NYU JOURNAL OF
Law & Business

VOLUME 13 FALL 2016 NUMBER 1

TABLE OF CONTENTS

ARTICLES

THE MULTIPLICATION EFFECT OF LEGAL INSURANCE 1
Jef De Mot, Ben Depoorter, and Michael G. Faure

REGULATING DIGITAL MARKETS 33
Max N. Helveston

DISREGARDING THE CORPORATE FORM: WHY JUDGES, NOT JURIES, SHOULD DECIDE THE QUIDDITS AND QUILLETS OF VEIL PIERCING 95
Brian D. Koosed, Anthony P. Badaracco, and Erica R. Iverson

STRATEGIC LEGAL BULLYING 137
David Orozco

MORTAL DEMOCRACY: WHEN CORPORATIONS BRIBE 193
Robert E. Wagner

STUDENT NOTES

NFL TEAM RELOCATIONS IN THE AGE OF MODERN STADIUM FINANCE: MOTIVATIONS FOR A TEAM TO MOVE AND IMPLICATIONS FOR SMALLER MARKETS 235
Adam B. Hanau

THE HAGUE PRINCIPLES ON CHOICE OF LAW IN INTERNATIONAL COMMERCIAL CONTRACTS: ENHANCING PARTY AUTONOMY IN A GLOBALIZED MARKET 271
Jonathan Levin

Copyright © 2016 by
New York University Journal of Law & Business
Cite as N.Y.U. J.L. & Bus.
ISSN #1558-5778

The *NYU Journal of Law & Business* is a student-edited periodical published biannually at New York University School of Law. As a nonpartisan periodical, the *Journal* is committed to presenting diverse views on law and business. Accordingly, the opinions and affiliations of the authors presented herein do not necessarily reflect those of the *Journal* or any of its members.

Article Submissions: The *Journal* invites authors to submit pieces for publication consideration. Footnotes and citations should follow the rules set forth in the latest edition of *The Bluebook: A Uniform System of Citation*. All submissions become the property of the *Journal*. Due to the large volume of submissions, a manuscript cannot be returned to its author, unless an envelope with adequate postage accompanies it. Submissions should be sent by mail to the Editorial Office or by email to law.submissions.jlb@nyu.edu.

Copyright/Permissions: All works copyright © 2016 by the author, except where otherwise expressly indicated. Except as otherwise provided, the author of each work in this issue has granted permission for copies of that article to be made for classroom use, provided that: (1) copies are distributed to students at or below cost, (2) the author and the *Journal* are identified on each copy, and (3) proper notice of copyright is affixed to each copy. All other rights reserved. For permission to reprint an article or any portion thereof, contact the Editorial Office by mail or by email.

Subscriptions: Subscriptions are sold by complete volume (two issues) with shipping and handling included. Subscription rates for print issues are $30 (domestic) and $35 (foreign). Single issues are $16 (all geographic regions). Payment may be made on the Internet at www.nyujlb.org or by check payable to the *NYU Journal of Law & Business*. Claims for non-receipt of an issue must be received within one year of the issue's publication date. Standard postage is paid at New York, New York, and at additional mailing offices. Direct all payments, claims, address changes, and other subscription correspondence to the Administrative Office.

The *Journal* is available electronically on the WESTLAW and LEXIS-NEXIS systems, and on the Internet at www.nyujlb.org. Individual issues, microfilm editions, and prior volumes also can be obtained directly from William S. Hein & Co., Inc., 2350 North Forest Road, Getzville, New York 14068, but might not be offered at our NYU prices.

Editorial Office
139 MacDougal Street
New York, New York 10012
212-998-6080
law.jlb@nyu.edu

Administrative Office
110 West Third Street
New York, New York 10012
212-998-6590
nyulawjournals@nyu.edu

The *NYU Journal of Law & Business* is a nonpartisan, student-edited periodical specializing in the analysis of the dynamic relationship between law and business. In particular, our publication provides a forum for scholars, legislators, judges, practitioners, and students to discuss contemporary legal regulation of business and markets. The *Journal* also focuses on recent developments and innovative successes in the law and business community, and it is committed to publishing authoritative writings on the convergence of the two professions. The *Journal* will consider expert treatment of any discipline arising out of these fields. It is the goal of the *Journal* to report on a wide variety of timely and relevant issues, and to offer its readers the most in-depth legal analysis of pending developments in the world of law and business.

NYU JOURNAL OF
Law & Business

2016–2017 BOARD OF EDITORS

Editor-in-Chief
JEFFREY G. MUDD

Executive Editors
KRISTIN E. CORBETT
JONATHAN LEVIN

Managing Editors
DANA C. BEHNKE
NATHANIEL J. MILLER

Senior Articles Editors
KATHERINE L. TANDLER
DAVID WANG
HEATHER A. WEIGEL

Academic Events Editors
LISA OKRAGLY
LAUREN C. WISEMAN
SAMANTHA C. COXE

Senior Notes Editor
JULIA L. REEVES

Online Content Editor
MICHAEL W. FAHNER

Article Editors
JOYCE CHANG
KATHLEEN MEHARY
MICHAEL J. PISEM

Staff Editors
MICHAEL D. ABRAMSON
AGNES N. ANIOL
CHASE C. BEAUCLAIR
HENRIK BORN
THOMAS I. BUSICK
MICHAEL CHEN
ETHAN J. CHESS
YU CHI
KARA E. CHUNG
ANDREW B. COHEN
SHUYANG DAI
FAITH DIBBLE
KEITH M. DORE
SAMUEL S. FELDMAN
BETSY J. FEUERSTEIN
MAXIME FISCHER-ZERNIN
RYAN P. FITZPATRICK
DAVIS B. FRANK
JUAN F. GARAVITO JANER
ANDREW GOLDMAN
CAROLYN J. HARBUS
ALIZA L. HASSINE
JUAN C. HERNANDEZ
KENNETH B. HERSHEY
JONATHAN O. HIRSCH
GABRIEL JIMENEZ GARCIA
ALEXNDRA D. JUNG
DAWSON KIRKLAND
BRIAN R. KLAPOW
KYEONG RIN KWAK
ADAM B. LERNER
YAWEN LI
HANNAH LITTMAN
MARYANNE LIU
XIAOYUN LIU
GRACE MCALLISTER
NATHANIEL A. MOONEY
CAITLIN A. MOYLES
OSEMUDIAMEN O. OKORUWA
CLAIRE R. OXFORD
ALEX D. PERILSTEIN
ARIELLA R. PULTMAN
WANG JAE RHEE
MELISSA RODRIGUEZ
BRETT M. ROSE
RACHEL L. SCHARF
RACHEL M. SCHLOSSER
ALEX SIEGEL
KAITLIN N. SIEMERING
HOLDEN A. STEINHAUER
FRANK T. UNGERER
JOHN H. VERAJA
HANG WANG
DAVID M. WEISS
ANDREW G. WOOD
YIMENG XIAO
SHUOPENG YIN
JOHN YIN
JIE ZHOU

Graduate Editors
AL-SHWAID DE LEON ISMAEL
RICHARD SOMADE
ZHAOGUO DENG
NIL ACAR
MICA RUPPIN
SUKTIKA BANERJEE

Faculty Advisors
WILLIAM T. ALLEN
JENNIFER H. ARLEN
HELEN S. SCOTT
KAREN BRENNER
MARCEL KAHAN
GERALD ROSENFELD

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 13 FALL 2016 NUMBER 1

THE MULTIPLICATION EFFECT OF LEGAL INSURANCE

JEF DE MOT,* BEN DEPOORTER,** AND MICHAEL G. FAURE***

Because legal insurance policies cover the expenses of plaintiffs in bringing legal claims, such policies increase the risk of negligent or careless acts by tortfeasors. For this reason, potential tortfeasors would prefer to avoid injuring holders of legal insurance policies. Since insurance coverage (or lack thereof) is not observable to a tortfeasor prior to an accident, tortfeasors can never exercise this preference ex ante. As a result, insured tort victims provide deterrence benefits to those that are uninsured by increasing the overall expected costs of engaging in negligent, harmful behavior. In magnifying a tort offender's overall risk of facing legal action, this multiplication effect of insurance policies enhances deterrence, inducing increased overall safety levels.

Unfortunately, however, the multiplication effect of legal insurance reduces the demand for legal expense insurance policies. Because policyholders do not capture the full benefits of legal insurance policies on safety, too few individuals sign up for such policies. As a result of this public good effect, the average price of insurance policies remains high, which reduces the

---

* Copyright © 2016 by Jef De Mot, Ben Depoorter, and Michael G. Faure. Jef De Mot: Senior Researcher at the National Foundation for Scientific Research Foundation Flanders (F.W.O.).

** Copyright © 2016 by Jef De Mot, Ben Depoorter, and Michael G. Faure. Ben Depoorter: Professor of Law & Sunderland Chair, University of California, Hastings College of Law; Ghent University, CASLE; Visiting Professor U.C. Berkeley Law (Summer) & Affiliate Scholar, Stanford Law School, CIS. This Article benefited from comments by Gideon Parchomovsky, Francesco Parisi, Guisseppe Dari-Mattiaci, Gerrit De Geest, Thomas Ulen and workshop participants at the University of Pennsylvania Law School, U.C. Berkeley Law School, Stanford Law School, the University of Toronto Law School. Email: depoorter@uchastings.edu.

*** Copyright © 2016 by Jef De Mot, Ben Depoorter, and Michael G. Faure. Michael G. Faure: Professor of Comparative Private Law and Economics, Erasmus University Rotterdam and Professor of Comparative and International Environmental Law, Maastricht University.

demand for legal expense insurance policies. In revealing these overlooked collective action issues, this Article opens new inroads for policy discussions regarding legal insurance markets.

INTRODUCTION 2
I. LEGAL EXPENSE INSURANCE IN CONTEXT 7
II. CHALLENGES TO LEGAL INSURANCE MARKETS: DEMAND SIDE 12
III. THE MULTIPLICATION EFFECT OF LEGAL EXPENSE INSURANCE 13
A. *Basic Effect* 13
B. *Multiplication as a Collective Action Problem* 15
C. *Analogies* 17
IV. SUPPLY SIDE COMPLICATIONS 20
A. *Adverse Selection and Moral Hazard* 20
B. *The Underuse of Subrogation* 21
V. POLICY OPTIONS 25
A. *Status Quo* 25
B. *Distinguishing Between Different Sources of Market Failure* 27
C. *Regulatory Approaches* 28
CONCLUSION 30

INTRODUCTION

Whenever litigation costs discourage a plaintiff from pursuing a rightful legal claim, the deterrent effect of the legal system is undermined.[1]

The burden of litigation is reduced if a potential litigant can take out insurance policies against prospective litigation.[2] Insurance policies commonly cover the costs of defending against a lawsuit (*passive* insurance policies), but insurance

1. Plaintiffs do not usually take into account the positive effect of their lawsuits on the deterrent function of the tort system. This problem will be especially acute if the social benefits of a lawsuit outweigh the private gains to the plaintiff. *See* Steven Shavell, *The Social Versus the Private Incentive to Bring Suit in a Costly Legal System*, 11 J. LEGAL STUD. 333 (1982). A recent study estimates that tort victims pursue legal recourse in barely one out of ten accidents. *See* DEBORAH HENSLER ET AL., COMPENSATION FOR ACCIDENTAL INJURIES IN THE UNITED STATES 175 (2005). Note, however, that proposals to stimulate legal claims must also take into account the additional costs of litigation that might result. Shavell, *supra*, at 336 (explaining the potential misalignment between private and social incentives to bring lawsuits).

2. *See infra* Part I.

companies may also offer policies that cover the expenses of plaintiffs to bring forth and litigate a claim in court (*active* insurance policies). By improving access to the justice system, legal expense insurance increases the overall deterrent effect of the tort system.[3] If active legal insurance policy subscriptions are widespread, victims are more likely to be able to afford the legal expenses to pursue a valid claim in court and hold tortfeasors accountable.[4] Consequently, by increasing the expected costs of negligent behavior, legal expense insurance induces careful behavior and potentially reduces the overall amount of accidents in society.[5]

---

3. *See* Michael Trebilcock, *Innovations in Service Delivery*, ONTARIO MINISTRY OF THE ATTORNEY GENERAL, http://www.attorneygeneral.jus.gov.on.ca/english/about/pubs/trebilcock/section7.asp (last visited Dec. 30, 2011) ("[L]egal insurance may be one means to significantly improve access to justice . . . ."); *see also* Alastair Gray & Neil Rickman, *The Role of Legal Expenses Insurance in Securing Access to the Legal Services Market*, *in* REFORM OF CIVIL PROCEDURE: ESSAYS ON 'ACCESS TO JUSTICE', 305, 310 (A.A.S. Zuckerman & Ross Cranston eds., 1995).

