAW DICTIONARY (8th ed. 2004).

⁶ Centers for Disease Control and Prevention, Trends in Current Cigarette Smoking Among High School Students and Adults, United States, 1965-2007, 2008, http://www.cdc.gov/tobacco/data_statistics/tables/trends/cig_smoking/index.htm.

Like the cause of the decline in smoking, the question of whether taxing unhealthy foods will be as effective as taxing cigarettes is complicated. To judge the possible effectiveness of taxes one has to first define success. One definition is increasing the health of American citizens. A second definition is a more accurate allocation of the costs of eating unhealthy food. These two definitions of success need not be mutually exclusive.

A. Healthier Citizens

If a healthier citizenry is what is sought the usefulness of taxing fatty foods is questionable. A ten percent tax is associated with only a .22 decline in body mass index (BMI) within two years, though in twenty or thirty years a person's BMI might decrease one to two points.⁷ It would be naïve to think the tax code could quickly affect something as fundamental as what Americans eat, how much Americans eat, and how frequently Americans eat. In the case of cigarettes, it took more than a generation to reduce the number of smokers from about forty percent to about twenty percent, but those changes occurred. There is hope.

Additionally, as the Urban Institute study points out, there are important similarities and between cigarettes and food.⁸ Some similarities include increased risk of chronic disease and premature death, as well as industry action including aggressive marketing campaigns and additives that trigger “hard-to-control cravings that increase consumption of fattening food, in some cases using the same neurological pathways involved with substance abuse and other classically addictive behaviors.”⁹ Conversely, the differences between cigarettes and fattening foods include the fact that some unhealthy foods do provide more than a trivial amount of nutrition and that exercise can reverse the overconsumption of unhealthy food.

Finally, food plays an immeasurable role in our overall health. As the health care debate continues in Washington, some point out that insuring more people and doing so more efficiently, without changing what we put into our bodies will be a fruitless strategy if we seek to improve our health and slow the rising cost of care.¹⁰

⁷ *Waist Banned*, THE ECONOMIST, Aug. 1, 2009.

⁸ ENGLEHARD, *supra* note 4, at 10.

⁹ *Id.*

¹⁰ Mike Pollan, *Big Food vs. Big Insurance*, N.Y. TIMES, Sept. 9, 2009, available at http://www.nytimes.com/2009/09/10/opinion/10pollan.html?pagewanted=2&_r=1.

B. Fair(er) Distribution of Health Care Costs Associated with Overweight and Obesity

A second measure of success for taxing unhealthy foods would be a fairer distribution of the cost of consuming such foods. Because the added cost of health care may escape the cost of a Quarter Pounder with Cheese, some argue that it makes sense to levy a tax to reduce the gap between the “true” cost (that is, the cost of the burger and the increased cost of care) and the price on the menu. For starters, overweight and obesity cost tax payers money, a lot of money. The CDC estimated that in 1998 the cost of overweight and obesity to be between 51.5 and 78.5 billion dollars.¹¹ The Urban Institute estimates tax payers directly pay one hundred billion dollars annually due to overweight and obesity.¹² But there are indirect costs as well. According to a recent study, more than a quarter of the per capita inflation adjusted rise in the cost of health care between 1987 and 2001 can be attributed to the obese.¹³ Furthermore, non-obese workers pay more than a quarter billion dollars extra in private insurance premiums because of their co-workers obesity.¹⁴ It seems that one who consumes more of a good, in this case healthcare, should be asked to pay his fair share.

IV. WILL A TAX ON UNHEALTHY FOODS HELP SOLVE EITHER OF THESE PROBLEMS?

Despite the fact that Americans weigh more than ever and the above suggestions that eating unhealthy foods are to blame for this outcome, the problem is not so simple. For starters, whether a person exercises has an effect on his health. Presumably a tri-athlete who eats fast food regularly does not pass health care costs on to his neighbors. Additionally, it has been suggested that eating unhealthy foods is itself a symptom of a change in food culture in the United States (and some of these changes were precipitated by government

¹¹ Centers for Disease Control and Prevention, *Aggregate Medical Spending, in Billions of Dollars, Attributable to Overweight and Obesity, by Insurance States and Data Source, 1996-1998, 2003*, <http://www.cdc.gov/obesity/causes/economics.html>.

¹² ENGLEHARD, *supra* note 4.

¹³ Kenneth E. Thorpe et al., *The Impact of Obesity on Rising Medical Spending*, HEALTH AFFAIRS, 2004, at 481, *available at* <http://content.healthaffairs.org/cgi/reprint/hlthaff.w4.480v1>.

¹⁴ ENGLEHARD, *supra* note 4, at 10.

intervention in the market in the first place).¹⁵ Another worry is the prevalence of “food deserts” which are “often urban residential areas with no grocery stores and where food-buying options are limited to fast food and convenience stores.”¹⁶ Finally, some reject the problem of overweight and obesity concluding that “our attitudes about fatness have much more to do with our concerns about social status, race, and sex than they do with health.”¹⁷ By ignoring the many opportunities to stop the possible negative health and financial consequences between ingestion and outcome, one would certainly be simplifying the problem. But with a problem as complicated as eating habits some simplification may be necessary.

Despite the complexity of American lifestyles, the government creating incentives for Americans to make better choices is not a bad idea. A Pigouvian tax would not disallow unhealthy foods from being made, marketed or consumed. Rather taxing unhealthy foods would nudge people to make better choices about what to consume more frequently. Furthermore, it is hard to argue that non-obese Americans should subsidize the diets of consumers of unhealthy foods through higher taxes and insurance premiums. Taxing a Whopper would make its price more accurately reflect its true cost.

At some point everyone is responsible for his own choices and the outcomes they lead to. But in the case of unhealthy food, one’s choices increase the costs to other people. It only seems fair that we allocate those costs to the people who incur them. Inviting Uncle Sam to the dinner table might seem like an overreaction, but obesity is an epidemic, and a better solution has yet to be offered.

¹⁵ MIKE POLLAN, *IN DEFENSE OF FOOD: AN EATERS MANIFESTO* (Penguin Books 2009).

¹⁶ Emily S. Achenbaum, *Food Desert Seeks Relief*, CHICAGO TRIBUNE, Sept. 1, 2008, at C3.

¹⁷ ERIC J. OLIVER, *FAT POLITICS: THE REAL STORY BEHIND AMERICA’S OBESITY EPIDEMIC* 15 (Oxford University Press 2006).

SHOULD CHEERLEADING BE A SPORT?

HELENA VARNAVAS

I. INTRODUCTION

There is an ongoing debate among the media and cheer world as to whether or not cheerleading should be recognized as a sport under Title IX.¹ A recent poll found that 60% of people thought cheerleading was a sport, while 35% did not.² Cheerleaders sometimes argue for this classification because “it takes just as much dedication and skill as any other sport.”³ Opponents argue that because the primary function of cheerleading is not competition, it does not meet the qualifications of a sport.⁴ The answer to this debate depends on your definition of a sport.⁵ The NCAA, the U.S. Department of Education’s Office for Civil Rights (OCR) and the Women’s Sports Foundation (WSF) all have their own definition of “sport” that a competitive cheerleading squad could possibly qualify under.⁶

¹ Laura Grindstaff, Emily West. (2006). *Cheerleading and the Gendered Politics of Sport*. *Social Problems*, 53(4), 500-518. Retrieved April 23, 2009, from ABI/INFORM Global database. (Document ID: 1180194901).

² *Is Cheerleading a Sport?*, ABOUT.COM, http://cheerleading.about.com/gi/pages/poll.htm?linkback=&poll_id=5769754306&poll=3&submit1=Submit+Vote (last visited Sept. 16, 2009).

³ Lauren Elizabeth White, *Cheerleading: Is it a Sport?*, Apr. 4, 2005, http://www.associatedcontent.com/article/944/cheerleading_is_it_a_sport.html?cat=14.

⁴ *Cheerleading as a Sport*, AMERICAN ASSOCIATION OF CHEERLEADING COACHES AND ADMINISTRATORS, <http://www.aacca.org/content.aspx?item=Resources/Test.xml> (last visited Sept. 16, 2009).

⁵ Marc Edelman, *Sports and the Law: Can Sports ‘Cheer’ Their Way into Title IX Compliance?*, ABOVE THE LAW, Feb. 4, 2009, http://www.abovethelaw.com/2009/02/sports_and_the_law_making_chee.php.

⁶ Rebecca Boyce, *Cheerleading in the Context of Title IX and Gendering in Sport*, UNITED STATES SPORTS ACADEMY, 2009, available at <http://www.thesportjournal.org/article/cheerleading-context-title-ix-and-gendering-sport>.

The question also brings up other issues that would need to be addressed. Cheerleading is an estimated half-billion dollar industry,⁷ and an underlying problem to solving this debate stems from national for-profit cheerleading associations that would prefer cheerleading to remain an “athletic activity” for financially-based reasons.⁸ There is also speculation of educational institutions upgrading cheer squads to varsity status in order to save money off of traditionally more expensive women’s sports.⁹ Cheerleading’s classification as a sport under Title IX may also influence courts’ decisions regarding liability issues arising from cheerleading injuries.¹⁰ This paper will discuss whether or not cheerleading should be sport and why it depends on if you are in favor of more regulated competitive cheerleading program governed by educational institutions or a less competitive self-regulated cheerleading program.