4. Trebilcock, *supra* note 3*; see also* Gray & Rickman, *supra* note 3.

5. An expanding body of empirical research substantiates the deterrent effect of tort law. First, studies have revealed the relation between product liability and safety improvements. *See, e.g.*, DON DEWEES ET AL., EXPLORING THE DOMAIN OF ACCIDENT LAW: TAKING THE FACTS SERIOUSLY 198 (1996) (reporting studies showing that over one in three companies had improved the safety of their products and almost half had improved product usage and warranties as a result of product liability law). Second, when states eliminated liability insurance in favor of no-fault systems, several studies report that this switch caused a statistically significant increase in auto accidents or fatalities. *See, e.g.*, J. David Cummins et al., *The Incentive Effects of No-Fault Automobile Insurance*, 44 J.L. & ECON. 427, 454–55 (2001) (linking no-fault systems and higher fatality rates in various states in the United States if negligence assignment under tort is sufficiently responsive to the driver's level of care); Elisabeth M. Landes, *Insurance, Liability, and Accidents: A Theoretical and Empirical Investigation of the Effect of No-Fault Accidents*, 25 J.L. & ECON. 49, 49–50 (1982) (reporting increased accident losses in no-fault states in various U.S. states); R. Ian McEwin, *No-Fault and Road Accidents: Some Australasian Evidence*, 9 INT'L REV. L. & ECON. 13, 14 (1989) (finding similar effects in New Zealand). Deterrent effects have also been observed in the trend towards more stringent regulation of alcohol use and driving. *See, e.g.*, Frank J. Chaloupka et al., *Alcohol-Control Policies and Motor-Vehicle Fatalities*, 22 J. LEGAL STUD. 161, 184 (1993); Lan Liang et al., *Precaution, Compensation, and Threats of Sanction: The Case of Alcohol Servers,* 24 INT'L REV. L. & ECON. 49, 67–68 (2004). For a summary of the research on the deterrent effects of tort law, see Ben C.J. Van Velthoven, *Empirics of Tort*, *in* 1 ENCYCLOPEDIA OF LAW AND ECONOMICS, TORT LAW AND ECONOMICS 453 (Michael Faure ed., 2d ed. 2009).

Despite these benefits, active legal insurance policies are surprisingly uncommon. By most accounts, only a very small fraction of U.S. households purchase legal expense insurance policies that cover the costs of bringing lawsuits.[6] Similarly, while legal expense insurance markets are growing in Europe, active legal insurance policies represent only one percent of total premiums there.

The scarcity of active legal expense insurance coverage is puzzling. The availability of alternative instruments that increase access to justice, such as contingency fee arrangements and public legal aid arrangements cannot explain the dearth of coverage observed today. While contingency fee arrangements may reduce the need for legal expense insurance, legal insurance policies are also uncommon in countries where contingency fees are prohibited.[7] Similarly, legal expense insurance policies are not widely subscribed even in countries that do not provide public legal aid programs.[8]

This Article explains the low demand for legal expense insurance coverage by identifying an important and currently

6. Most insurance policies in the United States involve prepaid plans for predictable and specified events that are low-cost but occur with high frequency (e.g., simple divorces, wills, and estates). These prepaid plans rarely offer assistance for complex legal problems (although some offer discounts on private lawyer services for more complex matters). *See* Francis Regan, *Whatever Happened To Legal Expense Insurance?*, 26 ALTERNATIVE L.J. 293, 295 (2001); *see also* GEOFFREY MCGOVERN ET AL., THIRD-PARTY LITIGATION FUNDING AND CLAIM TRANSFER (2010) (ebook) ("'Before-the-event' and 'after-the-event' legal insurance policies are not common in the United States. . . ."); Michelle Boardman, *Insurers Defend and Third Parties Fund: A Comparison of Litigation Participation*, 8 J.L. ECON. & POL'Y 673, 674 (2012) ("Litigation expense insurance is not yet an American phenomenon. . . ."); Matthias Kilian, *Alternatives to Public Provision: The Role of Legal Expenses Insurance in Broadening Access to Justice: The German Experience*, 30 J.L. & SOC'Y 31, 36 (2003) (reporting U.S. data on legal insurance coverage).

7. In many civil law countries contingency fees are prohibited. In Belgium, for instance, contingency fee agreements are prohibited even though merely 15% of the population is covered by public legal aid. Historically, the number of individuals with legal insurance in Belgium has been extremely low. In 2007, the Minister of Justice and the insurance companies agreed to set up a general legal expenses insurance system. For an annual subscription of _144 the system entitles an individual to costless legal aid by a lawyer. Only 6.7% of the population has enrolled for the program. Note that the scope of the legal matters covered by this insurance is rather limited. *See* Int'l Legal Aid Grp. Conf., *National Report: Belgium* (2009).

8. Gray & Rickman, *supra* note 3, at 315.

overlooked beneficial public good attribute of legal expense insurance. Due to the nature of accidents and the unobservable nature of insurance coverage ex ante, tort offenders are typically not able to distinguish or select between potential victims who have taken out a legal insurance policy and those who have not. While a potential tort offender might want to avoid getting involved in an accident with holders of legal expense insurance policies (i.e., those who can afford to pursue legal action more easily), tortfeasors are not able exercise this preference ex ante since an individual's insurance coverage (or lack thereof) is not observable to a tort offender prior to an accident. As a result, every additional policyholder increases the average likelihood that a negligent offender will be held accountable for his or her tortious actions. In other words, even if not every potential victim is insured to bring legal claims, those that are insured provide deterrence benefits to everyone else by increasing the overall expected costs of engaging in negligent, harmful behavior. By increasing tortfeasors' overall risk of facing legal action this multiplication effect of insurance policies significantly enhances deterrence and the bite of the tort system in general.[9] The capacity of legal insurance policies to spread out the deterrence effects across society—even if not everyone is covered by insurance—is socially valuable.

Paradoxically, however, the multiplication effect of legal insurance policies reduces the *demand* for legal insurance policies. Because the ex ante deterrent effect of any individual insurance policy is shared with all other potential accident victims—regardless of whether they are insured or not—individual policyholders do not capture the full benefits of their policies on deterrence; instead they subsidize the deterrence benefits of other members of the public who are uninsured.

---

9. The concept of a multiplication effect was introduced in a paper discussing the relative benefits of carrots versus sticks as legal incentives. *See* Gerrit De Geest & Giuseppe Dari-Mattiacci, *The Rise of Carrots and the Decline of Sticks*, 80 U. CHI. L. REV. 341 (2013). Although a punishment can be applied only once, the threat to punish can be repeated several times. This is possible because, when parties comply, the punishment is not applied and can thus be used to support a new threat. *Id.* at 361–62. On the choice between subsidies and taxes in making policy, see also Brian Galle, *The Tragedy of the Carrots: Economics & Politics in the Choice of Price Instruments*, 64 STAN. L. REV. 797 (2012).

Because individuals fail to consider the external deterrence benefits of legal insurance, less than the optimal number of individuals take out insurance policies. As a result of this public good aspect of legal expense insurance, the average price of such policies remains high, which further reduces demand. The situation resembles a collective action problem: since everyone necessarily shares in the beneficial deterrent effect of insurance, not enough individuals voluntarily take out such policies, and much of the potential social value of legal insurance (the potential deterrence benefits on the tort system) remains unexploited.[10]

Additionally, legal insurance markets are plagued by a second collective action problem. Specifically, because all insurance companies share the overall benefits (deterrence and reduced accident costs) that result if one or more companies offer legal expense insurance, legal insurance markets face a public good issue on the supply side as well. As a result of the modest demand by consumers and the positive externalities for competitors that do not offer legal insurance, most insurance companies do not actively promote legal expense insurance policies.

This Article proceeds as follows: Part I provides a concise background to legal insurance markets. Part II describes the conventional challenges to insurance markets. Part III first describes the beneficial multiplication effect of legal expense insurance before analyzing the hereto-overlooked collective action issue of legal insurance markets and its effect on the demand for legal insurance. We also describe similarities to historical prosecution societies and more recent instruments such as Lojack devices. Part IV discusses supply side issues in legal insurance markets. Part V formulates policy recommendations, including mandatory subrogation, providing insurance incentives, and compulsory insurance.

---

10. For classic descriptions on the public good problem, see, for example, Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387 (1954), and Harold Demsetz, *The Private Production of Public Goods*, 13 J.L. & ECON. 293 (1970).

I.
LEGAL EXPENSE INSURANCE IN CONTEXT

Most individuals are risk-averse.[11] When presented with a choice between a certain loss of $10 over a 10% chance of losing $100, individuals prefer the former option even though the expected value of these losses is the same.[12] For this reason, insurance policies are an attractive option for risk-averse individuals.[13] By making premium payments on a periodic basis, "insurance allows people to shift money from times when they do not need it very much to times when they need it much more."[14] In the area of torts, for instance, first-party damage insurance provides potential accident victims reassurance that they will recoup some of the costs incurred in case of an accident.

Tort accidents often raise important legal questions or factual matters relating to the level of precaution taken, safety measures and other issues that determine liability. Because legal procedures on tort liability are costly, most standard insurance policies include coverage for legal assistance. Legal expense insurance, also known as legal cost insurance, legal protection insurance, or simply legal insurance, is a voluntary private insurance instrument that covers the costs of lawsuits.[15] Although the expenses involved with defending policyholders against tort suits are included in most personal, professional, and commercial liability insurance policies (passive legal insurance), the costs of *bringing* legal suits (active insurance) is rarely included in insurance policies. Although generally avail-

---

11. Because individuals are risk-averse, money has a declining marginal utility. As a result, "insurance is a more efficient way than savings to equalize the marginal utility of consumption over time." Tom Baker & Peter Siegelman, *Law and Economics After the Behavioral Turn: Learning from Insurance* 6 (Petrie-Flom Center, Working Paper, 2011).

12. *See generally* STEVEN SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW (1987).

13. In a world with perfect information and no transaction costs, everyone would be better off insuring against all risks. *See* Kenneth J. Arrow, *Insurance, Risk and Resource Allocation, in* ESSAYS IN THE THEORY OF RISK BEARING 134 (1971) (discussing the problems created by adverse selection and moral hazard).

14. Baker & Siegelman, *supra* note 11, at 6.

15. First and foremost, coverage typically includes legal fees charged (including expenses incurred) by a lawyer or law firm representing the policyholder.

able in developed insurance markets,[16] individuals in the United States rarely take out legal insurance policies that cover the cost of bringing litigation.[17] Similarly, in most industrialized nations a relatively small fraction of households take out legal insurance policies. Although legal insurance markets are growing in Europe,[18] legal insurance coverage represents only one percent of total premiums.[19] Similarly, legal insurance coverage has not flourished in most countries, including France,[20] the United Kingdom, Australia, and New Zealand.[21]

The lack of success of legal insurance policies is intriguing. Legal expense insurance provides considerable benefits to policyholders. First, legal insurance shares in common with other insurance instruments the benefit of reducing one's exposure to risk. Since litigation is a small chance event with po-

---

16. Vivien Prais, *Legal Expenses Insurance*, *in* REFORM OF CIVIL PROCEDURE, *supra* note 3, at 431.

17. *See* sources cited *supra* note 6 and accompanying text.

18. In some countries, including Hungary, Luxemburg, Portugal, and Turkey, legal insurance coverage has in fact declined between 2000 and 2008. *See* CENTRE D'ETUDES D'ASSURANCE, EUROPEAN INSURANCE IN FIGURES (2009), http://www.argusdelassurance.com/mediatheque/5/1/6/000014615.pdf.

19. *Id.*; *see also* Michael Faure & Jef De Mot, *Comparing Third-Party Financing of Litigation and Legal Expenses Insurance*, 8 J.L. ECON. & POL'Y 743, 751 (2012) (comparing legal insurance to third-party financing and concluding that legal insurance is not as widespread in Europe as is sometimes alleged). One apparent exception is Sweden. While 97% of Swedes are covered by legal expense insurance, this high coverage is due to the fact that legal expense insurance is automatically added onto other insurance policies with a high market penetration (such as housing insurance). Furthermore, as a compulsory add-on insurance, such legal expense insurance policies typically restrict legal assistance to a relatively narrow range of legal claims. *See* C.M.C. VAN ZEELAND & J.M. BARENDRECHT, LEGAL AID SYSTEMS COMPARED (2003); Matthias Killian & Francis Regan, *Legal Expenses Insurance and Legal Aid—Two Sides of the Same Coin? The Experience from Germany and Sweden*, 11 INT'L J. LEGAL PROF. 233, 250 (2004); Francis Regan, *The Swedish Legal Services Policy Remix: The Shift from Public Legal Aid to Private Legal Expense Insurance*, 30 J.L. & SOC'Y 49 (2003).

20. For details see BERNARD CERVEAU, L'ASSURANCE DE PROTECTION JURIDIQUE: MARCHÉ, GARANTIES, PERSPECTIVES (L'Argus de l'Assurance ed., 2006).

21. Regan, *The Swedish Legal Services Policy Remix, supra* note 19, at 50–51. A study by the Ministry of Justice on the market for "before the event" insurance confirms this trend in the United Kingdom as well. OONA MCDONALD, IAN WINTERS & MIKE HARMER, THE MARKET FOR 'BTE' LEGAL EXPENSES INSURANCE, MINISTRY OF JUSTICE 51–56 (2007).

tentially substantial costs, risk-averse individuals stand to benefit from legal insurance coverage.[22] Second, legal insurance policies enhance a plaintiff's bargaining position.[23] Because the defendant is aware that an insurance provider will reimburse the plaintiff's litigation costs, the threat of litigation becomes more salient to a tortfeasor. As a result, insured defendants are more likely to receive fair settlement offers.

To illustrate the benefit that an active legal insurance policy confers to a subscriber, consider the following numerical example. If there is a 50% probability of obtaining $1000 in court and the legal costs are $300, the expected value of the plaintiff's legal claim is $200 (*50% x 1000 – 300*). The defendant's expected costs of the claim are $800 (*50% x 1000 + 300*). The claim will be settled if the parties can agree on a number that is within the bargaining range of the plaintiff's minimum settlement amount ($200) and the defendants maximum offer ($800). In an equal division of the surplus, the defendant and plaintiff would settle the claim at $500.[24] If, however, the plaintiff's claim is covered by a legal insurance policy, the plaintiff is in a stronger bargaining position given that the litigation costs are a concern to the defendant (*50% x 1000 + 300 = 800*) but not to the plaintiff (*50% x 1000 = 500*). In other words, if litigation costs are covered by legal expense insurance, a rational plaintiff will not settle at an amount below $500. In that case, an equal division of the surplus between the parties is a settlement amount of $650.

Moreover, society also benefits if legal insurance is widespread. Whenever, in the absence of legal insurance, a plaintiff lacks the resources to pursue a valid legal claim in court, the deterrent effect of the tort system is reduced.[25] Empirical re-

22. Empirical research suggests that individuals are risk-averse when facing losses with modest probabilities. *See* Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk,* 47 ECONOMETRICA 263 (1979).

23. Roland Kirstein, *Risk Neutrality and Strategic Insurance,* 25 GENEVA PAPERS ON RISK & INSURANCE 251, 252 (2000).

24. Behavioral research suggests that equal divisions can be a focal point in negotiations since they align with pre-existing notions of fairness among the parties. *See, e.g.*, Matthew Rabin, *Incorporating Fairness in Game Theory and Economics,* 83 AM. ECON. REV. 1281 (1993).

25. Legal insurance can be socially costly, however, if it induces frivolous lawsuits, especially if costly litigation forces defendants into accepting settlements for claims with little or no merit. This risk can be reduced by procedu-

search suggests that this is an acute problem in various areas of tort law. Empirical research shows that a very small percentage of injured Americans pursue legal recourse against tortfeasors.[26] In the area of medical malpractice, for instance, research shows that, contrary to public perception,[27] many legitimate cases are not pursued.[28] Moreover, victims are not always fully compensated by courts.[29] This has a potentially dev-

---

ral safeguards against frivolous litigation and the fact that defendants often carry litigation insurance. Finally the intervention by insurance companies mitigates this risk considerably. *See infra* Section IV.A.

26. *See* HENSLER ET AL., *supra* note 1, at 175 (observing that only about 10% of those who suffer from accidents file suit).

27. It is common to hear claims that the United States suffers from excessive tort litigation. *See, e.g.*, PHILLIP K. HOWARD, THE DEATH OF COMMON SENSE: HOW LAW IS SUFFOCATING AMERICA (1996) (claiming that the law is suffocating the country). Contrary to this popular wisdom, many reputed scholars have noted that the so-called litigation explosion in the United States in the last four decades is a myth. *See, e.g.*, John T. Nockleby, *How to Manufacture a Crisis: Evaluating Empirical Claims Behind "Tort Reform"*, 86 OR. L. REV. 533, 537–41, 550–51 (providing evidence that increased tort filings were caused by population growth and examples of stories about tort law that turned out to be false)*; see also* WILLIAM HALTOM & MICHAEL MCCANN, DISTORTING THE LAW: POLITICS, MEDIA, AND THE LITIGATION CRISIS (2004) (offering evidence that the media and interest groups have greatly overstated unrepresentative stories about tort law); Richard A. Posner, *Demand and Supply Trends in Federal and State Courts over the Last Half Century*, 8 J. APP. PRAC. & PROCESS 133 (2006) (empirical study reporting a drop off of tort litigation and damage awards since the 1980s). A recent study found no association between tort law and economic harm. On the contrary, a strong relationship between pro-plaintiff tort law and economic growth was observed. Frank B. Cross, *Tort Law and the American Economy*, 96 MINN. L. REV. 28 (2011) (examining the effects of tort law using indices created by two prodefendant organizations: the United States Chamber of Commerce and the Pacific Research Institute).

28. *See* Lori B. Andrews, *Studying Medical Error in Situ: Implications for Malpractice Law and Policy*, 54 DEPAUL L. REV. 357, 370 (2005) (reporting that about 1.2% of patients who suffered a medical error filed suit); David M. Studdert et al., *Negligent Care and Malpractice Claiming Behavior in Utah and Colorado,* 38 MED. CARE 250, 250 (2000) (reporting that 97% of those patients who suffered a negligent injury did not sue). For an overview of these and similar studies, see David A. Hyman & Charles Silver, *Medical Malpractice Litigation and Tort Reform: It's the Incentives, Stupid*, 59 VAND. L. REV. 1085, 1089–91 (2006).

29. *See, e.g.*, ROBERT A. KAGAN, ADVERSARIAL LEGALISM: THE AMERICAN WAY OF LAW 140 (2001) (finding that most malpractice actions containing strong legal claims result in compensation that does not even cover the victim's economic losses)*; see also* W. Kip Viscusi, *Toward a Diminished Role for*

astating impact on public safety.[30] In chemical industries for instance, researchers have linked chemical pollution safety issues to a lack of litigation and accountability.[31] Although tort liability has reduced chemical hazards to some degree, acute chemical injuries and chronic diseases due to chemical exposure remain largely unaccounted.[32]

To illustrate the deterrent effect of legal insurance, consider a second numerical example. A plaintiff has a negative expected value claim if, for instance, there is a 50% probability of obtaining $500 in court and the legal costs are $300. If, however, the plaintiff's claim is covered by legal insurance, the reduction of the plaintiff's litigation costs turns a negative value claim (*50% x 500 – 300 = -50*) into a positive value claim (*50% x 500 = +250*). If legal insurance is widespread, potential tort offenders will realize that it is more likely that they will be held accountable for their actions,[33] which might increase careful behavior and reduce the overall amount of accidents in society.[34] Overall, by increasing accountability for negligent behavior, legal expense insurance benefits individual policy subscribers as well as the general public.[35]

Tort Liability: Social Insurance, Government Regulation, and Contemporary Risks to Health and Safety, 6 YALE J. ON REG. 65, 95–97 (1989) (reporting judgments and settlements in product liability litigation which do not cover the actual harm suffered by the victim).

30. *See* Richard L. Abel, *The Real Tort Crisis—Too Few Claims*, 48 OHIO ST. L.J. 443, 447, 460 (1987); *see also* Michael J. Saks, *Do We Really Know Anything About the Behavior of the Tort Litigation System—and Why Not?*, 140 U. PA. L. REV., 1147, 1183–89 (1992).

31. *See* Nicholas A. Ashford & Robert F. Stone, *Liability, Innovation, and Safety in the Chemical Industry*, *in* THE LIABILITY MAZE: THE IMPACT OF LIABILITY LAW ON SAFETY AND INNOVATION 367 (Peter W. Huber & Robert E. Litan eds., 1991) (developing an optimal deterrence benchmark, reflecting on the total social costs of chemical harm, and evaluating the liability costs to the chemical industry in relation to this benchmark).

32. *Id.* at 368.

33. *Id.* at 377.

34. *See generally* SHAVELL, *supra* note 12 (analyzing the various incentive effects of the tort system on behavior).

35. One reservation is that when accidents are bilateral (victims also influence the accident rate), insurance might create careless behavior. This effect, also known as moral hazard, applies most strongly to general damage insurance. Moreover, insurance companies and tort rules can help reduce moral hazards by increasing the accountability of victims (for instance when courts apply comparative negligence or when insurance companies include deductibles). *Id.* at 26–31.

II.
CHALLENGES TO LEGAL INSURANCE MARKETS: DEMAND SIDE

Despite the clear advantages, legal expense insurance policies are not widespread.[36] Several explanations have been offered to understand the curious scarcity of legal expense insurance. First, contingency fees may reduce the need for legal expense insurance.[37] Indeed, contingency fees are functionally similar to insurance policies in that they remove litigation costs from consideration for the individual plaintiff: the plaintiff lawyer carries the burden of litigation costs under a contingency fee arrangement and the insurance company finances the litigation. There are some differences however; a plaintiff will need to retain a lawyer who is willing to take the case on a contingency fee basis. While insurance companies are well suited to spread out litigation costs across a large group of policyholders ex ante (so called "before the accident events"), lawyers will be reluctant to take on ex post disputes ("after the accident events") that involve relatively high litigation costs, especially since the contingency fee arrangement provides the lawyer only a fraction of the potential damage award.[38] In other words, contingency fees are not a perfect substitute for legal insurance. Additionally, legal expense insurance is infrequent in countries where only a modest fraction of the population is eligible for legal aid and where contingency fees are prohibited.[39]

Second, the low demand for legal insurance is sometimes attributed to the fact that individuals tend to underestimate both the probability that they will be involved in a legal case[40] and the expenses involved in litigation,[41] or incorrectly assume

36. *See supra* Part I.

37. *See supra* Part I.

38. Accordingly, contingency fees do not turn negative value suits into positive value lawsuits. By contrast, since legal expense insurance removes litigation costs from an individual policyholder's consideration, the plaintiff will have a more credible claim. Of course, the insurance company will need to sign off on the litigation, but insurance companies might be able to spread the costs of litigation across a larger pool of disputes than any individual lawyer or law firm working on a contingency fee. Note that, even if insurance companies regularly settle tort disputes, the deterrent effect of the policies is sustained for the most part.

39. Int'l Legal Aid Grp. Conf., *supra* note 7.

40. Regan, *supra* note 6, at 295.

41. Gray & Rickman, *supra* note 3, at 310.

that they are covered by legal aid policies.[42] If individuals underestimate the potential costs of adverse events, this reduces their willingness to incur the expense of monthly premiums that cover legal insurance.[43] On the other hand, behavioral research suggests that individuals are very sensitive to salient risks involving high potential costs.[44] This certainly applies to litigation since, when reporting on legal issues, mainstream media outlets tend to focus disproportionally on the most salient legal stories that involve outliers encompassing, for instance, exorbitant legal fees, massive jury awards, and excessive litigation costs.[45] As a result, it is unlikely the low demand for legal insurance can be attributed solely to behavioral dispositions, such as underestimation of tort risk and litigation costs.

To summarize, although the conventional explanations regarding the scarcity of legal insurance have some merit, they cannot fully explain, nor justify, the uncommonness of legal expense insurance. As we explain below, the scarcity of legal expense insurance cannot be fully understood without recognizing the multiplication effect of legal insurance.

III. THE MULTIPLICATION EFFECT OF LEGAL EXPENSE INSURANCE

A. *Basic Effect*

In many potential accident situations, individuals make decisions that affect the relative likelihood and magnitude of harm inflicted on potential victims. For instance when deciding to engage in a relatively dangerous activity (e.g., street car racing) in one neighborhood over another, harm is more likely to be inflicted on residents in the designated neighborhood as opposed to the non-selected neighborhoods. But even in situations where individuals control how and where they conduct dangerous activities, potential tort offenders are not

42. *Id.* at 315.

43. For a review of "demand side anomalies" in the insurance market, see HOWARD KUNREUTHER, MARK PAULY & STACY MCMORROW, INSURANCE AND BEHAVIORAL ECONOMICS: IMPROVING DECISIONS IN THE MOST MISUNDERSTOOD INDUSTRY (2013).

44. Cass R. Sunstein & Richard Zeckhauser, *Overreaction to Fearsome Risks*, 48 ENVTL. & RESOURCE ECON. 435 (2011).

45. Saks, *supra* note 30, at 1161 (documenting how news media outlets focus on outliers in legal news reports).

able to distinguish between potential victims who have taken out a legal insurance policy and those who have not. Insurance coverage is unobservable before any given accident. Although a potential tort offender might want to avoid injuring insurance policyholders (who can afford to pursue legal action more easily), they can never exercise this preference ex ante.

Since tort offenders are unable to distinguish ex ante between potential plaintiffs who have taken out a legal insurance policy and those who have not, every additional holder of legal expense insurance increases the probability that a negligent offender will be held accountable. Even if not every potential victim is insured to bring legal claims, those that are insured provide benefits to others since every additional policy increases the overall expected costs of engaging in negligent, harmful behavior. This multiplication effect of insurance policies significantly enhances deterrence and the bite of the tort system.

The following stylized example illustrates the multiplication effect and its consequences. Assume a world in which there is just one potential injurer and ten potential victims. The injurer must decide how much care he or she will exercise (investment in precautions, etc.) when engaging in an activity. If the injurer takes no care, each victim suffers a loss of $100 with certainty. If the injurer takes care (at a cost of $10 to the potential injurer), victims will not incur any harm. Assume further that the victim would need to spend $150 to successfully pursue the legal claim. The courts apply a rule of strict liability.[46] Only two out of ten potential victims purchase legal insurance coverage. Imagine first a scenario where the injurer knows who is insured and who is not. If so, the injurer will take care (spend $10) in order to prevent an accident involving the two individuals that are insured (because the cost of care is smaller than the damages), but will forsake these investments with regard to the uninsured victims (who will not file suit because their claim has negative expected value). As a result, the two insured victims will not suffer any harm, while the other eight victims will each suffer $100 in harm. In a second, more realistic scenario the injurer cannot distinguish before the accident between insured and uninsured victims. Consequently,

46. This example also illustrates that the multiplication effect occurs if a rule of negligence applies.

for each potential victim that is harmed, the injurer faces a 20% chance that a legal claim will be pursued. This encourages the injurer to invest in precautions at all times, as it pertains to all ten potential victims (both insured and uninsured). Investing in precautions costs only $10. By contrast, the expected costs of engaging in the activity without taking any precautions is $20 since there is a 20% probability that any given victim will pursue legal action in which case the court will award $100. This example illustrates how the difficulty of distinguishing across insured and uninsured defendants has a magnifying effect of every individual legal insurance policy. Next we address a demand side complication that undermines the full potential of the beneficial multiplication effect described in this part.