II. CHEERLEADING AS A SPORT UNDER TITLE IX

Approximately half of the states in the U.S. have already recognized high school cheerleading under Title IX.¹¹ Cheerleading has grown significantly in popularity among women, almost 25%, since 2000.¹² Cheerleading’s largest barrier to achieving Title IX status nationwide seems to be its inferior status as a second-rate sport to others that are more traditionally known.¹³ Raising a woman’s cheerleading club status to that of a varsity sport is the easiest way a school can comply with Title IX.¹⁴ A cheerleader that wants their club to be a

⁷*Cheerleading: Controversy and Competition*, ABOUT.COM, <http://cheerleading.about.com/od/cheerinjuries/l/aa103102a.htm> (last visited Sept. 16, 2009).

⁸*Cheerleading as a Sport*, *supra* note 4.

⁹David Moltz, *But I’m an Athlete*, INSIDE HIGHER ED, June 30, 2009, <http://www.insidehighered.com/news/2009/06/30/cheer>.

¹⁰17 J. LEGAL ASPECTS OF SPORT 213, Mary Virginia Moore Johnson & Beth A. Easter, *Legal Liability for Cheerleading Injuries: Implications for Universities and Coaches*.

¹¹Boyce, *supra* note 6.

¹²*Sanctioned Team Sports Play*, SGMA, Oct. 2, 2008, http://www.sgma.com/press/93_Sanctioned-Team-Sports-Play-In-the-US-Remains-Strong,-But...

¹³Dennis Dodd, *Colleges giving cheerleading a sporting chance*, CBS SPORTS, June 11, 2004, <http://www.cbssports.com/print/collegefootball/story/7412313>.

¹⁴GLESS M. WONG, *ESSENTIALS OF AMATEUR SPORTS LAW* 547, Second Edition (1994).

sport would need to show the school was out of Title IX compliance and raising their status to a varsity sport would constitute compliance.¹⁵ Determinations of whether cheerleading is a sport needs to be made on a case-by-case basis, beginning with whether the competitive squad meets the qualifications under the definitions traditionally used to make that determination.¹⁶ The way in which Title IX applies to cheerleading usually depends on whether the educational institution defines it as a sport or an extracurricular activity.¹⁷ Common authorities on the definition of “sport” are the OCR, the WSF and the NCAA.

A. OCR’s Definition of “Sport”

The OCR’s criteria are as follows: The OCR’s criteria are as follows: (1) athletic ability; (2) athletic competition; (3) preparation similar to other athletic teams; (4) multi-level championship competitions; and (5) administration by an athletics department.¹⁸ If a cheerleading squad selects its members according to their athletic ability, makes it their primary purpose to compete against other squads, prepares for competitions like other sports, competes in regional championships and allows their athletic department to administer their activity, then it seems like cheerleading may easily qualify as a sport under the OCR’s definition.¹⁹ Because the OCR’s definition requires squads to make it their primary purpose that they compete against other teams,²⁰ cheerleading clubs that traditionally cheered for other sports might not be able to do so anymore if they’re trying to achieve varsity sport status.²¹ The OCR’s definition does not exclude sideline cheering,²² but it would be to a squad’s detriment if they still engaged in cheering for other sports.²³

¹⁵ *Id.*

¹⁶ Edelman, *supra* note 5.

¹⁷ *Id.* at 2.

¹⁸ April Hennefer, *Dance and Cheerleading as Competitive Sports: Making a Case for OCR Sport Recognition and NCAA Emerging Sport Designation*, Aug. 2003, available at http://www.eric.ed.gov/ERICDocs/data/ericdocs2sql/content_storage_01/0000019b/80/1b/51/91.pdf.

¹⁹ *Id.*

²⁰ Hennefer, *supra* note 18.

²¹ Steven E. Rhoads, *Sports, Sex, at Title IX*, 2004, http://findarticles.com/p/articles/mi_m0377/is_154/ai_n6062432/pg_5/.

²² Hennefer, *supra* note 18.

²³ Boyce, *supra* note 6.

B. WSF's Definition of "Sport"

The WSF's definition of a sport is: (1) physical activity involving mass resistance; (2) against/with an opponent; (3) governing rules; and (4) skill-based competition.²⁴ Cheerleaders compete against other squads and function under the regulations of the NCAA.²⁵ As long as cheer squads in pursuit of becoming a varsity sport make it their primary purpose to compete against other similar squads, they should qualify under the Women's Sports Foundation's definition as well.²⁶ Currently, the WSF has found that cheerleading is not a sport because their purpose is not to compete and "most competitions are not structured like school sport competitions."²⁷ By assuming that all cheerleading squads have the same purpose, WSF has not allowed room for judgments to be made on a case-by-case basis.²⁸

C. NCAA's Definition of "Sport"

For purposes of reviewing emerging sports, a sport is defined by the NCAA as: (1) An institutional activity involving physical exertion with the purpose of competition within a collegiate competition structure;²⁹ (2) at least five regularly scheduled competitions within a season; and (3) standardized rules with official rating/scoring systems.³⁰ Many educational institutions choose not to elevate their cheerleading clubs to the level of varsity sport because they do not want

²⁴ Hennefer, *supra* note 18.

²⁵ American Association of Cheerleading Coaches and Administrators, *CBS Story Deceives the Public*, <http://www.aacca.org/content.aspx?item=News/Featured%20Test3.xml> (last visited Sept. 16, 2009).

²⁶ Boyce, *supra* note 6.

²⁷ J. Brad Reich, *All the [Athletes] Are Equal, but Some Are More Equal than Others: An Objective Evaluation of Title IX's Past, Present, and Recommendations for Its Future*, 108 Penn St. L. Rev. 525.

²⁸ Edelman, *supra* note 5.

²⁹ *Id.*

³⁰ *Id.*

increased regulations imposed by the NCAA,³¹ nor do many schools want to phase out the non-competitive sideline activities of cheerleaders altogether.³² Although the NCAA does not recognize cheerleading as a sport, “an estimated 225 junior and four-year colleges award some kind of cheerleading scholarships.”³³ Cheerleaders can practice and compete more hours a week than other sports because they are not recognized as a varsity sport by the NCAA, which requires no more than twenty hours of practice per week.³⁴ Cheerleaders are not forced to follow requirements such as mandatory physical examinations, collegiate participation past four years or only practicing certain times of the year.³⁵ These risk factors increase their chances of injuries,³⁶ and leave educational institutions susceptible to negligence litigation depending on the cheerleading stance of the court.³⁷ Educational institutions that unintentionally or recklessly create risks outside of the ordinary activities related to cheerleading may not be able to claim that the cheerleaders assumed the risks of the dangerous athletic activity.³⁸

III. LIABILITY ISSUES ARISING FROM CHEERLEADING INJURIES

High school and college cheerleading accounted for 57% of catastrophic injuries and direct fatalities in U.S. female students from 1982-1997.³⁹ From

³¹ Beth Rosenberg, *Competitive cheerleaders stand up and holler to be varsity*, NCAA, Oct. 27, 2003, <http://ncaa-wcmrun.ncaa.org:9081/wps/wcm/connect/NCAA/NCAA+News/NCAA+News+Online/2003/Association-wide/Competitive+cheerleaders+stand+up+and+holler+to+be+varsity+-+10-27-03>.

³² Grindstaff, *supra* note 1 at 6.

³³ Dodd, *supra* note 13.

³⁴ Jennifer Allen, *The Athlete on the Sidelines*, NATIONAL ASSOCIATION OF COLLEGIATE WOMEN ATHLETICS ADMINISTRATORS, Feb. 20, 2004, http://www.nacwaa.org/rc/rc_articlepr_sidelines.php.

³⁵ *How to Be a College Cheerleader*, College Sports Scholarships, <http://www.collegesportsscholarships.com/scholarship-news-cheerleading.htm> (last visited Sept. 16, 2009).

³⁶ Allen, *supra* note 34.

³⁷ Annotation, *Liability of School or School Personnel for Injury to Student Resulting From Cheerleader Activities*, 25 A.L.R.5th 784, 3a (2009).

³⁸ Mary Virginia Moore Johnson & Beth A. Ester, *Legal Liability for Cheerleading Injuries: Implications for Universities and Coaches*, 17 J. Legal Aspects Of Sport 214.

³⁹ *Id.*

1982 to 1992, partner stunts caused 41.9% of college cheerleading injuries and gymnastic routines accounted for 20.5%.⁴⁰ In 1995, the Consumer Product Safety Commission data found that, “an estimate of 16,982 cheerleading injuries involved an individual going to a hospital emergency room.”⁴¹ Most female cheerleaders have had at least one injury in their cheerleading careers.⁴² A university will either take a hands-off approach that views their cheerleading squad as a club or a full-service approach that organizes cheerleading like an athletic team by providing coaches, safety training and regulations.⁴³ This is why a sport classification would mean so much for liability purposes.