B. *Multiplication as a Collective Action Problem*

Despite the positive effect on deterrence, the multiplication effect of legal insurance reduces the demand for legal expense insurance coverage. Because the ex ante deterrent effect of any individual insurance policy is shared with all other potential accident victims—regardless of being insured—individual policyholders do not capture the full benefits of their policies on deterrence; instead they subsidize the deterrence benefits of other members of the public that are uninsured. Because individuals fail to consider the external deterrence benefits of legal insurance, fewer individuals take out insurance policies. As a result of this public good problem, the average price of such policies is high,[47] which further reduces demand. The situation resembles a collective action problem: since everyone necessarily shares in the beneficial deterrent effect of insurance, not enough individuals voluntarily take out such policies and much of the social value (the potential deterrence benefits of insurance on the tort system) remains unexploited.[48]

---

47. Low insurance premiums require that the risk be pooled across a large group of individual policyholders. In California, for instance, earthquake insurance premiums are relatively high because only 17% of homeowners have taken out such policies. In order to lower premiums, insurance companies would need to be able to spread the risk across a greater number of policyholders. *See* Liz Pulliam Weston, *Rethinking Your Stance on Earthquake Coverage*, L.A. TIMES, July 15, 2013.

48. *See supra* sources cited note 30 and accompanying text.

A numerical example may illustrate this collective action issue among potential policyholders. Suppose that all potential victims of a given accident have purchased first party damage insurance that covers all harm. Every policyholder pays a premium of $500. Additionally, insurance companies offer legal expense insurance. Victims must decide whether they will take out the additional policy.[49] If 50% of the potential victims purchase legal insurance coverage, more legal claims will be pursued—by removing legal costs, legal insurance turns negative expected value lawsuits into credible, positive value claims.[50] This, in turn, will induce more careful behavior among potential tort offenders and likely reduce accident frequency. Since insurance premiums reflect the overall expected harm, the reduction of accidents will lower damage insurance premiums overall. Assume that damage insurance premiums decrease to $450. The premium for the legal insurance is $75. Policyholders who opt for both damage insurance and legal insurance will pay a total premium of $525. But the benefits of the increased deterrence (and lower premium for first party damage insurance) result regardless of whether any individual policyholder buys legal insurance—as long as 50% of individuals subscribe. So every policyholder is likely to subscribe only for the damage insurance since (1) he or she might hope that enough other individual will take out a legal insurance policy; (2) even if not enough individuals subscribe to legal insurance, the damage insurance premium without higher deterrence ($500) is still below the cost of a policy for damage and legal insurance combined ($525). As a result, policyholders enlist only for the damage insurance policy and the deterrent potential of legal insurance remains underexploited.[51] This outcome is disadvantageous to society and to the collective interests of the policyholders in the example. If merely 50% of the potential victims had subscribed to legal insurance, social welfare would have increased: for every victim that spends $75 on legal insurance, *two* potential victims enjoy a reduction of

49. If a third party causes the accident, the victim can sue for damages. If he loses the case, the damage insurance kicks in. In most instances, of course, the victim receives compensation from his insurer while the court case is ongoing.

50. *See supra* Part I.

51. The fact that accident damage insurance is not always complete (due to deductibles, etc.) may provide an incentive to purchase legal insurance.

their expected accident losses of $50 ($75 < 2 \times 50$). However, potential victims do not take these positive externalities into account, leading to a socially suboptimal level of legal insurance in society.

C. *Analogies*

An analogy can be made between legal expense insurance and "prosecution societies" in eighteenth-century England.[52] Historically, the English legal system had a criminal system in place that lacked a police force or public prosecutors. In theory, any Englishmen could prosecute any crime, but in practice the victim needed to take upon herself the duties of a private prosecutor. But why would a victim ever prosecute? If a tort victim sues and wins, he or she collects damages. But a private plaintiff in a criminal suit does not typically obtain any financial compensation. Although there were some potential benefits to seeing justice served by way of private prosecution (e.g., vindication, incapacitation of the defendant when a prison term is imposed, etc.), a damage award was generally not available to offset the financial costs of prosecution by the victim.[53] In order to address this issue, societies for the prosecution of felons were formed in the eighteenth century. These societies typically operated within a single town. Each member contributed a small sum once a year.[54] The money was devoted to prosecuting anyone who committed a felony against any member of the society. Interestingly, these societies were able to avoid the free rider problem by publishing the list of members in the local newspaper. This avoided (or at least mitigated) the free rider problem for two reasons. First, because local felons could find out whether someone was a member of a prosecution society in any given town, only paying members obtained the benefits of being a part of the prosecution soci-

52. *See, e.g.*, Craig B. Little & Christopher P. Sheffield, *Frontiers and Criminal Justice: English Private Prosecution Societies and American Vigilantism in the Eighteenth and Nineteenth Centuries*, 48 Am. Soc. Rev. 796, 797–98 (1983).

53. One reason to prosecute is the possibility of settling out of court (especially if the defendant has a lot to lose from a conviction). Agreements between the victim and the defendant were, however, illegal in felony prosecutions. Another reason to prosecute was that people who expected to be victims of multiple offenses could establish a reputation for prosecuting and thus buy deterrence. *Id.*

54. *See id.*

ety. In other words, members were able to overcome the public good problem by internalizing the deterrent benefits (i.e., positive externalities) of prosecution societies. Second, by advertising that they were subscribing to an association that furthered the public good, members shamed non-members into joining.[55]

The collective action analogy of legal insurance is also closely related to a key insight from the literature on crime prevention[56]—the distinction between observable and unobservable private precautions.[57] Observable precautions, such as putting iron bars on the windows of a house, generate diversion effects (e.g., a thief who notices iron bars across windows may decide to approach another house). If precautions are unobservable, some potential victims may be tempted to free ride on the precautionary investments made by others. A well-known example involves the installation of Lojack security systems in cars. A Lojack system is a small radio transmitter that is

55. Joel Mokyr observes:

> The enforcement of property rights through private-order institutions reflects something deep and supremely important about British institutions in the eighteenth century. The culture of respectability and gentility helped solve the standard collective action problems that bedevil the production of public goods. The emergence of a plethora of networks, clubs, friendly societies, academies, and associations created a civil society, in which the private provision of public goods became a reality and created what might be called a *civil economy*.

JOEL MOKYR, THE ENLIGHTENED ECONOMY 381 (2009); *see also* Mark Koyama, *Prosecution Associations in Industrial Revolution England: Private Providers of Public Goods?* 32 (Ctr. for Historical Econ. and Related Research at York, CHERRY Discussion Paper Series) ("[P]rivate prosecution associations not only drew upon, but, in their turn, cultivated, a form of social capital that made the private provision of some forms of public goods feasible.").

56. *See, e.g.*, Ian Ayres & Steven D. Levitt, *Measuring Positive Externalities from Unobservable Victim Precaution: An Empirical Analysis of Lojack*, 113 Q.J. ECON. 43 (1998); Omri Ben-Shahar & Alon Harel, *Blaming the Victim: Optimal Incentives for Private Precautions Against Crime,* 11 J.L. Econ. & Org. 434 (1995); Charles T. Clotfelter, *Private Security and the Public Safety,* 5 J. URB. ECON. 388 (1978); David de Meza & J. R. Gould, *The Social Efficiency of Private Decisions to Enforce Property Rights,* 100 J. POL. ECON. 561 (1992); Keith N. Hylton, *Optimal Law Enforcement and Victim Precaution*, 27 RAND J. ECON. 197 (1996); Steven Shavell, *Individual Precautions to Prevent Theft: Private Versus Socially Optimal Behavior,* 11 INT'L REV. L. & ECON. 123 (1991).

57. *See* Hylton, *supra* note 56; *see also* Shavell, *supra* note 56 (discussing theft prevention as a public good problem).

hidden in one of many possible locations within a car. When a car is reported stolen, the police can activate the transmitter and can track the precise location and movement of the stolen vehicle. If Lojack car systems are very widespread, stealing cars becomes a riskier activity for car thieves. But since criminals cannot ex ante distinguish whether a car has a Lojack system (even if the owner were to put a sticker on the window to signal the presence of a Lojack system), installing Lojack only trivially reduces the likelihood that your own car will be stolen (although it does increase the chance that your car will be retrieved when stolen). Any decrease in the aggregate crime rates due to Lojack is an externality from the perspective of the individual Lojack purchaser. A study by Ayres and Levitt estimates that individuals who install Lojack in their cars obtain less than ten percent of the total social benefits of Lojack. This causes Lojack to be undersupplied in markets.[58] If there are not enough individuals that purchase Lojack, society losses its deterrence benefits. A similar reasoning applies to legal insurance. The relevant analogy is that the positive externality emerges because potential criminals do not know ex ante whether a car has Lojack since a potential criminal cannot recognize this feature ex ante.[59] Since potential criminals do not know ex ante which cars have Lojack, they will not be able to select their victims. The same reasoning applies to potential injurers and victims who are covered by legal insurance: since insurance coverage is not ascertainable prior to negligent action by a wrongdoer, a free riding problem might emerge.

---

58. Ayres & Levitt, *supra* note 56. Others have pointed out that a free-rider problem could easily materialize, since would-be thieves will stay away from cars without Lojack out of fear that these cars might have the device. *See* ROBERT E. HALL & MARC LIEBERMAN, MICROECONOMICS: PRINCIPLES AND APPLICATIONS 478–81 (4th ed. 2008). *But see* JOHN R. LOTT, FREEDOMNOMICS: WHY THE FREE MARKET WORKS AND OTHER HALF-BAKED THEORIES DON'T (2007) (recognizing the potential for a free-rider problem but also expressing skepticism about the real effects of Lojack on theft). Note that even if a Lojack owner wanted to signal the presence of Lojack, it would be difficult to do so in a credible manner.

59. It would be different if the crime-deterring technology could be detected ex ante, through, for example, a visible alarm system.

IV.
SUPPLY SIDE COMPLICATIONS

The relatively weak demand for legal insurance goes hand in hand with supply side complications. Because of the multiplication effect of legal insurance on deterrence, as explained in the previous Part, insurance companies share in the combined benefits of increasing deterrence and reducing accident costs on the basis of legal expense insurance and subrogation. This second order collective action problem helps explain why insurance companies rarely promote legal expense insurance. This incentive issue in the supply of legal insurance is heightened further by several other challenges associated with insurance markets: adverse selection, moral hazard, and the underuse of subrogation.

A. *Adverse Selection and Moral Hazard*

As applied to most insurance settings, providers of legal insurance are faced by the dual challenge of adverse selection and moral hazard. Because insurance premiums are especially valuable to customers that are likely to engage in litigation, there is a risk that legal insurance policies will disproportionally attract litigious subscribers. Because such customers create more costs on average, insurance companies might need to raise premiums over time, which, in turn, makes insurance coverage worthwhile only to the most litigious individuals.[60] Additionally, because insurance coverage reduces the costs of litigation, policyholders' reduced concern with litigation might make them less careful in avoiding incidents or disputes that lead to litigation.[61] Although this issue of moral hazard is recognized more generally with regard to *accident* insurance, the problem is actually even more acute in the context of legal insurance. Even an individual with the most comprehensive accident insurance policy will exercise some care since he or she knows that certain accident losses (severe physical injuries, etc.) cannot be fully undone by way of damage compensation.

---

60. George A. Akerlof, *The Market for Lemons: Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488, 492–93 (1970) (classic paper explaining the adverse selection problem created by information asymmetry in secondhand car markets).

61. Bengt Hölmstrom, *Moral Hazard and Observability*, 10 BELL J. ECON. 74, 74 (1979).

The costs of litigation, by contrast, do not impose such residual concern for a policyholder. Litigation costs can be fully compensated by the insurance company. Due to these adverse selection and moral hazard problems, insurance companies might be less attracted to legal insurance instruments.

B. *The Underuse of Subrogation*

After an insurance company has compensated the expenses of the client, it may seek reimbursement from the person or entity legally responsible for the accident. Such subrogation rights are common in insurance relationships more generally, arising either by contract or by public regulation.[62] If insurance companies effectively use their right of subrogation (or added legal insurance policies as a default to damage insurance), negligent behavior becomes more costly since tortfeasors (or their insurance companies) are more likely to bear the full costs of their actions.

In practice, however, subrogation is underused in insurance markets.[63] Moreover, insurance companies seldom sell damage insurance with legal insurance as a standard (compulsory) addition, unless they are forced to do so by law, as is the case in Sweden.[64]

Upon first sight, insurance companies clearly stand to benefit if they exercise their right of subrogation. What ex-

62. In most jurisdictions, the common law provides a subrogation right to insurers under property, liability, and some casualty policies. Most health and medical policies expressly include subrogation clauses. *See* JOHN F. DOBBYN, INSURANCE LAW IN A NUTSHELL 385, 389 (4th ed. 1996). On the economics of subrogation generally, see SHAVELL, *supra* note 12, at 255; Alan O. Sykes, *Subrogation and Insolvency*, 30 J. LEGAL STUD. 383 (2001); Thomas S. Ulen, *The View from Abroad: Tort Law and Liability Insurance in the United States*, *in* TORT LAW AND LIABILITY INSURANCE 207 (Gerhard Wagner ed., 2005).

63. Richard Carris and William Bartlett criticize insurers for not asserting their subrogation interests to the fullest extent. *See* Richard Carris & William Bartlett, *Benchmarking Claims Performance*, RISK MGMT., Dec. 1994, at 30, 34. A recent survey finds a subrogation recovery ratio average (gross subrogation dollars recovered divided by paid losses) of merely 8.41%. The survey was commissioned by Praxis Consulting and conducted by the Ward Group. In it, twenty chief financial officers completed surveys about the subrogation policies at their companies. *Focus on Subrogation Missing from Many Firms, Survey Finds*, PROP. CASUALTY 360° (Dec. 9, 2009, 3:32 PM), http://www.property-casualty.com/News/2009/12/Pages/Focus-On-Subrogation-Missing-From-Many-Firms-Survey-Finds.aspx.

64. Regan, *The Swedish Legal Services Policy Remix*, *supra* note 19.

plains the lack of subrogation? The costs of using the legal process to arrive at the correct division of liability costs between insurance companies may explain the lack of subrogation witnessed in insurance markets. Indeed, the expense of apportioning costs across insurance providers has prompted several scholars to advocate the elimination of subrogation rights in different contexts.[65] In many countries, insurers have taken measures to avoid an unnecessarily litigious atmosphere within the industry.[66] Subrogation rights are often exercised on the basis of ex ante agreements (e.g., bulk recoupment, knock for knock, etc.).[67] While these agreements may economize on administrative costs, bulk arrangements reduce the incentives to take care because individual risk differentiation becomes impossible. A complementary explanation for the limited use of subrogation could be that current law restricts insurance subrogation to the amount of benefits that the insurer has paid its subscribers.[68] Since first-party insurance is typically restricted to economic losses,[69] the restrictions preclude an insurer from acquiring control over a substantial por-

65. *See* FOWLER V. HARPER ET AL., THE LAW OF TORTS (3d ed. 1996); PAUL C. WEILER, MEDICAL MALPRACTICE ON TRIAL 103–04 (1991); Richard A. Epstein, *Coordination of Workers' Compensation Benefits with Tort Damage Awards*, 13 FORUM 464 (1978).

66. Richard Lewis, *Insurers' Agreements Not to Enforce Strict Legal Rights: Bargaining with Government and in the Shadow of the Law*, 48 MOD. L. REV. 275 (1985).

67. Bulk recoupment agreements involve a standard payment of an agreed percentage of all reported claims at a certain amount, usually where the individual amounts involved are relatively small. *See* WERNER PFENNIGSTORF WITH DONALD G. GIFFORD, A COMPARATIVE STUDY OF LIABILITY LAW AND COMPENSATION SCHEMES IN TEN COUNTRIES AND THE UNITED STATES 134–36 (Donald G. Gifford & William M. Richman eds., 1991). For the case of the Netherlands, see Michael G. Faure & Ton Hartlief, *Social Security Versus Tort Law as Instruments to Compensate Personal Injuries: A Dutch Law and Economics Perspective*, *in* THE IMPACT OF SOCIAL SECURITY LAW ON TORT LAW 222 (Ulrich Magnus ed., 2003). In knock for knock arrangements, rights of subrogation are waived. In the United Kingdom, these agreements are made between individual motor insurers. *See* Lewis, *supra* note 66, at 280–81. In the United States, insurance companies often make use of an ex post lay arbitration service.

68. TOM BAKER, INSURANCE LAW AND POLICY 331–32 (2d ed. 2008).

69. W. Kip Viscusi, *Pain and Suffering: Damages in Search of a Sounder Rationale*, 1 MICH. L. & POL'Y REV. 141 (1996).

tion of personal injury claims (non-pecuniary and punitive damages).[70]

Whether the substantial costs of litigation are an acceptable reason to favor the elimination of subrogation or to applaud incentive-dulling agreements between insurers depends on the deterrence benefit of subrogation. From a theoretical viewpoint, many scholars support subrogation because of its positive effect on deterrence.[71] Without subrogation at least part of the damage will not be shifted to the injurer, which reduces his or her incentive to prevent the loss.

Subrogation is usually exercised on the liability insurer, who would optimally differentiate risks and would thus incorporate this increased risk (as a result of subrogation) in the policy conditions of the insured injurer.[72] Of course, a deterrence effect will be doubtful if the exercise of subrogation has no or very little effect on liability insurance premiums. As has been noted by Viscusi, it may be difficult to justify the abolition of subrogation actions in the absence of any empirical support indicating that the loss in controlling risks will be minor.[73] Recent empirical studies confirm the deterrent effect of tort law accountability.[74] Klick and Strattman find that collateral

70. For example, two thirds of medical malpractice awards in Illinois are non-pecuniary. *See* NEIL VIDMAR, MEDICAL MALPRACTICE AND THE TORT SYSTEM IN ILLINOIS 66 (2005). In an interesting article, Kenneth Reinker and David Rosenberg and have proposed to change the law of insurance subrogation for medical malpractice liability to allow insurers to acquire their insureds' potential malpractice claims without limitation. They argue that this will improve both deterrence and insurance results of medical malpractice liability. Kenneth S. Reinker & David Rosenberg, *Unlimited Subrogation: Improving Medical Malpractice Liability by Allowing Insurers to Take Charge*, 36 J. LEGAL STUD. 261 (2007).

71. *See, e.g.*, SHAVELL, *supra* note 12; Patricia M. Danzon, *Tort Reform and the Role of Government in Private Insurance Markets*, 13 J. LEGAL STUD. 517 (1984); Reinker & Rosenberg, *supra* note 70.

72. Theoretically, this could mean that the exercise of subrogation against a liability insurer would amount to an increase in premiums or the imposition of other policy conditions to prevent accidents. *See* Faure & Hartlief, *supra* note 67.

73. W. Kip Viscusi, *The Dimensions of the Product Liability Crisis*, 20 J. LEGAL STUD. 147, 148 (1991).

74. Under the collateral source rule, the victim of an accident who has received insurance or similar benefits collects full damages from a liable injurer. No reduction is made due to the benefits that have partially or totally eliminated the accident loss. Since the mid-seventies there has been a trend against the collateral source rule; many states introduced a regime of collat-

source reform leads to higher infant mortality rates.[75] Rubin and Shepherd find that the introduction of various forms of set-off regimes had a statistically significant effect on the number of non-motor vehicle accidental deaths.[76] Overall, it is not unreasonable to expect some positive, deterrent effect from subrogation.

Even though the deterrence effects of subrogation might be substantial, insurance companies may not necessarily adopt an aggressive subrogation strategy, however. If an insurance company has a market share of, say, ten percent, then ninety percent of the deterrence benefits would go to other insurance companies (whose premiums do not reflect the costs of subrogation suits). This could lead to a free rider problem that prevents the insurance industry from taking meaningful action. Consider the following example. Suppose that if one of ten existing (e.g., casualty) insurance companies active in a certain region adopts an aggressive subrogation strategy, including the pursuit of many negative expected value suits, the accident rate declines five percent. Consequently, all ten insurance companies could lower their premiums by, for example, $50 (from $250 to $200). Note that this is not an attractive proposition to insurance companies. Doing so would force the insurance company to raise its premium beyond $200. Due to this effort to finance the litigation costs of subrogation, the insurer would suffer a competitive disadvantage.

A similar argument has been made with respect to Lojack prevention technology. Academic commentary offers two opposing perspectives on the question of why most auto insurance companies fail to provide discounts on Lojack devices.[77] According to one viewpoint, Lojack is not advantageous to insurers with a modest market share, since most of the benefit

---

eral benefits offset. In this regime, the amount of insurance or like benefits is deducted from the damage payment the injurer is liable for. *See* Fernando Gomez & Jose Penalva, *Insurance and Tort: Coordination Systems and Imperfect Liability Rules*, *in* INTERNALISIERUNGS DES RECHTS UND SEINE ÖKONOMISCHE ANALYSE [Internationalization of the Law and its Economic Analysis] 217–37 (Jochen Bigus et al. eds., 2008).

75. Jonathan Klick & Thomas Stratmann, *Medical Malpractice Reform and Physicians in High-Risk Specialties*, 36 J. LEGAL STUD. 121, 134 (2007).

76. Paul H. Rubin & Joanna M. Shepherd, *Tort Reform and Accidental Deaths*, 50 J.L. & ECON. 221 (2007).

77. In some states discounts are mandated.

will go to their rivals.[78] According to another view, Lojack is probably not very effective. If it were, the free rider problem could be easily solved. For instance, if car manufacturers like Porsche would install Lojack standard on all their cars, thieves would stay away from these cars, and these car manufacturers would reap the benefits.[79] Note however that, even if this argument is correct, it would be hard to find an analogous market solution in the context of legal insurance and tort accident prevention. Overall, these observations suggest that the public good problem of legal insurance markets might be quite pervasive. In Part V, we discuss potential policy options and market interventions.

V.
Policy Options

Whenever litigation costs prevent victims from pursuing valid legal tort claims, the deterrent effect of the tort system is undermined. In this regard, contingency fee arrangements,[80] legal aid, and legal insurance all serve the valuable purpose of facilitating legal claims when individual plaintiffs lack the financial means to pursue a dispute in court. Given the multiplication effect identified in this Article, legal insurance has a unique potential to increase overall accountability and deterrence. In this light, the under-provision of legal insurance policies is a cause of grave concern. In this Part, we discuss a number of policy options that might bolster the adaptation of legal insurance policies.

A. *Status Quo*

Before taking a closer look at the possible solutions for the curious scarcity of active legal insurance policies, it is wise

78. Ian Ayres & Barry Nalebuff, *Stop, Thief!*, Forbes (Jan. 10, 2005), http://www.forbes.com/forbes/2005/0110/088_print.html.

79. When the rate of theft of a particular car model decreases, that model becomes more attractive to consumers because insurance premiums will be lower. *See* Lott, *supra* note 58, at 43–44.

80. *See, e.g.*, Richard Moorhead & Peter Hurst, "Improving Access to Justice:" Contingency Fees: A Study of Their Operation in the United States of America, Civil Justice Council 9–10 (Robert Musgrove ed., 2008) (concluding from a review of the literature that contingency fees may broaden access to justice for multi-party and higher value cases, but also that they may narrow access to justice for lower value cases).

to consider whether or how markets might evolve in the absence of regulatory intervention.[81] Sometimes, insurance industries adjust their practices in reaction to external events. For instance, while disaster insurers did not promote loss control measures for many years, the severe losses caused by Hurricane Andrew urged the insurance industry to take a new perspective on mitigation measures.[82] Likewise, external events may eventually stimulate (first-party) insurers to promote legal expenses insurance more aggressively, since the added deterrence will likely reduce accidents and payouts to insured victims. Note, however, that huge exogenous shocks are not likely with regard to most accidents. An important difference between the damage caused by natural disasters and human actions in accidents relates to the predictability, frequency, and extent of damage caused by the former. The unpredictable nature of disasters can leave insurers with immense losses and take away their opportunity to invest income from premiums. Especially when disasters occur in periods when capital markets provide high returns on investments, the profit margins of insurance companies will decrease substantially. By contrast, the frequency and extent of damage caused by humans (e.g., traffic accidents) is much more predictable. Over the years, these damages may increase, but they often follow quite stable and logical evolutions, giving insurers the possibility to take them into account well in advance.

81. Any Regulatory Impact Analysis Checklist starts with the advantages and disadvantages of deciding to take no action. *See, e.g.*, OECD, REGULATORY IMPACT ANALYSIS: BEST PRACTICES IN OECD COUNTRIES, 146, 158, 225 (1997), http://www.oecd.org/gov/regulatory-policy/35258828.pdf; *see also* OFFICE OF INFO. & REGULATORY AFFAIRS, REGULATORY IMPACT ANALYSIS: A PRIMER 4 (2011), http://www.whitehouse.gov/sites/default/files/omb/inforeg/regpol/circular-a-4_regulatory-impact-analysis-a-primer.pdf (ordering agencies to "define the baseline" and stating that "the baseline represents the agency's best assessment of what the world would be like absent the action. To specify the baseline, the agency may need to consider a wide range of factors and should incorporate the agency's best forecast of how the world will change in the future, with particular attention to factors that affect the expected benefits and costs of the rule. For example, population growth, economic growth, and the evolution of the relevant markets should all be taken into account.").

82. Howard Kunreuther, *Mitigating Disaster Losses Through Insurance*, 12 J. RISK & UNCERTAINTY 171 (1996).

Still, even if exogenous circumstances could fundamentally alter incentives for the supply of insurance policies, legal insurance coverage will not be widespread unless the demand for policies increases as well. Of course, if the attitudinal change on the supply side causes insurers, for example, to automatically add legal insurance to other insurance policies, any demand side intervention would be unnecessary. But short of that, for instance, if insurers merely put more effort into convincing potential clients to take legal insurance, too many individuals may still decide to remain uninsured. In that case, other policy measures may still be necessary.

B. *Distinguishing Between Different Sources of Market Failure*

This Article has highlighted that the market for legal insurance is plagued by several sources of market failure. We have discussed various challenges on the demand side as well as the supply side.[83]

Consequently, before deciding how to intervene, regulators need to identify what source(s) of market failure(s) is (are) most influential. If the lack of legal insurance coverage is mainly due to individuals' underestimation of the probability that they will be involved in an accident or the chances that they might need to file a claim in court,[84] the most straightforward regulatory approach is to enhance the available information and to correct widespread misperceptions about the costs and risk of litigation. A strand of literature in behavioral science has recently focused on information regulation in a wide range of legal issues, especially involving consumer protection, to correct behavioral anomalies and irrational attitudes towards risk.[85] Empirical evidence suggests however that these behavioral attitudes are quite pervasive and difficult to correct.[86]

83. *See supra* Parts II & IV.

84. *See supra* Part II. Also, see generally DAN ARIELY, PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS (2008).

85. *See* Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1375 (2004); RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (2008).

86. *See, e.g.*, Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1545 (1998); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the*

Before taking action, regulators might want to assess to what extent the demand and supply of legal insurance is caused by the collective action problem identified in this Article. One possible test for the incidence of collective action problems is to examine whether legal insurance coverage is more extended for instances where the injurer can distinguish between victims with and without legal insurance. This might confirm the presence of collective action issues since the other available explanations (e.g., lack of information) do not distinguish between instances where deterrence benefits are shared or where they are fully captured by the individual policyholder. Empirical data from the United Kingdom provide some affirmation that collective action problems help explain the under-provision of legal insurance. Although stand-alone legal insurance policies are not very common in England,[87] a lot of commercial insurance policies are sold on a stand-alone basis.[88] Such policies are the third major component of the English legal insurance market and account for a third of gross premiums. The policies cover typical commercial areas such as contract disputes, data protection, tax, employment, etc. Note that in commercial relationships, insured companies are able to inform their contractual counterparties (prior to disputes) that they have legal expense insurance. Moreover, commercial relationships are often long-term. Once a (potential) dispute arises, it may become known that the victim has legal insurance, and this information will have its effect on the future relations between the parties (and potentially between the victim and other potential injurers when some information flows to them). To summarize, more extensive research might be in order to compare the public good effect of legal insurance markets with other potential factors that reduce the demand for legal expense insurance policies.