A. Assumption of Risk

Although courts generally hold that cheerleaders assume the risk of injuries while cheerleading, this assumption may not completely bar them from recovery.⁴⁴ However, some courts still find that since there is a high and definite risk of physical harm involved, a school does not owe a duty to cheerleaders to provide adult supervision and monitor their activities.⁴⁵ To build a case for assumption of risk, educational institutions often use exculpatory clauses to shield themselves against future negligence liability that may arise in the course of cheerleading.⁴⁶ These clauses may appear in the form of a warning, waiver or release that a cheerleader must sign in order to engage in cheerleading activities.⁴⁷

B. Duty of Care

If a duty of care exists, injuries caused by cheerleading may be a result of negligence.⁴⁸ Most courts have agreed with juries that, “schools owe a duty to provide its student cheerleaders with adequate supervision, training, and coaching

⁴⁰ *Id.* at 213.

⁴¹ FREDERICK O. MUELLER, CHEERLEADING AND THE LAW: RISK MANAGEMENT STRATEGIES, 431 (2008)

⁴² Brenda J. Shields, *Cheerleading-Related Injuries to Children 5 to 18 Years of Age: United States, 1990-2002*, OFFICIAL JOURNAL OF THE AMERICAN ACADEMY OF PEDIATRICS, Jan. 2006, available at <http://pediatrics.aappublications.org/cgi/content/short/117/1/122>.

⁴³ Johnson & Ester, *supra* note 38.

⁴⁴ Annotation, *supra* note 37.

⁴⁵ Fisher v Northwestern State Univ., 624 So. 2d 1308 (La App. 3d Cir. 1993).

⁴⁶ Johnson & Ester, *supra* note 38.

⁴⁷ WALTER CHAMPION, FUNDAMENTALS OF SPORTS LAW, 13 (2008).

⁴⁸ *Id.*

for its student cheerleaders.”⁴⁹ University administrators must be aware of any factors that may constitute a special relationship between the university and its cheerleaders.”⁵⁰ If there is a mutual benefit to both parties, a court may find a special relationship exists between the parties that designate a duty of care by the educational institution.⁵¹

C. Governmental Immunity

Some courts have statutes that provide them immunity from “negligence actions for participants in a recreational activity that involves physical contact between persons in a sport involving amateur teams.”⁵² The Wisconsin Supreme Court held on January 27, 2009 that cheerleading is a contact sport, and as such they are “immune from negligence actions under *Wis. Stat.* § 895.525(4m)(a) (2005-06) because they participate in a recreational activity that includes physical contact between persons in a sport involving amateur teams.”⁵³ The Wisconsin Supreme Court defined “sport” as “an activity involving physical exertion and skill that is governed by a set of rules or customs”⁵⁴ According to the National Cheer Foundation, “this is the first decision of its kind in the nation.”⁵⁵ This ruling also meant that coaches and school districts may not be sued for lack of supervision.⁵⁶ If more courts agree with the Wisconsin Supreme Court and adopt their contact sport rule, cheerleaders may need to take out insurance policies to guard themselves against future injuries.⁵⁷

IV. CHEERLEADING IS BIG BUSINESS

It would be to the largest cheerleading governing institutions’ detriment for cheerleading to be classified as a sport under Title IX.⁵⁸ These associations

⁴⁹ Annotation, *supra* note 37.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Wis. Stat.* § 895.525.

⁵³ *Noffke v. Bakke*, No. 2006AP1886, 2009 WI 10 (Wis. 2009).

⁵⁴ *Id.*

⁵⁵ *Cheerleading is a Contact Sport*, *Wisc. Court rules*, NBC SPORTS, Jan. 27, 2009, <http://nbcsports.msnbc.com/id/28879229/print/1/displaymode/1098>.

⁵⁶ *Wisconsin Court: Cheerleading a Contact Sport, Participants Can’t Be Sued for Accidental Injury*, FOX NEWS, Jan. 27, 2009, available at http://foxnews.com/printer_friendly_story/0,3566,483704,00.html.

⁵⁷ *Id.*

⁵⁸ Moltz, *supra* note 9.

make their money from merchandise sales, cheer camps and privately run competitions.⁵⁹ “Cheerleading is big, serious business, right down to the network of state, regional and national cheerleading competitions the two big companies hold each year.”⁶⁰ If educational institutions were given the power to govern cheerleading, these private for-profit organizations would lose a lot of money.⁶¹ Varsity Spirit, the largest cheerleading company, made almost 150 million dollars in revenue in 2001.⁶² Recent movies such as *Bring it On* have heightened interest in cheerleading, along with the *Dallas Cowboy Cheerleaders* reality television show series.⁶³ Privately owned institutions have no reason to push for cheerleading to be classified as a sport if it’s going to cut into their revenues.⁶⁴

V. CONCLUSION

Whether cheerleading should be classified as a sport should vary on a case-by-case basis for those squads that deem competitions more important than “raising school unity through leading the crowd at athletic functions.”⁶⁵ It is possible for cheerleaders to fulfill the qualifications of commonly used and accepted “sport” definitions, but it’s unclear whether cheerleaders themselves actually want this to happen. If more educational institutions qualify their cheerleading squads for sport status, the cheerleaders themselves would be better regulated under safety guidelines,⁶⁶ injuries would most likely decrease,⁶⁷ and

⁵⁹ *Id.*

⁶⁰ Sonja Steptoe, *Cheerleading has become a big and serious business, which isn't anything to cheer about*, SPORTS ILLUSTRATED, Dec. 30, 1991, <http://sportsillustrated.cnn.com/vault/article/magazine/MAG1140041/1/index.htm>.

⁶¹ Moltz, *supra* note 9.

⁶² Eric Brady, *Cheerleading in the USA: A Sport and an Industry*, USA TODAY, Apr. 26, 2002, http://www.usatoday.com/sports/_stories/2002-04-26-cheerleading-cover.htm.

⁶³ Orlan Ree, *Dallas Cowboys Cheerleaders Bid Farewell To 2008 Season*, DALLASCOWBOYS-CHEERLEADERS.COM, May 20, 2009, http://www.dallascowboyscheerleaders.com/news/news_detail.cfm?id=5EF24DED-DC7B-296A-617E59FC27D41427.

⁶⁴ Moltz, *supra* note 9.

⁶⁵ *Cheerleading as a Sport*, *supra* note 4.

⁶⁶ *Cheerleading Truth Hurts*, THE DOCTORS, Jan. 14, 2009, <http://www.thedoctorstv.com/forums/85-January-14-2-9-Cheer-Dangers/topics/2949?page=1>.

women would have a greater chance to compete participate in a varsity sport at their respective institutions.⁶⁸ Although these are important concerns for cheerleaders nationwide, the for-profit cheerleading governing institutions have too much influence over the cheerleading world for there to be a push towards a more school-regulated sport classification for cheerleading.

⁶⁷ Barbara Pytel, *How to Reduce Cheerleading Injuries; This High School Activity Has Little to no Regulation*, SUITE 101, Dec. 26, 2008, http://student-health-issues.suite101.com/article.cfm/how_to_reduce_cheerleading_injuries.

⁶⁸ Doug Bonham, *Ducks pushing the envelope with cheer*, DAILY EMERALD, July 18, 2007, http://www.dailyemerald.com/home/index.cfm?event=displayArticle&ustory_id=2bba867d-e101-472c-abfd-b2299c577572.

NO STARTS, NO STATS, NO PROBLEM

PAUL WHITEHAIR

I. INTRODUCTION

Virtually everyone has looked for a job and found that they just did not meet the previous experience requirements laid out in the description. The salary looks great, but you may not have three to five years of Big Four accounting experience. Society generally rewards those that have been through the rigors of the profession before. However, the growing trend in the NFL is to hand over bags of money to college athletes who have not yet played a snap in the NFL or faced the challenge of competing against the world's best.¹ The NFL does have a rookie salary cap in place, with a pool of money allotted to each team stating how much it can spend on salaries.² However, guaranteed money and signing bonuses have allowed teams to continue to shell out more and more money for their new "face of the franchise," and still miraculously stay under the salary cap.³ Is there hope for resolution before the uncapped year and potential future lockout? This article will discuss the problems with the current system in the NFL as well as potential resolutions that would benefit the NFL, current players and fans.

II. AMIDST CBA DISCUSSIONS THE ROOKIE PAY SCALE CONTINUES TO BE A HOT TOPIC

The NFL is heading full steam into an uncapped year in 2011, and while the problems facing the NFL talking heads and the NFLPA are vast and numerous, the lack of a manageable rookie pay scale is a glaring issue that needs to be resolved.⁴ Writers, veteran players, and NFL Brass alike are pining for a

¹ *NFL Rookie Salary Cap Needed*, TAMPA TRIBUNE, July 29, 2007, <http://www2.tbo.com/content/2007/jul/29/sp-nfl-rookie-salary-reform-needed/>.

² PAUL D. STAUDOHR, SALARY CAPS IN PROFESSIONAL TEAM SPORTS, COMPENSATION AND WORKING CONDITIONS, BUREAU OF LABOR STATISTICS (1998), <http://www.bls.gov/opub/cwc/archive/spring1998art1.pdf>.