C. *Regulatory Approaches*

More direct corrective action might be necessary in order to correct the public good market failure of legal insurance.

Rationality Assumption from Law and Economics, 88 CALIF. L. REV. 1051, 1059 (2000).

87. Stand-alone policies are individual insurance policies that have no other policies included.

88. *See* Kilian, *supra* note 6, at 34.

Various options are available to regulators.[89] First, legislators might consider making legal insurance compulsory or mandating that legal insurance be added to other widespread insurance policies. This approach would solve the collective action issues highlighted above.[90] Also, the pooling of risk on such a large scale would make legal insurance more cost-effective to insurance companies. The effect on insurance policyholders would be more ambiguous. On the one hand, all policyholders would stand to benefit since every subscriber would share in (and contribute to) the increased overall deterrence and the reduction of accident costs. On the other hand, it is important to recognize that this approach takes away the individual autonomy of potential policyholders who might have information or resources that render legal insurance less valuable to them.[91]

Second, regulators might address the lack of subrogation among insurance companies. Avoiding subrogation may assist insurance companies in mitigating administrative costs. Yet, as discussed previously, this attitude also reduces overall accountability and amplifies some of the collective action problems highlighted in this Article. Part of the challenge of mandating subrogation would of course be in the details, especially as it relates to how to structure mandatory subrogation effectively without imposing too high an administrative burden on insurance companies. Of course, if mandatory subrogation causes premiums to go up too, the policy is likely to be counterproductive.[92] Third, policymakers could rely on financial incentives by rewarding individuals who take legal insurance and/or punishing individuals who do not.[93] For example, a tax benefit could be provided to individuals who subscribe to legal insurance.[94] Alternatively, court fees might be raised for

89. *See generally*, Seth J. Chandler, *Insurance Regulation*, *in* 3 ENCYCLOPEDIA OF LAW & ECONOMICS 837 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000).

90. *See supra* Section III.B.

91. *See* Michael G. Faure, *Economic Criteria for Compulsory Insurance*, 31 THE GENEVA PAPERS ON RISK AND INSURANCE 149 (2006).

92. *See supra* Section IV.B.

93. *See* De Geest & Dari-Mattiacci, *supra* note 9 (discussing the relative benefits of applying carrots or sticks).

94. A few European countries, including Belgium, have enacted tax breaks for legal insurance. *See* MICHAEL FAURE ET AL., RESULTAATGERELATEERDE BELONINGSSYSTEMEN VOOR ADVOCATEN: EEN VERGELIJKENDE

plaintiffs who do not have legal insurance. Finally, if none of these regulatory approaches prove viable, another option would be to expand the available system of legal aid to cases that hold the promise of generating substantial deterrence.[95] Since the essence of the problem concerns litigation costs, legal aid assistance can be useful in raising overall accountability while also sustaining the multiplication benefits associated with legal insurance.[96] Of course such approach would encounter the familiar costs involved with subsidized litigation and one would have to be mindful of the problems encountered today with legal aid policies.[97]

CONCLUSION

This Article provides new insights into the various causes and costs of the modest demand and supply of active legal insurance policies. First, we pointed out an overlooked multiplication benefit of legal insurance in the field of tort law. Because legal insurance coverage is non-observable to tort offenders ex ante, such policies affect the average likelihood that a negligent offender will be held accountable. As a result, even if not everyone is insured to bring legal claims, legal insurance increases the overall expected costs of engaging in negligent,

---

BESCHRIJVING VAN BELONINGSSYSTEMEN VOOR ADVOCATEN IN EEN AANTAL LANDEN VAN DE EUROPESE UNIE EN HONG KONG [Showing Related Lawyers' Fees: A Comparative Description of Lawyers' Fees in Some Countries in the European Union and Hong Kong] 41 (2006).

95. Gary Bellow, *Legal Aid in the United States*, 14 CLEARINGHOUSE REV. 337, 344–45 (1980); Tom C. Clark, *Changing Times*, 1 HOFSTRA L. REV. 1, 6 (1973) (urging the bar to consider a "prepaid legal insurance similar to hospital and health insurance in the medical field") *cited in* Nora V. Demleitner, *The Challenges to Legal Education in 1973 and 2012: An Introduction to the Anniversary Edition of the Hofstra Law Review*, 40 HOFSTRA L. REV. 639, 648 (2012).

96. Depending on the criteria that would be imposed to receive legal insurance, it is reasonable to assume that potential offenders or tortfeasors would often not be able to distinguish between victims that are eligible to receive legal aid and those that are not.

97. *See, e.g.*, FRANCISCO CABRILLO & SEAN FITZPATRICK, THE ECONOMICS OF COURTS AND LITIGATION 138–44 (2008); John Flood & Avis Whyte, *What's Wrong with Legal Aid? Lessons from Outside the UK,* 25 CIV. JUST. Q. 80 (2006) (arguing that legal aid has to be viewed in tandem with the provision of welfare services); Charles S. Potts, *Right to Counsel in Criminal Cases: Legal Aid or Public Defender*, 28 TEX. L. REV. 491 (1950). See also, on the efficacy of public defenders, LISA J. MCINTYRE, PUBLIC DEFENDER: THE PRACTICE OF LAW IN THE SHADOWS OF REPUTE (1987).

harmful behavior. Second, we showed that the potential of legal insurance remains unexploited due to a host of collective action issues among policyholders and the mixed incentives within insurance industries. Individual policyholders do not capture the full deterrence benefits of their individual subscriptions, while insurance companies may have incentives to promote other insurance instruments. Third, the potential policy options discussed in this Article, ranging from promoting policies to more coercive approaches such as mandatory subrogation and compulsory insurance, could help address these issues and bolster the deterrent effect of the tort system.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 13 FALL 2016 NUMBER 1

REGULATING DIGITAL MARKETS

MAX N. HELVESTON*

It has become popular for scholars and non-academic commentators to claim that technological advances have reshaped consumer markets and empowered individuals. Some have argued that the digitization of commerce has leveled the playing field between consumers and businesses, with the growth of the internet, social media, and applications granting individuals the power necessary to combat exploitative business practices. These technological changes have led some to question the necessity of continued governmental intervention in consumer markets.

The existing literature fails, however, to grasp the extent to which technological innovations have empowered private firms. The omnipresence of the internet provides businesses with unprecedented access to consumers. The easy availability of individuals' personal information opens the doors to a world where firms can customize advertisements and sales contracts to take advantage of individuals' interests, fears, and vulnerabilities. Most importantly, the transition to digital markets has introduced a new threat to consumer welfare that commentators, academics, and regulators have failed to notice. It has fostered consumer dependence on digital reputational data, while permitting firms to easily (and often legally) manipulate this information.

The digital revolution will not be a panacea for consumers, and calls for deregulation of markets are misplaced. Existing consumer protection practices need to be updated to account for the evolving commercial landscape. In order to protect consumers' interests in today's markets, the state should act to prohibit the manipulation of reputational data, restrict companies' uses of consumer data, and foster private consumer activist actions.

---

* Copyright © 2016 by Max N. Helveston. Associate Professor of Law, DePaul University College of Law. This Article benefited greatly from presentations at the Rutgers–Camden Insurance Law Scholars Workshop; the University of Chicago Junior Scholar Workshop; and the DePaul University Faculty Roundtable. Thanks due to Jay Feinman, Peter Siegelman, Rick Swedloff, Christopher French, Michael Grynberg, Zoe Robinson, Emily Cauble, Michael Jacobs, Nathan Nagy, and all of the other scholars who provided feedback on earlier drafts.

INTRODUCTION 34
I. CONSUMER VULNERABILITIES AND REMEDIAL TECHNOLOGIES 40
A. *Commercial Exploitation in Traditional Markets* . 41
B. *Consumer Empowerment Through Innovation* ... 45
C. *(De)Regulatory Implications* 52
II. THE LIMITS OF PRIVATE REGULATION AND NEW FORMS OF COMMERCIAL EXPLOITATION 56
A. *Manipulation of Digital Reputational Information* 57
1. *Review Firms and Self-Interested Manipulation of Reputational Markets* 59
2. *Firms' Efforts to Assert Control Over Reputational Data* 61
B. *Consumer Activism's Inherent Costs* 64
C. *Firms' Enhanced Advertising and Transactional Capabilities* 67
D. *Limits on Private Actions' Regulatory Effects* 71
III. REGULATING COMMERCE IN A DIGITAL ECONOMY . 77
A. *The Status Quo* 78
B. *Necessary Reforms* 81
1. *Requiring Disclosure for Review Sites and Prohibiting Deceptive Reviews* 83
2. *Supporting Grassroots Consumer Protection Movements* 85
3. *Increasing Substantive Regulation of Firms' Relationships with Consumers* 87
CONCLUSION 92

INTRODUCTION

It has become popular for scholars and non-academic commentators to argue that the digital revolution has reshaped consumer markets and empowered individuals.[1] They

1. Wayne R. Barnes, *Social Media and the Rise in Consumer Bargaining Power*, 14 U. PA. J. BUS. L. 661, 662 (2012) ("Recently, however, some consumers have used social media to assert a new kind of power over merchants."); S. Umit Kucuk & Sandeep Krishnamurthy, *An Analysis of Consumer Power on the Internet*, 27 TECHNOVATION 47, 54 (2007) ("The ability of consumers to access a variety of information sources enhances their voice at the individual and community level, and is changing markets."); Guilherme D. Pires, John Stanton & Paulo Rita, *The Internet, Consumer Empowerment and Marketing Strategies*, 40 EUR. J. MARKETING 936, 945 (2006) (arguing that the

have identified the maturation of the internet, the emergence of social media, and the incredible expansion in the accessibility of information as forces that have irrevocably changed what it means to be a consumer.[2] Some have asserted that the digitization of commerce has significantly leveled the playing field between consumers and businesses, as the growth of the internet, social media, and applications grants individuals the power necessary to combat exploitative business practices.[3] These changes have led some experts to question the necessity of traditional governmental interventions in modern consumer markets.[4]

---

shift to a web-based economy has caused the "power relationship between consumers and suppliers" to change); Jeff Howe, *The Rise of the Consumerate*, NAT'L J. (June 7, 2012), http://www.theatlantic.com/business/archive/2012/06/the-rise-of-the-consumerate/426231/ (describing how "[n]ew technologies have given consumers a lot of leverage over companies"); Brian Solis, *Corporate America, Meet 'Generation C,'* WASH. POST (June 28, 2012), https://www.washingtonpost.com/national/on-innovations/corporate-america-meet-generation-c/2012/06/27/gJQAQlKG9V_story.html ("In the age of social media, we are witnessing a C-change (as in 'C' for customer) in the balance of power between consumers and businesses.").

2. S. Umit Kucuk, *Consumer Exit, Voice, and 'Power' on the Internet*, 15 J. RES. FOR CONSUMERS 1, 10 (2008) (discussing how the internet has caused a "revolutionary transformation in consumer exit and voice"); Michael B. Farrell, *Social Media Offer New Outlet for Complaints: Consumers Get Action as Corporations Tune in*, BOS. GLOBE (Nov. 3, 2011), https://www.bostonglobe.com/business/2011/11/02/social-media-offer-new-outlet-for-customer-complaints/vP5m9ADZun9RU0BjUbijeN/story. html ("Social media outlets have given consumers a real-time vehicle to express their outrage. And corporations are listening.").

3. Josh Bernoff & Charlene Li, *Harnessing the Power of the Oh-So-Social Web*, 49 MIT SLOAN MGMT. REV. 36, 36 (2008) (discussing how new technologies are "tilting the balance of power from company to consumer"); Simon Mainwaring, *The New Power of Consumers To Influence Brands*, FORBES (Sept. 7, 2011), http://www.forbes.com/sites/simonmainwaring/2011/09/07/the-new-power-of-consumers-to-influence-brands/ (arguing that social media grants consumers the power to force businesses to change their practices).

4. Scott R. Peppet, *Freedom of Contract in an Augmented Reality: The Case of Consumer Contracts*, 59 UCLA L. REV. 676, 745 (2012) ("The doctrines born out of judicial distrust for standard form contracts were created before computers, the internet, or wireless technologies—before consumers had constant real-time access to information about the places, goods, people, firms, and contracts around them."); Havas Worldwide, *Power Shift: Consumers and Corporations Step in Where Government Has Failed*, HAVAS WORLDWIDE (Jan. 18, 2013), http://www.slideshare.net/HavasWorldwide/havas-worldwide-prosumer-report-communities-and-citizenship (presenting international polling data showing that more people believe that social media is better suited to

Claims that new technologies will unequivocally increase consumers' strength and decrease the need for public regulation of markets are wrong. While it is true that many of these developments will grant consumers capabilities that were once unimaginable, the power disparity between individuals and businesses will continue to exist.[5] Additionally, the transition to a digital economy will introduce new threats to consumer welfare.[6] Recent technological advances should not be viewed as reducing the need for governmental market interventions, but rather should be seen as creating a need to revise existing regulatory structures to better fit the new world.

It is easy to see why some have viewed the digital revolution as a boon to consumers. Mainstream and online media sources have showcased a number of stories about individuals successfully engaging in web activism—getting commercial giants like United Airlines, Amazon, and Facebook to change internal policies or compensate aggrieved customers.[7] Further, economic analysis reveals a variety of ways that online technologies enhance consumers' capabilities: they decrease consumers' search costs,[8] reduce informational asymmetries

resolve problems than government regulation); *see also* Joe Jacquot, *Old Consumer Protection Laws Don't Necessarily Fit Sharing Economy*, NAT'L L.J. (June 20, 2016), http://www.nationallawjournal.com/id=1202760365524/Old-Consumer-Protection-Laws-Dont-Necessarily-Fit-Sharing-Economy; Giacomo Lev Mannheimer, *Consumer Protection in the Digital Age: Has Innovation Displaced Regulation?*, CAPX (June 7, 2016), http://capx.co/consumer-protection-in-the-digital-age-has-innovation-displaced-regulation/ (arguing that technological innovation has decreased the need for governmental regulation of markets).

5. *See, e.g.*, Lauren I. Labrecque et al., *Consumer Power: Evolution in the Digital Age*, 27 J. INTERACTIVE MARKETING 257, 257 (2013) (stating that some predictions about the increase in consumer power "have come to fruition; others have rotted on the vine").

6. *See* discussion *infra* Sections II.A, II.C.

7. *See* Barnes, *supra* note 1, at 674–88 (summarizing successful consumer activism efforts); Kucuk & Krishnamurthy, *supra* note 1, at 49.

8. *See* Joshua A.T. Fairfield, *The Search Interest in Contract*, 92 IOWA L. REV. 1237, 1242–48 (2007) (discussing decreasing search costs in digital contracting behavior).

between consumers and businesses,[9] and bolster reputational policing in consumer markets.[10]

The overall effect that these developments will have on consumer power, however, has been overstated.[11] Little attention has been given to how these pro-consumer effects are inherently self-limiting.[12] While anecdotal evidence establishes that digitally facilitated protests can influence firms' conduct in certain contexts, these protests appear to be incapable of achieving regulatory goals on a market-level scale.[13] Furthermore, commentators have rarely accounted for the fact that technology can only reduce, not eliminate, the agency costs associated with consumers taking action against businesses.[14]

Additionally, many have failed to grasp the extent to which innovations have empowered groups other than consumers. Firms' capabilities have also been enhanced by the digital era, enabling businesses to employ new tactics for exploiting consumers' individual and collective weaknesses.[15] The omnipresence of the internet and social media provides

---

9. *See* Kucuk & Krishnamurthy, *supra* note 1, at 50–51 (discussing how consumers in digital markets are better able to access information than consumers in traditional markets).

10. *See, e.g.*, Yubo Chen, Scott Fay & Qi Wang, *The Role of Marketing in Social Media: How Online Consumer Reviews Evolve*, 25 J. INTERACTIVE MARKETING 85 (2011) (reviewing studies establishing that online consumer product reviews have powerful effects on consumers).

11. *See, e.g.*, Steven Rosenbaum, *The New World of the 'Empowered Consumer'*, FORBES (July 16, 2015), http://onforb.es/1Mwwtof (describing how technology has "driven the shift from passive to empowered consumers"); Sandhya Venkatachalam, *Five Things That Make You an Empowered Consumer*, WORLD ECON. F. (Nov. 9, 2014), https://www.weforum.org/agenda/2014/11/five-things-that-make-you-an-empowered-consumer/ (claiming that "[e]nterprises have to view their customers . . . in a new light" because of technological empowerment).

12. *See* discussion *infra* Section II.B.

13. *See* discussion *infra* Section II.D.

14. *See* discussion *infra* Section II.B.

15. *See* Ryan Calo, *Digital Market Manipulation*, 82 GEO. WASH. L. REV. 995, 1003–18 (2014) (describing how technology has granted firms new capabilities that allow them to take advantage of consumers); Brian Fung, *Internet Providers Want To Know More About You Than Google Does, Privacy Groups Say*, WASH. POST (Jan. 20, 2016), https://www.washingtonpost.com/ news/the-switch/wp/2016/01/20/your-internet-provider-is-turning-into-a-data-hungry-tech-company-consumer-groups-warn/ (describing the ability of telecom and cable companies to monitor every action their customers take online).

businesses with unprecedented access to consumers.[16] The availability of incredible amounts of personal information opens the doors to a world where advertisements and sales contracts are customized to take advantage of individuals' interests, fears, and vulnerabilities.[17] Advances in monitoring and communication capabilities will allow firms to actively manage their customers and prevent disputes from being brought before the state bodies that regulate markets.[18]

The shift to digital markets has also introduced a new threat to consumer welfare that commentators, academics, and regulators have failed to notice. The growth of the internet and online applications has increased individuals' reliance on customer reviews and other reputational information.[19] This has created large economic incentives for firms to try to influence how they are portrayed on the websites and applications that review their products. These incentives have started to manifest in a multitude of different ways—firms posting duplicitous reviews or contracting with third parties to do the same, review-hosting companies allegedly extorting money from reviewed companies, etc.[20] Federal and state regulators have been slow to react to these developments, permitting the corruption of reputational information and allowing businesses to undermine a force that would punish exploitative business practices.

16. *See* Richard Hanna, Andrew Rohm & Victoria L. Crittenden, *We're All Connected: The Power of the Social Media Ecosystem*, 54 BUS. HORIZONS 265, 272 (2011) ("Social media platforms . . . have begun to revolutionize the state of marketing, advertising, and promotions."); Steven Melendez, *Customized or Creepy? Websites and Your Data, a Guide*, FAST COMPANY (July 6, 2016), http://www.fastcompany.com/3061205/customized-or-creepy-how-websites-toe-the-line-with-user-data (describing how companies can use cookies and other mechanisms to collect information about their customers' digital activities); *Getting to Know You*, ECONOMIST (Sept. 13, 2014), http://www.economist.com/news/special-report/21615871-everything-people-do-online-avidly-followed-advertisers-and-third-party (detailing how "[e]verything people do online is avidly followed by advertisers and third-party trackers").

17. *See* Calo, *supra* note 15, at 1016–18.

18. *See* discussion *infra* Section II.D.

19. *See* Michael Anderson & Jeremy Magruder, *Learning from the Crowd: Regression Discontinuity Estimates of the Effects of an Online Review Database*, 122 ECON. J. 957, 957 (2012) (discussing how technology has increased the importance of reviews and other reputational information to consumers).

20. *See* discussion *infra* Section II.A.

Given all of these threats to consumer well-being, it is clear that the digital revolution is far from a panacea and that large scale deregulation of markets would be a mistake. Technology will cause consumer and firm behaviors to change substantially, creating new dangers to individuals' welfare and threatening the health of commercial markets. Even if the technologically enhanced efforts of consumers become powerful enough to prevent some abusive conduct, there are some forms of exploitation that can only be addressed through governmental intervention.

It is worth noting at the outset that the government has taken a patchwork approach to consumer protection issues and market regulation. While the Federal Trade Commission (FTC) can be viewed as the main public entity responsible for promoting consumer welfare, there are many different federal and state actors that control consumer protection efforts.[21] Just as multiple governmental bodies may sometimes assert jurisdiction over the same issue, some consumer problems do not fall squarely within the ambit of any regulatory actor. Many of the exploitative uses of technology discussed in this Article appear to fall outside of agencies' traditional bounds.

Existing regulatory practices will have to be revised to account for technological changes and new rules will need to be put into place. State and federal actors must begin actively policing private sector practices and prohibiting conduct that unfairly disadvantages consumers. For instance, the state should bar companies from intentionally manipulating consumer review information and limit their ability to collect and use individuals' data. The government should also take steps to bolster consumer awareness and empower consumer activism movements.

After providing a brief overview of the traditional justifications for state intervention in consumer markets, Part I discusses how digital technologies, the maturation of the web, and the rapid growth of social media can enhance the power of consumers. It also describes the arguments that some have made about how these technological enhancements decrease

---

21. *See* Edward M. Crane, Nicholas J. Eichenseer & Emma S. Glazer, *U.S. Consumer Protection Law: A Federalist Patchwork*, 78 DEF. COUNS. J. 305, 305 (2011) ("Federal consumer protection law reflects piecemeal congressional efforts to protect consumers.").

the need for state regulation of consumer markets. Part II establishes flaws in the arguments of proponents of deregulation. It describes a variety of factors that will mitigate consumer gains in bargaining power. Most significantly, it describes how the digitization of commerce has fostered consumer dependence on reputational information and, at the same time, has provided firms with low-cost opportunities to manipulate such data. Part III discusses how consumer protection laws will have to change to remain effective in the modern era. It begins with a summary of the primary ways that the government regulates consumer markets, then moves on to describe reforms that would prevent abusive commercial practices in a digital environment.

I.
CONSUMER VULNERABILITIES AND REMEDIAL TECHNOLOGIES

Concern for the welfare of consumers has a long history of motivating governmental intervention in markets.[22] In its infancy, the state's primary involvement in consumer protection efforts involved imposing common law liabilities on businesses for harms caused by their products.[23] As markets evolved, the goods and services being sold to consumers became more complex and the state instituted further forms of regulation. Legislatures passed laws establishing certain commercial standards and created administrative bodies responsible for overseeing certain market sectors.[24] In the modern era, new regulatory measures seem an inevitable consequence of any major development in consumer markets.

---

22. *See* CAROLYN L. CARTER, NATIONAL CONSUMER LAW CENTER, CONSUMER PROTECTION IN THE STATES 5–6 (2009) (describing the historical antecedents to modern state consumer protection laws); Mark E. Budnitz, *The Federalization and Privatization of Public Consumer Protection Law in the United States: Their Effect on Litigation and Enforcement*, 24 GA. ST. U. L. REV. 663, 663 (2008) (describing the forces driving the enactment of consumer protection legislation); Victor E. Schwartz & Cary Silverman, *Common-Sense Construction of Consumer Protection Acts*, 54 U. KAN. L. REV. 1, 6–14 (2005) (providing a history of consumer protection efforts in the twentieth century).

23. *See* CARTER, *supra* note 22, at 5–6; Schwartz & Silverman, *supra* note 22, at 6–8 (discussing the two different models of enforcement).

24. *See* Budnitz, *supra* note 22, at 666–77 (describing the current status of federal and state consumer protection laws); Schwartz & Silverman, *supra* note 22, at 15–16 (describing the history surrounding the enactment of state consumer protection acts).

This general pattern is almost certain to repeat itself when it comes to the changes introduced by the digitization of commerce. Oddly, many of the scholars and social commentators that have theorized about the digital revolution and consumer markets have myopically focused on its positive characteristics.[25] While they correctly identify ways these developments will empower individuals, they fail to recognize that they will also imperil consumers' interests.

A. *Commercial Exploitation in Traditional Markets*

In the wake of Supreme Court decisions like *AT&T v. Concepcion*[26] and *Mutual Pharmaceutical Co. v. Bartlett*,[27] there has been a renewal of interest in consumer protection law among legal academics. Scholars have documented growing hostility to consumer suits in the judiciary.[28] They have argued that the state needs to play a larger role in protecting consumers from private commercial entities, advocating for pro-consumer doctrinal changes, legislation, and agency actions.[29]

---

25. *See, e.g.*, sources cited *supra* notes 2–3.

26. AT&T Mobility LLC v. Concepcion, 563 U.S. 333 (2011) (affirming the enforceability of arbitration clauses in consumer contracts that prohibit class-based suits, even when class-based relief is the only mechanism capable of providing consumers with an economically rational means for pursuing their claims).

27. Mut. Pharm. Co. v. Bartlett, 133 S. Ct. 2466 (2013) (holding that the existence of federal drug labeling laws was sufficient to preempt consumers' state-based tort law claims against generic drug manufacturers, effectively immunizing generic drug manufacturers from common law liability).

28. *See, e.g.*, Lee Epstein, William M. Landes & Richard A. Posner, *How Business Fares in the Supreme Court*, 97 MINN. L. REV. 1431, 1471 (2013) (finding that "the Roberts Court is much friendlier to business than either the Burger or Rehnquist Courts, which preceded it"); J. Maria Glover, *The Structural Role of Private Enforcement Mechanisms in Public Law*, 53 WM. & MARY L. REV. 1137 (2012) (describing how the Supreme Court has limited private enforcement mechanisms); Max N. Helveston, *Judicial Deregulation of Consumer Markets*, 36 CARDOZO L. REV. 1739 (2015) (arguing that the judiciary has trended towards an anti-consumer jurisprudence); Erwin Chemerinsky, Op-Ed., *Justice for Big Business*, N.Y. TIMES (July 2, 2013), http://www.nytimes.com/2013/07/02/opinion/justice-for-big-business.html?_r=0 (stating that the Supreme Court "consistently favors manufacturers over consumers" and has "sharply limit[ed] class action suits against companies").

29. *See* MARGARET JANE RADIN, BOILERPLATE 154–186, 217–42 (2013); Helveston, *supra* note 28, at 1769–81; Rory Van Loo, *Helping Buyers Beware: The Need for Supervision of Big Retail*, 163 U. PA. L. REV. 1311, 1382–92 (2015).