³ *Id.*

⁴ Jarrett Bell, *What it Means, Possibility of an Uncapped Year*, USA TODAY, May 29, 2008, http://www.usatoday.com/sports/football/nfl/2008-05-20-owners-labor-deal_N.htm.

system that would be more reflective of the contributions of players.⁵ While owners and the NFLPA quibble over revenue sharing and (hopefully) a new Collective Bargaining Agreement, the issue of a proposed rookie pay scale or the like will most likely be vigorously supported by the NFL.⁶ In fact, Roger Goodell himself has vehemently pushed for such a system through the media.⁷ Going forward into the offseason, the absence of a rookie pay scale seems as though it may be a sticking point in labor negotiations.⁸ However, although their voices have been heard across various media athletes, the simple truth is that without NFLPA and NFL supported resolution, the NFL draft will continue to be a windfall for 22 year-olds with no experience playing on Sundays, and the league and players in it will suffer.⁹

III. THE NFL IS NOT GROWING AS FAST AS FIRST ROUND SALARIES AND VETERANS ARE SUFFERING

The reality of the current situation is that NFL first round salaries are increasing faster than team revenues. While the NFL continues to operate the most successful professional league in the United States, the teams within have not been impervious to the economic downturn or, more permanently, the exponential rise of the rookie salary cap. The Green Bay Packers have been fortunate enough to turn a sizeable profit, but that is not enough to convince the Team President and Chief Executive, Mark Murphy, that the system is working.¹⁰ Furthermore, NFL rookie salaries are increasing faster than the salary cap and

⁵ John Czarnecki, *Why Goodell is Pushing for a Rookie Pay Scale*, FOX SPORTS, Mar. 31, 2009, <http://msn.foxsports.com/nfl/story/9400474/Why-Goodell-is-pushing-for-rookie-pay-scale>.

⁶ Mike Florio, 10-Pack: CBA, *Personal Conduct Policy at Forefront of Issues Facing NFL*, SPORTING NEWS, Jan. 30, 2009, <http://www.sportingnews.com/nfl/article/2009-01-30/10-pack-cba-personal-conduct-policy-forefront-issues-facing-nfl>.

⁷ *Goodell Jabs Players, NFL Rookie Pay Scale "Ridiculous"*, June 29, 2008, http://www.usatoday.com/sports/football/nfl/2008-06-27-goodell-comments_N.htm.

⁸ *Id.*

⁹ Czarnecki, *supra* note 5.

¹⁰ Chris Jenkins, *Recession Hasn't Sacked Pack, But Officials Wary*, YAHOO! SPORTS, June 20, 2009, <http://sports.yahoo.com/nfl/news?slug=ap-packers-economy&prov=ap&type=lgns> (stating that Packers President and CEO voices his concern that player salaries are rising faster than revenues).

veterans are feeling the hit.¹¹ From 2003-2007, the average guarantee for first round draft picks rose by approximately 67%.¹² Contrast that with the fact that the NFL salary cap only increased by 45% in the same time period.¹³ Matthew Stafford was recently signed to a \$78 million contract, with over \$41 million coming in guaranteed money.¹⁴ Matthew Stafford was a good NCAA quarterback, with admittedly great measurables. However, Tom Brady, the golden boy of the NFL, has three Super Bowls to his name, but his “paltry” \$8 million this year cannot hold a candle to Stafford’s Trump-esque take home pay.¹⁵ Pittsburgh Steelers’ quarterback Ben Roethlisberger had to win two Super Bowls before he could come close to Stafford’s numbers.¹⁶ Although it seems absurd that Tom Brady and Ben Roethlisberger, with five Superbowls and numerous Pro Bowls between them, would not get paid as much as a 21 year-old rookie quarterback, the Mt. Olympus of the NFL are not the group being slighted the most in the current system.¹⁷ NFL veterans, the few that have defied the odds and made it through multiple seasons, proving themselves time and time again, are being most affected.¹⁸ Teams have recently had to make conscious decisions to pay a Stafford-like salary to a first round pick, trade down in the draft to reduce salary demands for draft picks, or re-sign important and proven veterans.¹⁹ Unfortunately, it seems like the trend is to get rid of valuable or roster filling veterans to bring in the glamour of a first round draft pick. The system also has first round draft picks and their agents feeling entitled to ridiculous salary

¹¹ Jarrett Bell, *Guaranteed Money a Windfall for NFL Draft Picks*, USA TODAY, Apr. 28, 2008, http://www.usatoday.com/sports/football/nfl/2008-04-23-first-round-money_N.htm.

¹² *Id.*

¹³ *Id.*

¹⁴ *Stafford is the 1. Georgia QB Signs Six-Year Deal with Lions as Top Pick*, NFL.com Wire Reports, <http://www.nfl.com/news/story?id=09000d5d80ff7434&template=without-video-with-comments&confirm=true> (last visited Sept. 21, 2009).

¹⁵ Tom Brady Player Profile, <http://msn.foxsports.com/nfl/player?categoryId=70173> (last visited Sept. 21, 2009).

¹⁶ Florio, *supra* note 6 (stating that Roethlisberger signed a contract extension last year and will collect \$36 million in guarantees).

¹⁷ Bob Kravitz, *If Brady Earns Less Than Stafford, The System Is Broken*, USA TODAY, Apr. 29, 2009, http://www.usatoday.com/sports/football/nfl/2009-04-28-salary-issue_N.htm.

¹⁸ *Id.*

¹⁹ Bell, *supra* note 11.

increases each year, and often times this leads to the player sitting out of camp, or potentially the whole season. This hurts not only the team, but the player as well.²⁰ The amount of holdouts in the past five years is incredible, with the most recent example being Michael Crabtree and his potentially sitting out the 2009 season because he feels he is not getting paid what he is worth at the number ten pick overall.²¹

IV. THE NBA ROOKIE SCALE – A WORKABLE MODEL

With all the problems with getting players in camp, as well as financial concerns of teams and veterans, what is the league to do? One idea supported by various columnists and athletic academia is to put a rookie pay scale in place, much like the NBA. In the NBA, players are signed to contracts reflective of where they were chosen in the draft. Players are paid similarly to the player chosen last year in their draft slot, with a slight raise from year to year.²² The benefits to this system are numerous. First, contract disputes over money would be minimized, getting players into camp and meshing with their new teammates.²³ This would also help alleviate the massive increase in salaries from year to year for first round draft picks in the NFL, with the only raise coming by way of a natural increase.²⁴ This would also allow teams to spend money on players that have proven themselves on the field and off. This is especially true with teams like the Detroit Lions who need not only a new quarterback, but valuable veterans to fill out their roster and provide depth. While this may not sound like the best solution to future first round draft picks, they will embrace it in years to come when they are veterans fighting for contracts and roster spots. Just ask Joey Harrington.

V. CONCLUSION

The NFL is reaching the critical point for negotiations. The allure of the NFL is partly because of the great parity in the league. The Dolphins went from

²⁰ Liz Mullen, *What's the Holdup?*, STREET AND SMITH'S SPORTS BUSINESS JOURNAL, Aug. 1, 2005, <http://www.sportsbusinessjournal.com/article/46286>.

²¹ Joe Schad, *Adviser: Crabtree could re-enter draft*, ESPN, Aug. 7, 2009, <http://sports.espn.go.com/nfl/news/story?id=4381335>.

²² Josh Salman, *NFL Draft needs a salary cap*, SPINNAKER ONLINE, Nov. 25, 2008, <http://www.unfspinnaker.com/staff-blogs/2008/11/25/nfl-draft-needs-a-rookie-salary-cap/>.

²³ *NFL Rookie Salary Cap Needed*, supra note 1.

²⁴ *Id.*

nearly winless to the toast of the division in one year. This is due in large part to the fact that teams are on the same level in the NFL, and an uncapped year would bring this crashing down. Teams like the Washington Redskins will become the New York Yankees of professional football. While a rookie salary cap would not completely alleviate the concern, it would be a monumental step towards a resolution.

CAN I GET A PIECE OF THAT? POLICIES ON SAMPLING AND HOW IT AFFECTS CREATIVITY IN HIP HOP

BRITTANY ESTELL

I. INTRODUCTION

Jay-Z's *Blueprint III*¹ was released on September 11, 2009 with an abundance of featured artists as well known producers.² Exactly two months after his release date, this huge name will be at Assembly Hall performing for thousands of students, fans, adults, and professors.³ In 2005, there was a grave controversy about DJ Danger Mouse's mixtape *The Grey Album*,⁴ a compilation created by sampling Jay Z's *The Black Album*⁵ and the Beatles' *The White Album*.⁶ DJ Danger Mouse was sought out by record companies who owned both Jay-Z and The Beatles' music for copyright infringement, after his mixtape became popular all over the internet as well as the radio airwaves.⁷ More about DJ Danger Mouse and his legal troubles and how it relates to sampling will be discussed at length below. Today, on *Blueprint III*,⁸ Jay Z has producer Kanye West, who is famed, among other things, for his use of sampling in his very popular beats.⁹ On his album *Graduation* (2007)¹⁰ he gave sample credit on ten out of the fifteen songs on the CD.¹¹

¹ Jay Z, *Blueprint III* (Roc-A-Fella Records 2009).

² Tjames Madison, *Jay-Z Announces Fall Dates, Releases New Album*, LIVEDAILY, Sept. 8, 2009, <http://www.livedaily.com/news/20053.html>.

³ Jay Z, *Blueprint III*, *supra* note 1.

⁴ DJ Danger Mouse – *The Grey Album*, <http://www.illegal-art.org/audio/grey.html> (last visited September 20, 2009).

⁵ Jay Z, *The Black Album* (Roc-A-Fella Records 2005).

⁶ The Beatles, *The White Album* (Capitol EMI Records 1978); W. Y. Durbin, *Recognizing the Grey: Toward a New View of the law Governing Digital Music Sampling Informed by the First Amendment*, 15 WM. & MARY L. REV.1021 (2007).

⁷ *See generally id.*

⁸ Jay-Z, *Blueprint III*, *supra* note 1.

⁹ Arienne Thompson, *Kanye West, The Future of Hip-Hop*, THE OBSERVER ONLINE, Feb. 26, 2004, <http://media.www.ndsmcobserver.com/media/storage/>

What is intriguing about these two sampling situations are the dichotomy between persons who have the means to sample, and those who do not. Persons who have the power and who are surrounded by people with knowledge of the music industry have everything they need at their fingertips and creativity is endless. On the other hand, there are persons who are creative, and their creativity and popularity can be stifled for fear of being prosecuted by the law for not having the proper licenses and copyrights to publish their work. The following will discuss this dichotomy at length. This article discusses sampling and the policy/law affects on hip-hop. Part II will define the term sampling. Part III will give a small background on sampling and how it affected DJ Danger Mouse, he would represent the ordinary citizen. Part III will discuss how hip-hop creativity is stifled. Part IV will discuss an expression of the dichotomy between the famous and the general public and how sampling creativity affects each of these groups. Also, Part IV will discuss options the industry and the Supreme Court should seek in creating policies about sampling music. Part V will be the conclusion.

II. WHAT IS SAMPLING?

At its most basic definition, sampling is when a producer, “chops, screws, arranges, and assembles” a previously recorded sound and then use it for their own purposes.¹² Sampling is taking a snippet of music, a loop repeated through an entire song, or five notes taken from a song, and re arranged, similar to a collage, sampling is like that with music, and it is really one of the building blocks of hip hop is on.¹³ The type of sounds that are used can be anything from nature sounds to actual speech, any type of previously recorded sound.¹⁴ Central ideas in policy revolve around “a chain of concepts: property, originality, ownership, possession, authenticity, authority, creation, and genesis.”¹⁵ These

paper660/news/2004/02/26/Scene/Kanye.West.The.Future.Of.Hip.Hop-618594.shtml.

¹⁰ Kanye West, *The Graduation* (Roc-A-Fella Records 2007).

¹¹ Kanye West Production Discography, http://en.allexperts.com/e/k/ka/kanye_west_production_discography.htm (last visited Sept. 19, 2009).

¹² Mark Katz, *Making Beats: The Art of Sample Based- Hip Hop*. 61 NOTES 1028 (2004).

¹³ Sampling in Hip-Hop, <http://www.artistshousemusic.org/videos/sampling+in+hip+hop> (last visited Sept. 13, 2009).

¹⁴ *Id.*

¹⁵ Carol Becker & Romi Crawford, *An Interview with Paul D. Miller a.k.a. DJ Spooky That Subliminal Kid*, 61 ART JOURNAL 83, 89 (2002).

variables are responsible for creating policy. The sixth circuit court made a decision about sampling which again altered the way it was governed in *Bridgeport Music, Inc. v. Dimension Films*.¹⁶ In *Bridgeport*, several publishing groups including Bridgeport Music, Inc. brought suit against Dimension Films and No Limit Records, for using a piece of a song, which they had the copyright to, in their movie.¹⁷ It was held that no matter how much of a musical work is sampled, it never be defined by being insubstantial enough to not grant copyright protection.¹⁸

Furthermore, the Supreme Court used this act to help define originality of work by law. The Supreme Court stated that the time when a sample is something original is when it is something vastly different from what was taken from the first musical selection in other words transformative.¹⁹

III. EFFECTS OF POLICY

In the case of sampling, one of the most notable affects that policy has had on society at large is the case of DJ Danger Mouse and the *Grey Album*.²⁰ This case in point exemplifies confusion within the courts on sampling. Courts agree that if an artist takes more than a few notes this is infringement.²¹ However, courts are in dispute over whether a piece that is entirely transformative infringes copyright, even though a large portion of vocal or non-vocal pieces are used.²² In a transformative piece, the artist creates something exemplary differential from the original piece so much so that it can be called his own.²³

DJ Danger Mouse was an underground DJ who compiled vocals of Jay Z's *Black Album* and the Beatles *White Album* and created his own *Grey Album*.²⁴ Not expecting it to get much play, he distributed 3,000 copies.²⁵ Once the album became distributed on the Internet it gained a wider audience and critical

¹⁶ *Bridgeport Music, Inc v. Dimension Films*, 401 F.3d 647 (6th Cir. 2004).

¹⁷ *Id.*

¹⁸ John Schietinger, *Bridgeport Music Inc. v. Dimension Films: How the Sixth Circuit Missed A Beat On Digital Music Sampling*, 55 DEPAUL L. REV. 13555, 13555 (2005).

¹⁹ Webber, *supra* note 5, at 375.

²⁰ DJ Danger Mouse, *supra* note 4.

²¹ Becker, *supra* note 16, at 93.

²² Schietinger, *supra* note 19, at 13555.

²³ DJ Danger Mouse, *supra* note 3.

²⁴ Durbin, *supra* note 7, at 1021.

²⁵ *Id.*

acclaim.²⁶ Jay Z and Roc-A-Fella Records did not object to Danger Mouse use of vocals; however EMI, Capitol Records, and Sony Music/ATV Publishing did find serious issues with his “creative art.”²⁷ Publishing groups: EMI, Capitol Records, and Sony Music/ATV took steps to shut down this successful DJ.²⁸ EMI, Capitol Records, and Sony Music/ATV took steps to shut down this successful DJ.²⁹ However, brining the issue to the DJ himself, people in the interest of the Beatles White Album, went to his Internet Service Provider and threaded to get them involved in a lawsuit because their subscriber was committing copyright infringement.³⁰ They were able to get the Internet Company to agree as they proceeded to take action against DJ Danger Mouse for his infringement practices.³¹ EMI Group issued a cease and desist letter to Danger Mouse, and his retailers, ordering them to stop distributing the album.³² Danger Mouse agreed to avoid further legal action.³³

IV. WHAT DOES ALL THIS MEAN?

There is value in copyright law in protecting people’s creativity, but there is the question of how much value, ownership, and rights do individuals have? Individuals cannot create music without having to worry that someone could take their work and credit for themselves. It seems as though the Courts are beginning to crack down on people for sampling, only because their music becomes popular, as in the case of DJ Danger Mouse.³⁴ Therefore, do people have to worry that if society likes their music too much they could be charged with committing various crimes? Clearing samples is not as easy as companies make it seem. There are a lot of loop holes and knowledge that the common person would have to acquire just to attain the rights to be sampled.³⁵ The record companies hold a vast amount of power because they have the employees who will take care of getting copyrights for them.³⁶ With this monopoly of power, creativity is constrained. Many artists believe that the copyright laws that are being imposed on the public

²⁶ *Id.*

²⁷ *Id.* at 1022.

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.* at 1023.

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ Webber, *supra* note 5, at 392.

³⁶ *Id.*

are not actually protecting their music.³⁷ The owner of the music receives compensation for the sample not the artist him/her self.³⁸ This is why the Beatles don't get paid if one of their songs gets sampled; Michael Jackson bought their entire library of music copyrights so he gets paid.³⁹ The recording industry is the reason why copyright policy functions to maintain the monopoly. It is hard when major companies have conglomerated into the big five, where a small amount of companies are responsible for a whole lot of work.⁴⁰

Would an artist without copyright protection have his creativity stifled? Would a person create music for the love of music or would a person only be concerned with the profit? As of right now, law and policy are doing both a service and injustice to the music art form. Policy is protecting creativity through shielding people's work from being stolen without due credit while protecting a capitalistic market. There must be a change in policy in order for copyright to fully function in the interest of hip-hop artist, hip-hop producers, and the public.

In *Bridgeport* the court states that "the purpose of copyright laws is to deter wholesale plagiarism of prior works."⁴¹ However, a balance must be struck between protecting an artist's interest, and depriving other artists of the building blocks of future works."⁴² It seems as though the court has the right idea, but there is a question on where is the line drawn? The court attempts to make a "bright line" rule stating that, when determining whether a copyright has been infringed on the court must determine whether the sample has created something original which is substantially different from sampled music.⁴³

However, who is to be the judge? No pun intended. Is it the record labels that have their hands out attempting to gain some sort of profit after lost in monies from pirates. Is it the artist who determines whether too much of their work has been used? Or is it the producer using the work who is responsible for making his own decision? Artist work should be protected; it is their ideas and work which is being put out on the market. Therefore, they should take a more active role in policy making behind sampling. Artist should advocate to legislature for leniency against public persons who merely use the artist work to create a new original piece. However, once profit is beginning to be made off of another artists work, there should be steps taken before seeking legal action. For example, the record company could contact the DJ to request the ability to contract with them for the

³⁷ *Id.* at 396.

³⁸ *Id.*

³⁹ *Id.* at 395.

⁴⁰ BEN BAGDIKIAN, *THE NEW MEDIA Monopoly* 27-54 (Beacon Press 2004).

⁴¹ *Bridgeport Music, Inc v. Dimension Films*, 401 F.3d 647 (6th Cir. 2004).

⁴² *Id.*

⁴³ Schietinger, *supra* note 19, at 13557.

sampling product used. If measures such as these do not work, legal action could then be sought.

V. CONCLUSION

It seems to me that creativity comes with some sort of limit of success. If a DJ wants to use his creative abilities to sample another artist's work, he better hope that he does not gain too much success for the fear that he will be sued for infringement. On the opposite end of the spectrum, there are producers and DJ's like Kanye West who understands the copyright system and is thus, able to get all necessary licenses and permission to sample as much as they want from whoever they want. If the court system cannot establish a bright line rule of when copyright is being infringed, then what is it that the general artists are supposed to do? Those without means, it seems, are left in the dark once again, to figure out for themselves what is right and what is wrong.

PROTECTING “THE PROGRESS OF SCIENCE AND USEFUL ARTS”

WARREN ALBERT WILKE III

I. INTRODUCTION

Patents have recently received a great deal of attention as tradable commodities, attracting the attention of several hedge funds, and giving rise to investment firms that specialize in patent acquisition.¹ This aspect is not unanticipated, and in fact is on its face congruent with the original means for attaining the goals behind patent law – “to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.”² The idea behind providing this protection is simple: encourage innovation by giving the innovator certain property rights and protections under the law which in turn encourages market participation.³ The ability to monetize innovation is the means by which the U.S. Constitution proposed to incentivize the research and distribution of innovations. Nowhere else has this been more relevant than in the “Technology Sector,” where patents can make or break market share, and mean big bucks for the holders of those patents.⁴ With the increasing number of patents issued and the amount of money tied up in them, the amount of litigation regarding those patents has increased accordingly.⁵ This paper will address some of the issues created by the right to in IP litigation. Part II will outline a specific scenario which creates

¹ See *eBay v. MercExchange, LLC*, 547 U.S. 388 (2006); Alamy, *Trolls Demanding Tolls: Intellectual Property Comes of Age as an Alternative Investment*, THE ECONOMIST, Sep 10th 2009, available at http://www.economist.com/businessfinance/displaystory.cfm?story_id=14416641.

² U.S. CONST. art. 1, § 8.

³ See ROBERT COOTER AND THOMAS Ulen, LAW & ECONOMICS (Pearson Addison Wesley 2008).

⁴ Alamy, *supra* note 1.

⁵ U.S. PATENT AND TRADEMARK OFFICE, ELECTRONIC INFORMATION PRODUCTS DIVISION, PATENT TECHNOLOGY MONITORING TEAM (PTMT), U.S. PATENT STATISTICS CHART CALENDAR YEARS 1963-2008, http://www.uspto.gov/go/taf/us_stat.htm (last visited Sept. 12, 2009).

several problems in IP litigation, and discuss some of those problems in depth. Part III will outline the need for alternative remedies in this scenario, and discuss some possible alternatives. Part IV presents a conclusion that highlights the difficulties with current IP regulation and stress the need for alternatives to follow the goals illustrated in the constitution.

II. DISCUSSION

Of the rights afforded to the patent holder (“Holder”) none is more powerful than the right to an injunction.⁶ Injunctive relief allows the Holder to obtain a court order requiring the defendant to cease any infringement, thereby protecting the aforementioned monetary interests which incentivize innovation. In order to obtain this relief the Holder must show “(1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.”⁷ The Supreme Court’s holding in *eBay*, which eschewed the matter of course right to injunctive relief in favor of the aforementioned four part test, followed traditional notions of equitable relief and was a crucial step towards a more logical application of injunctive relief in IP law.⁸ Injunctive relief achieves its greatest utility as a means protecting the interests of one market participant (“Producer”) against infringements by another. In this situation injunctive relief affords the Holder the ability to eliminate potential future losses, and the ability to protect their current market share. The utility of injunctive relief in this situation is further highlighted because it reduces the burden placed on the courts – an injunction allows the court to avoid costly damages calculations for future and past infringements.⁹ A recent holding congruent with this theory can be seen where a Holder was found to be using the patent in question and thus granted an injunction.¹⁰

However, when reasonable royalties are the only damages claimed and the Holder shows little to no inclination towards market participation the utility of,

⁶ *eBay*, 547 U.S. 388.

⁷ *Id.*

⁸ *Id.*; *Boomer v. Atlantic Cement Co., Inc.*, 257 N.E.2d 87 (N.Y. App. Ct. 1970).

⁹ Cooter, *supra* note 4, at 105-07.

¹⁰ John Timmer, *Killing the cash cow: Microsoft ordered to stop selling Word*, ARS TECHNICA, Aug. 12, 2009, <http://arstechnica.com/microsoft/news/2009/08/court-gives-microsoft-60-days-to-stop-shipping-word.ars>.

and the rights protected by, injunctive relief rarely fit the purpose of “promot[ing] the progress of the arts and useful sciences.”¹¹ In this situation the right to an injunction does very little to increase the incentive to bargain, affords the Holder unfair bargaining advantages, and can cause a loss to society. The reason for the inefficiencies associated with injunctions in the aforementioned scenario stems from the fact that the possible desirable outcomes create more externalities under regimes with injunctions than without. It should be noted that the scope of this article is restricted to the scenario in which the Holder seeking reasonable royalties and an injunction is neither a market participant (“Producer”) nor an exclusive licensor, and a design workaround (“workaround”) is either excessively cost prohibitive, or unavailable to an Infringer – other scenarios are beyond the scope of this argument.

Firstly, the right to an injunction creates little additional incentive to bargain because it does not change the most desirable outcome (the outcome which both parties have the most incentive to achieve), but rather only affects the results when bargaining fails (the outcomes which both parties have more or the most incentive to avoid). The most desirable outcome in both schemes is for the parties to come to an agreement which reduces transaction, administrative, and social costs. The infringer wants to bargain because he can continue selling his product. The holder wants to bargain because a licensed patent generates more revenue than an unlicensed one. In fact, if the Holder’s only profit interest is royalty revenue their best goal would be to obtain as many licensing agreements as possible. By saturating the market with their idea the Holder would increase the volume of his profits, as well as hedge off any losses due to downstream market competition. Therefore, if both parties wish to maximize profits they will want to reach an agreement, preferably out of court to reduce transaction costs. An injunction would be the least desirable outcome for either party because it would decrease the total revenue each party would be able to obtain. If an injunction is granted the Infringer would no longer be able to sell its product, decreasing its revenue, which would in turn decrease the amount of reasonable royalties the Holder would be able to claim. Even if the parties fail to reach an agreement, it would appear that the most desirable outcome would be for the infringer to keep producing and selling such that the Holder could maximize its profits from the reasonable royalty damages obtained by a lawsuit.

Secondly, injunctive relief affords the Holder an additional unfair bargaining advantage because the only interest injunctive relief protects, beyond those protected by reasonable royalties, is the ability to leverage the potential losses against the infringer. When bargaining, each party has a certain threat value, or in other words the maximum price which a party is willing to pay to

¹¹ U.S. CONST. art. 1, § 8.

obtain a benefit, avoid a cost, or some combination of the two. An infringer in an injunction regime faces the additional threat of an injunction and in settling avoids a higher cost than he would in a regime without injunctions. Therefore the infringer in such a scheme is more inclined to pay a higher (or more burdensome) premium to avoid the additional costs of an injunction, which is typically quantified as an increased threat value. The Holder in this case, aside from lost reasonable royalty claims, suffers little potential damage as a result of an injunction when compared to the potential losses the infringer may suffer. Although a Holder may run the risk of losing potential royalties from the period of the injunction, the Holder's ability to leverage the threat of a continued injunction allows them recoup or offset those losses should an agreement be reached. The threat of increased costs does not necessarily increase the incentive for the infringer to bargain, but rather it increases the amount the infringer is willing to pay. This cost is created regardless of the reasonableness of the infringers negotiations thus penalizing the unwitting infringer or potential licensor who attempts to reach a reasonable agreement. Furthermore the consumer and society has a high likelihood of bearing this cost because the additional value that the Holder is able to demand will likely affect the sale price of the finished product. If a particular product is in high demand the value lost by the producer because of an injunction will be greater, thus the price that can be leveraged by the Holder will increase. An excellent example in the similar area of copyright law is how Apple, in response to record label pressure, increased the prices on many of the most popular songs.¹² Because injunctive relief only affords the Holder the ability to leverage additional royalties created by potential costs associated with the threat of an injunction this relief should be avoided unless a significant showing congruent with the "Progress of Science and useful Arts."¹³

Thirdly, the consumer will be disadvantaged by no longer having access to the infringer's product, creating waste and arguably slowing the progress of "Science and Useful Arts."¹⁴ If a preliminary injunction is granted and unsuccessfully appealed in this situation the results could have a dramatic effect on the market, and the ability of consumers to use certain products. Stopping new and useful technology from entering the stream of commerce could significantly slow the development of that technology, and interfere with the development of other technologies. Furthermore the damages to an unwitting infringer that would result from an injunction could be far in excess of the damages to the Holder as a result of the infringement. If the purpose of patent law is to "to promote the

¹² Jay Wright, *iTunes Raising Prices Next Month*, POLLSTAR, Mar. 29, 2009, <http://www.pollstar.com/blogs/news/archive/2009/03/26/656962.aspx>.

¹³ U.S. CONST. art. 1, § 8.

¹⁴ *Id.*

Progress of Science and useful Arts,” then the laws enacted should recognize that the dissemination of knowledge is the cornerstone of innovation.¹⁵ Dissemination of knowledge or innovations “allows more people to enjoy [their] advantages [,]” this dissemination can lead to improvements of that specific knowledge or facilitate innovation in other fields, by the sheer fact of increased “static-efficiency” and exposure.¹⁶

III. RESOLUTION

The right to Injunctive relief is generally best used as a means to give “Producers” incentive to innovate.¹⁷ Injunctive relief gives “Producers” incentive to innovate because it allows them to invest the capital to do so with the security that their hard earned innovations will be protected and allow them to gain an advantage in the market.¹⁸ If the Holder was a producer and did not have the right to injunctive relief he would lack an adequate remedy at law, and would stand a much stronger chance of showing irreparable harm. Injunctive relief is a fair and adequate solution in this situation because a bargaining or licensing agreement may never happen between a Holder who is a producer and any other party.

However, in the situation addressed in this article injunctive relief, in addition to reasonable royalties, protects little if any right which furthers the progress of “Science and useful Arts,” because the Holder in this situation still has revenue maximizing incentive.¹⁹ Though it can be argued that the threat of injunction serves as a cheap and effective means of deterring willful infringement, the willful infringement doctrine takes care of this problem quite nicely by allowing the damages (which will already be calculated in this scenario) to be tripled.²⁰ Thus a willful infringer already risks significant damages and the remedy afforded to the Holder does not necessarily afford the Holder an unfair bargaining advantage.

In situations where a reasonable agreement between the Infringer and the Holder cannot be reached the court should strive to achieve a remedy that would put the Holder in a situation which he would have been in had the parties been able to strike a reasonable agreement. The doctrine of willful infringement can still apply in this scenario in order to deal with Infringers who are unreasonable in

¹⁵ *Id.*; Cooter, *supra* note 4.

¹⁶ Cooter, *supra* note 4.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ U.S. CONST. art. 1, § 8.

²⁰ *See In re Seagate Tech., LLC*, 497 F.3d 1360, 1371 (Fed. Cir. 2007).

their dealings or obviously copied or stole the Holder's innovation.²¹ Furthermore the unwitting infringer should be afforded a similar mechanism to combat the problem of a Holder who holds a patent and waits to initiate a suit after an infringer has already begun production of a product in thereby increasing the Holder's bargaining advantage. This practice "pejoratively referred to as 'patent troll[ing]'" has created many problems in its own right.²² In the U.S., several companies, universities, and tech firms have founded non-profit patent acquisition firms to combat this practice.²³ Several legal systems have systems which combat this practice by affording infringers or potential infringers the ability to seek a compulsory license.²⁴ Though the courts do not have to embrace this doctrine in its entirety the concept here could apply to function as a de facto non-exclusive license a finding for which could be supported by the Holder's unwillingness to license his innovation for unreasonable means. Though this practice might be at "tension with *Continental Paper Bag Co. v. Eastern Paper Bag Co.*" it would provide a workable alternative to merely obtaining a permanent injunction.²⁵ In short the leverage created by the threat of an injunction (the current remedy) in this situation is created solely by the law; any future remedy (or alteration to the current one) should not force citizens to resort to private practices to protect themselves from oversight in policy.

IV. CONCLUSION

The rights afforded to patent holders are not the goal of patent but rather the means for lubricating "the Progress of Science and the useful Arts."²⁶ The right of injunctive relief in the scenario discussed does not protect any right that furthers the constitutional goals of patent law. Minimizing the externalities created by these transactions is more important to the long term progression technology. The progress desired in the constitution relies as much on innovation as it does on the proliferation of and access innovation. Having access to new and

²¹ eBay v. MercExchange, 547 U.S. 388 (2006).

²² Alamy, *supra* note 1.

²³ Ashby Jones, *In Fight Against 'Patent Trolls,' a New Arrow in the Quiver?*, WALL ST. J., Nov. 24, 2008, <http://blogs.wsj.com/law/2008/11/24/in-fight-against-patent-trolls-a-new-arrow-in-the-quiver/>.

²⁴ Cooter, *supra* note 4, at 133-34.

²⁵ eBay, 547 U.S. at 393 (citing *Cont'l Paper Bag Co. v. E. Paper Bag Co.*, 210 U.S. 405, 422-30 (1908)).

²⁶ U.S. CONST. art. 1, § 8.

useful technology allows society to function better as a whole, thereby increasing the likelihood of future innovation. The increased commoditization of patents needs to take this effect into account, many patent holders these days are not interested in developing and producing their items, but rather receiving money from someone who is willing to do it. Profit maximizing incentives that lubricate bargaining can be achieved through policy that does not impede the proliferation of innovation.

KNOCK-OFF THE KNOCKOFFS: THE FIGHT AGAINST TRADEMARK AND COPYRIGHT INFRINGEMENT

MEGHAN COLLINS

I. INTRODUCTION

Gucci, Fendi, Prada, Coach; Designers most individuals know, but few can afford. Yet, despite their high prices, countless individuals sport these designer labels on a daily basis. Chances are however, the majority of these ‘designer duds’, including sunglasses, handbags, electronics, and even drugs, are not authentic. Over the past few years, this knockoff fetish has become increasingly popular throughout the world, especially with the recent economic downfall. With a high demand for these items and popular acceptance of this act, few consumers consider the illegality and danger of owning and supporting these unlawful products.

Throughout this article, the reader will discover the legal process of product copyright and trademark infringement and how counterfeit items directly hinder intellectual property laws. Additionally, the reader’s awareness of the trouble that these items create within not only the United States, but also worldwide, as well as recommendations on how to counter this rising problem, will be raised.

II. BACKGROUND

In order to protect their product from infringement, designers engage in both trademark and copyright practices. In cases of product design, trademark looks largely at its trade dress or “overall appearance of a product’s packaging or dress.”¹ Trademarks assist consumers when individuals take note of the packaging of merchandise, effectively lowering the search cost and providing a reliable guide to finding such items.²

¹ Daliah Saper, “*Designer*” Jewelry vs. “*Inspired-by*” Jewelry: Intellectual Property Infringement and Unfair Competition Consideration, SAPERLAW, Sept. 18, 2008, <http://saperlaw.com/blog/2008/09/18/%e2%80%9cdesigner%e2%80%9d-jewelry-vs-%e2%80%9cinspired-by%e2%80%9d-jewelry-intellectual-property-infringement-and-unfair-competition-considerations/>.

² PETER B. MAGGS & ROGER E. SCHECHTER, TRADEMARK AND UNFAIR COMPETITION, 26 (West Group 1950) (2002).

When claims of trademark infringement arise, a creator must prove that the supposed infringer's design is not functional and that their original design is distinctive and has acquired secondary meaning prior to the introduction of the possible infringer's product to the market.³ By trying to prove functionality, the purpose of the product and its effect on the marketplace is analyzed; the greater the disadvantage to others in the marketplace in conjunction with exclusivity, the more functional the design becomes.⁴ After functionality of the product has been demonstrated, distinctiveness of the design is analyzed through (1) a combination of the design's elements which identifies the original brand; and (2) that the general public identifies the design of the brand through a variety of factors such as consumer surveys, advertisements, sale records, and unsolicited media coverage.⁵ Taken together, this process serves to identify trademark infringement.

Copyrights on the other hand, encompass rights in the producer's original work.⁶ This includes reproduction, distribution, and future access to generate products from the original source.⁷ However, unlike trademarks, "copyrights are not apt to be infringed without conscious duplication of copyrightable subject matter."⁸ Therefore, those who look at a product and reproduce it in a manner similar to the original product would be liable for copyright infringement.

When testing for copyright infringement, there are certain tests the creator can initiate in order to protect their product. In *Van Cleef & Arpels Logistics, S.A. v. Landau Jewelry*, the Court found the defendant's product was an infringement of the plaintiff's design using the 'substantially similar' test.⁹ Under this two part test, an individual infringes upon another's copyright when (1) themes, ideas, patterns, organization, or other details of the product are substantially similar to the original design; and (2) whether an individual outside the case would find the 'concept and feel' of the product design to be similar to the original.¹⁰ Often the

³ *Id.* at 41.

⁴ Saper, *supra* note 1.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ Thomas G. Field, *Avoiding Patent, Trademark and Copyright Problem*, Pierce Law, <http://www.piercelaw.edu/thomasfield/ipbasics/avoiding-patent-trademark-and-copyright-problems.php>.

⁹ *Van Cleef & Arpels Logistics, S.A. v. Landau Jewelry*, 583 F. Supp. 2d 461 (S.D.N.Y. 2008).

¹⁰ Saper, *supra* note 1.

difference between copyright infringement and fair use hinges on the minute details of the product.¹¹

Through implementing both copyright and trademark protection, original creators guard their design against possible infringers. In order to stop individuals from duplicating other's designs and products, injunctions and sometimes statutory damages are awarded as punishment.¹² Although injunctions and damages do not always prove the best deterrent for infringers due to their lack of rigidity and severity, they serve as the best alternative until stricter laws are enacted.¹³

III. ANALYSIS

Counterfeit products would cease to exist if individual consumers' demand stopped. However, this impracticality is realized by both lawmakers and companies who analyze why the general public strives to obtain these illegal products rather than purchase authentic merchandise. This issue is not merely a localized problem, but rather has swept far and wide across the globe.¹⁴ As companies look to reduce the number of counterfeit purchases, a variety of factors must first be considered.

First and foremost, the recent downturn of the economy has caused less disposable income for individuals to spend on luxury items such as designer merchandise.¹⁵ In fact, the International Anti-Counterfeiting Coalition found that over the past two decades, intentionally infringing an established trademark has risen over 10,000 percent and accounts for almost seven percent, roughly equally \$600 billion, of goods sold globally.¹⁶ Hence, the belief that consumers value purchase quantity over quality becomes evident.¹⁷ Many Americans feel that the price of the counterfeit item, be it drugs, movies, or the like, ranks high amongst the factor list, whereas the ability to obtain such items falls below the importance of price.¹⁸ However, if consumers continue to look out for their own self-interests

¹¹ *See id.*

¹² *Id.*

¹³ *Id.*

¹⁴ Randy Myers, *Counter Attack*, CFO, June 1, 2008, available at <http://www.cfo.com/article.cfm/11475740?f=search>.

¹⁵ Peggy E. Chaudhry & Stephen A. Stempf, *Getting Real About Fakes*, WALL ST. J., Aug. 17, 2009, available at <http://online.wsj.com/article/SB10001424052970204038304574151703747284822.html>.

¹⁶ Myers, *supra* note 14.

¹⁷ Chaudhry, *supra* note 15.

¹⁸ *Id.*

and remain unaware of the problems that imitation products create, they cease to see the issues that result from the knockoff industry.

Issues with counterfeiting affects countless industries ranging from apparel to medicine to entertainment and even technology. Companies such as Abercrombie & Fitch and New Balance Athletic Shoe have seen the effect of counterfeiting and now limit consumer purchases as a way to counteract the illegal activity of creating and selling knockoff versions of in-store items.¹⁹ Although this activity worries some companies regarding their short-term success, the majority worry about counterfeiting's longevity, which could ultimately bring about company and even industry failure.²⁰

As a method to attempt and counteract the possibility of industry failure, companies such as Tiffany are suing those who facilitate the successful exchange or purchase of these goods. In the Southern District of New York, Tiffany & Co. sued eBay for the promotion and sale of 'bogus goods.'²¹ Tiffany accused eBay of being responsible for the sale and encouragement of counterfeit merchandise by suggesting that the items were genuine Tiffany jewelry.²² If eBay falsely presented the knockoff items as real Tiffany jewelry, an unassuming consumer would be easily confused and misled, leading to the continuation of the illegality of the act if a purchase resulted.

The consumer's misdirection is not the only problem that results from the exploitation of illegal and counterfeit materials. In fact, health and safety risks, reduction in employment, loss of innovation and profit, funding of terrorism, and United States government tax revenue loss would ensue.²³ In recent years, technology has also aided this problem. In fact, the internet "is the Wild West for counterfeiters and pirates because of the anonymity."²⁴ Despite the fact that the internet helps the knockoff industry to reach all corners of the world, the largest problem is still the source of product creation.

The American movie, as well as software and music, industries estimate that Chinese pirated goods cost the United States industry over \$2 billion in sales

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Tiffany Inc. v. eBay*, 576 F. Supp. 2d 463 (S.D.N.Y. 2008).

²² John P. Mello Jr., *All That Glitters Isn't Legit*, CFO Magazine, March 20, 2006, available at <http://www.cfo.com/article.cfm/5651571?f=search>.

²³ See Chaudhry, *supra* note 15; see also Stephen Taub, *Bush Inks Anti-Knockoff Measure*, CFO, Mar. 17, 2006, available at <http://www.cfo.com/article.cfm/5649562?f=search>.

²⁴ Myers, *supra* note 14.

per year.²⁵ In April 2009, more than 100,000 Chinese-made counterfeit items were seized in Bay Bridge, Brooklyn, leading to an arrest and second-degree trademark counterfeit charge.²⁶ With items easily shipped out of China to the United States, companies currently have little power to fight this production. As a result of this outcry from companies claiming that their intellectual property has not been adequately protected, China's government has pledged to help attack the problem head on.²⁷ Following through on this pledge seems questionable; however, because China still serves primarily as a manufacturer rather than a designer, the country would therefore reap little benefit from such action.²⁸ Until stricter standards are taken with China, it seems as though only a slap on the wrist has been executed. However, China is not the only country that fails to protect foreign company's intellectual property rights. In fact, United States businesses remain leery about putting serious effort into selling and distributing their product in India due to a lack of reliable standards.²⁹ Before a company feels secure in selling and distributing their product, more stringent intellectual property practices must be arise. In order for this to be possible, countries must heed recommendations to secure the rights of the original producer.

IV. RECOMMENDATION

After witnessing the effects of intellectual property theft, in 2006 President Bush signed the *Stop Counterfeiting in Manufactured Goods Act* to allow the government to confiscate both knockoff products as well as any equipment used to make them.³⁰ Although this bill clearly does not solve the infringement problem, it is a step in the right direction for the protection of designers and creators. Rather than relying solely on Congress to pass bills

²⁵ Sharon LaFraniere, *Facing Counterfeiting Crackdown, Beijing Vendors Fight Back*, N.Y. TIMES, Mar. 2, 2009, available at http://www.nytimes.com/2009/03/02/world/asia/02piracy.html?_r=1.

²⁶ Colin Moynihan, *Counterfeiters Favored Nike, and Obama, Too*, N.Y. TIMES, Apr. 25, 2009, available at <http://www.nytimes.com/2009/04/25/nyregion/25counterfeit.html?scp=1&sq=Counterfeiters%20Favored%20Nike,%20and%20Obama,%20Too&st=cse>.

²⁷ LaFraniere, *supra* note 25.

²⁸ Moynihan, *supra* note 26.

²⁹ Heather Timmons, *Retailer Knockoffs Abound in India*, N.Y. TIMES, July 16, 2009, available at <http://www.nytimes.com/2009/07/16/business/global/16brands.html?adxnml=1&adxnmlx=1253516554-/ddDBOFOLmNZ51FXCY7iCQ>.

³⁰ Taub, *supra* note 24.

further protecting intellectual property rights, companies have begun to take matters into their own hands.³¹

In fact, companies take greater precaution against trademark and copyright infringers, many typically spending between \$1 million to \$2 million of their own revenue for extra protection.³² Consequently, not only do companies pay experts to help guard their goods, but also try and advertise to consumers to stop buying illegal products.³³ Through this advertising, companies can warn individuals about the potential dangers of some knockoff items such as drugs, whose use could lead to serious consequences, or even about the illegality and unethical action of counterfeiting products.³⁴ Furthering the source of advertisements, a few years ago, the International Anticounterfeiting Coalition initiated a ‘fight the fakes’ message at Hunter College in New York City.³⁵ Although the results of these advertising campaigns might not become clearly evident, if the message is constantly in the media that counterfeit product purchase is unacceptable, companies may save money in the future for protection when sales of knockoffs falter.

After the July 2008 holding in *Tiffany v. eBay*, a French court rejected L’Oreal’s claim that eBay was profiting off of counterfeit perfume purchases.³⁶ This Court noted eBay’s good faith efforts in trying to detect the sale of counterfeit items as well as determining that “preventing counterfeits will only be effective through a close collaboration between rights holders and eBay.”³⁷ Working together may be one of the most important mechanisms in which to foster greater protection for the products and serve as a deterrent to product infringers.

³¹ Myers, *supra* note 14.

³² *Id.*

³³ LaFraniere, *supra* note 25.

³⁴ See Chaudhry, *supra* note 15.

³⁵ Rob Walker, *School of Hard Knockoffs*, N.Y. TIMES, Sept. 21, 2008, available at <http://www.nytimes.com/2008/09/21/magazine/21WWLN-consumed-t.html?scp=5&sq=rob%20walker%20and%20knockoffs&st=cse>.

³⁶ *Tiffany Inc. v. eBay*, 576 F. Supp. 2d 463, 527 (S.D.N.Y. 2008); Eric Pfanner, *French Court Clears eBay in Selling Fake Goods*, N.Y. Times, May 14, 2009, available at <http://www.nytimes.com/2009/05/14/technology/companies/14loreal.html?scp=1&sq=French%20Court%20Clears%20eBay%20in%20Selling%20Fake%20Goods,&st=csehttp:www.nytimes.com/2009/05/14/technology/companies/14loreal>.

³⁷ Pfanner, *supra* note 36.

V. CONCLUSION

Counterfeiting products has become a staple in today's society. Almost anywhere one goes they are bound to see consumers carrying, holding, or wearing illegally manufactured goods. What most individuals are not aware of are the problems that these knockoff items create. With safety risks, decreasing incentives for creators, as well as profit loss, counterfeit products initiate more harm than benefit. With more industries working together as well as the support of the government, illegally copyrighted and trademarked items will hopefully fade. Until that time however, consumer awareness serves as the most powerful weapon against such a prominent market.