State intervention, they contend, is justified because consumers lack the ability to effectively negotiate the contractual terms set by the companies from whom they buy goods and services.[30] Companies have become increasingly cognizant of this dynamic and have demonstrated that they have no qualms about structuring sales in ways that maximize their utility at the expense of their customers' interests. This has led to the gradual degradation of consumers' rights.[31] For example, modern contracts for the sale of goods typically use arbitration clauses, choice of law provisions, and prohibitions against class-based relief to severely restrict individuals' ability to hold the company accountable for breaching their contracts.[32]

The standard explanation for why private actors fail to effectively police exploitative commercial practices is set forth in economic terms. In most consumer transactions the cost associated with an individual contesting a term (or informing the retailer that she would prefer a different term) is substantial, the potential utility gains are small, and the likelihood of success is minimal.[33] These three factors taken together make it inefficient for any individual consumer to even attempt to negotiate alternative terms.[34] Exacerbating this tendency is the fact that the terms offered by all of the firms within a market are often the same.[35] This effort–reward calculus is often so unbalanced that it is inefficient for consumers to spend time even learning about the terms of their commercial transactions.[36] Other private market forces—like inter-firm competi-

---

30. *See* Daniel D. Barnhizer, *Inequality of Bargaining Power*, 76 U. COLO. L. REV. 139, 149–150 (2005) (describing the standard view of the negotiating dynamic between consumers and firms); Andrew A. Schwartz, *Consumer Contract Exchanges and the Problem of Adhesion*, 28 YALE J. ON REG. 313, 346–48 (2011) (describing consumers' lack of power and non-negotiable contracts).

31. *See* RADIN, *supra* note 29, at 19–51.

32. *Id.*

33. *See id.* at 12; Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and Economics Meets the Real World*, 24 GA. L. REV. 583, 594–608 (providing an overview of the standard law and economics explanation of consumer-firm contracting).

34. *See* RADIN, *supra* note 29, at 12; Lee Goldman, *My Way and the Highway: The Law and Economics of Choice of Forum Clauses in Consumer Forum Selection Clauses*, 86 NW. U. L. REV. 700, 716–17 (1992).

35. *See* W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 556–61 (1971).

36. *See* sources cited *supra* note 30.

tion and pro-consumer efforts spearheaded by private entities—have often failed to effectively combat exploitation, as evidenced by the continued use of abusive terms in consumer contracts.[37]

Consumer advocates have long argued that the private market's failure to adequately protect consumers justifies active state regulation of these markets. Over the course of the twentieth century, these advocates have often succeeded in their lobbying efforts, resulting in the passage of a variety of legislative and regulatory measures at every level of government. For example, Congress amended Rule 23 of the Federal Rules of Civil Procedure concerning class action suits to make suits based on small consumer claims economically viable.[38] State legislatures enacted consumer protection acts prohibiting unfair and deceptive commercial practices, often allowing successful complainants to recover attorney's fees and statutory fees.[39] Federal and state administrative agencies like the FTC, the Securities and Exchange Commission, and the Consumer Financial Protection Bureau were created and charged with protecting consumers from abusive commercial practices.

Since the turn of the century, federal and state legislatures have passed a number of large acts that advance consumer interests in specific commercial contexts. In the wake of the 2007 financial crisis, the federal government enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act,[40] which contains a multitude of provisions that protect

---

37. *See, e.g.*, Aaron E. Ghirardelli, *Rules of Engagement in the Conflict Between Businesses and Consumers in Online Contracts*, 93 OR. L. REV. 719, 733–42 (2015) (discussing the use of exploitative terms in online contracts); Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 375–77 (2005) (describing the growing use of collective action waivers in consumer contracts).

38. *See* Kenneth W. Dam, *Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest*, 4 J. LEGAL STUD. 47, 48 (1975) (describing how the changes to the procedural rules reduce transactions costs, increase individual compensation, and deter wrongful conduct); Judith Resnik, *Lessons in Federalism from the 1960s Class Action Rule and the 2005 Class Action Fairness Act: "The Political Safeguards" of Aggregate Translocal Actions*, 156 U. PA. L. REV. 1929, 1940 (2007) ("[T]he drafters of Rule 23 assumed that groups of plaintiffs . . . would enable federal judges to enforce federal regulations aimed at corporate misbehavior.").

39. *See* CARTER, *supra* note 22, at 5–6.

40. 12 U.S.C. §§ 5301–5641 (2010).

consumers from commercial entities' exploitative practices.[41] The crisis also inspired the executive branch to push the FTC to bolster its policing of markets and charter studies on how technological advances are changing commercial entities' behaviors, creating a need for new forms of regulation.[42] Likewise, concerns about abusive conduct in health insurance markets contributed to the passage of the Patient Protection and Affordable Care Act,[43] which proscribed insurers' more questionable practices.[44]

Despite these successes, many commentators and scholars believe that state regulation of markets remains inadequate, arguing that governmental efforts have failed to prevent consumer exploitation in a variety of contexts.[45] They also disagree about the best way to improve upon the status quo. While some advocate on behalf of class action reform, others focus on improving statutory consumer protection acts, and still others have favored more robust market regulation by state or federal agencies. Some proposals have been particularly popular among consumer-rights scholars. First, concerns about the fairness of the mandatory arbitration clauses contained in many consumer contracts have led to calls to limit or ban their use.[46] Similar worries have induced support for circumscribing the enforceability of contract provisions that limit businesses' liabilities and consumers' remedies.[47] Finally, a cohort of scholars has argued that the United States should adopt regu-

41. *See* Arthur E. Wilmarth, Jr., *The Dodd-Frank Act's Expansion of State Authority to Protect Consumers of Financial Services*, 36 J. CORP. L. 893 (2011) (describing the Act's consumer protections).

42. *See* FED. TRADE COMM'N, PROTECTING CONSUMER PRIVACY IN AN ERA OF RAPID CHANGE: RECOMMENDATIONS FOR BUSINESSES AND POLICYMAKERS (2012), http://ftc.gov/os/2012/03/120326privacyreport.pdf.

43. Pub. L. No. 111–148, 124 Stat. 119 (2010).

44. *See* Kathleen Sebelius, *Affordable Care Act at 3: Consumer Protections*, WHITE HOUSE BLOG (Mar. 18, 2013), https://www.whitehouse.gov/blog/2013/03/18/affordable-care-act-3-consumer-protections (discussing the consumer protections in the Affordable Care Act).

45. *See, e.g.*, Helveston, *supra* note 28, at 1739 (documenting the rise of an anti-consumer jurisprudence in federal courts); Christopher R. Leslie, *The Arbitration Bootstrap*, 94 TEX. L. REV. 265 (2015) (arguing that the judiciary and legislatures have enabled private firms to use arbitration clauses to exploit consumers); Van Loo, *supra* note 29, at 1311 (documenting anticompetitive behaviors by large retail firms).

46. *See, e.g.*, Leslie, *supra* note 45.

47. *See, e.g.*, Gilles, *supra* note 37.

lations that are modeled on the European Union's Directive on Unfair Terms in Consumer Contracts.[48] While many of these proposals are good ideas, none of these would be sufficient to address the threats to consumer welfare that will arise in a digital economy.

B. *Consumer Empowerment Through Innovation*

Recently commentators have argued that the growing centrality of social media and the internet in modern life has helped level the playing field by providing consumers with more effective means for combating exploitative commercial practices.[49] The arguments that they rely on to support the claim that digital marketplaces empower consumers are typically couched in economic theory and include references to well-publicized events of consumer activism. There are three factors that stand out as being at the core of many of these analyses of how digitization will increase consumer protection: (1) decreases in consumers' search costs for products, (2) reductions in the informational asymmetries between consumers and businesses, and (3) drastic changes in the role of reputational effects in consumer markets.

High search costs are one of the factors that disadvantage consumers in traditional modes of commerce. In competitive markets—i.e., where consumers have the ability to choose from several businesses when purchasing a good or service—consumers must perform an initial search to discover what products exist that could satisfy their needs.[50] The costs associated with gathering this information can deter a consumer from selecting the product that would maximize her utility.[51] For example, the amount of effort that it would take someone

---

48. *See* Ghirardelli, *supra* note 37, at 753–62, 768–70; Michael L. Rustad & Maria Vittoria Onufrio, *Reconceptualizing Consumer Terms of Use for a Globalized Knowledge Economy*, 14 U. PA. J. BUS. L. 1085, 1189–90 (2012).

49. *See, e.g.*, Pires, Stanton & Rita, *supra* note 1 at 936; Simon Mainwaring, *The New Power of Consumers to Influence Brands*, FORBES (Sept. 7, 2011), http://www.forbes.com/sites/simonmainwaring/ 2011/09/07/the-new-power-of-consumers-to-influence-brands/; Solis, *supra* note 1 ("In the age of social media, we are witnessing a C-change (as in 'C' for customer) in the balance of power between consumers and businesses.").

50. *See* Fairfield, *supra* note 8, at 1242–48 (discussing search costs in contracting behavior).

51. *Id.*

looking for a laptop to become aware of Company X's product could be large enough that she purchases Company Y's inferior, but more easily discovered, product.[52]

Search costs impair consumer choice in other ways as well. Even if a consumer is aware of multiple companies' products, she must expend further effort to learn about the products' features and terms of sale.[53] Additionally, if these products or terms of sale are difficult for the consumer to discover or understand, then her search costs will be even greater. For instance, even if a consumer greatly values warranties of merchantability and the availability of class-based relief, the costs associated with learning which companies' sales contracts contain these terms may cause her to make purchases that do not reflect these preferences.

The growth of the web has catalyzed reductions in both types of search costs. Initial search costs are dramatically minimized in the digital era.[54] Online retailers like Amazon and Google Shopping give consumers the ability to generate long lists of products that could satisfy their desires with very little effort. Similarly, social media sites like Reddit and Facebook provide consumers with low cost opportunities to receive similar information from other individuals. Search costs are reduced even for products and services that are only available through companies' proprietary websites, as browsing many of these sites will still typically require less effort than collecting an equivalent amount of information offline.

In addition to making it easier for consumers to access and compare basic information about companies' products and services, the digital era has helped smooth informational asymmetries between businesses and consumers.[55] Traditionally, consumers only had access to the information provided by the company in its marketing materials and product packaging. While information from governmental bodies (e.g., safety warnings, recalls) or media outlets (e.g., reviews in consumer reports) could give consumers additional information, it was most often the case that consumers were severely limited in

---

52. *Id.*
53. *Id.* at 1247–48.
54. *Id.* at 1275–77.
55. *See* Leyland F. Pitt et al., *The Internet and the Birth of Real Consumer Power*, 45 BUS. HORIZONS 7, 8 (2002).

what they could learn about products. Much of the information that consumers might consider important was inaccessible. Businesses, however, had access to information from product development, internal tests, customer complaints, and other sources. This informational disparity was particularly pronounced in markets where consumers made infrequent purchases, as individuals in these markets had little personal experience to draw upon to aid their decision making.

Similarly, it was difficult for individuals to access information about other consumers' commercial experiences in the pre-digital era. In order to provide such access, an entity would have to spend countless work-hours surveying the public, analyzing their responses, and then coming up with a means of conveying this information to consumers.[56] Transmitting the information to consumers was a particularly daunting task—not only were there high publication and distribution costs, but also even the best modes of distribution were unable to ensure that consumers would be able to access key information at the time when it would be most helpful to them.[57] Further, the fact that individuals' opinions were being mediated through third parties raised concerns about bias or industry capture of the entities presenting the reviews. Because of these structural barriers, reputational information about many products and services was hard (if not impossible) to find.

The internet, and social media apps, have helped expand consumers' access to information by creating an environment where the aggregation and publication of certain data is, for the first time, economically viable.[58] Entities no longer have to incur large costs to collect consumers' reviews of businesses—individuals have demonstrated that they will freely volunteer such information through online forms and applications.[59]

56. *See* Yubo Chen & Jinhong Xie, *Third-Party Product Review and Firm Marketing Strategy*, 24 MARKETING SCI. 218, 218 (2005) ("Moreover, the Internet and fast-developing information technology have significantly reduced reviewers' information-delivery cost and consumers' information-retrieval cost.").

57. *See* Fiona Scott Morton, *Consumer Benefit from Use of the Internet*, 6 INNOVATION POL'Y & ECON. 67, 73–75 (2006) (describing how the digital revolution has improved the ability of third-party reviewers to get information to consumers).

58. Labrecque et al., *supra* note 5, at 261–62.

59. *See, e.g.*, Kucuk, *supra* note 2, at 6 (stating that the internet has made "collecting information from consumers less costly for companies"); Press

Further, not only is consumer access to online content increasing rapidly, but digital publication is also considerably faster and less expensive than print media.[60] Many of the internet's most popular websites collect individuals' views about products and businesses: Amazon has its product star ratings and customer comments; Yelp provides user reviews of restaurants and retail establishments; Reddit and traditional message boards contain discussions of virtually every commercial good or service; etc.

The practices of online retailers and the growth of digital communities have increased consumers' ability to obtain information about products. First, many companies selling items on the internet present product information in a relatively uniform, consumer-friendly format. Because most product information is not portrayed consistently (if at all) in physical sales environments, online practices reduce the toll that information collection imposes on consumers and facilitate the comparison of products.[61] Second, websites that feature products from multiple companies typically provide consumers with the ability to identify key characteristics (e.g., price thresholds, warranties) that they are looking for and filter out all items that do not match these criteria.[62] Furthermore, social media and consumer-oriented sites make it easier for consumers to learn about different companies' terms of sale and to compare companies' offerings against one another. Finally, the digital era has made it much easier for individuals to have their product-related questions answered by others.[63] Company and retailer websites often include features that allow users to submit inquiries to product representatives, while social media sites allow individuals to obtain similar information from other con-

---

Release, ReleaseWire, New Soc. Network Gives Big Cos. Free R&D While Consumers Speak Their Innovative Minds (Sept. 26, 2014), http://www.releasewire.com/press-releases/new-social-network-gives-big-companies-free-rd-while-consumers-speak-their-innovative-minds-549402.htm.

60. Michael Anderson & Jeremy Magruder, *supra* note 19, at 957 (discussing how technology has lowered the costs of making reputational information available to consumers).

61. Kucuk & Krishnamurthy, *supra* note 1, at 50–51.

62. Behrang Rezabakhsh et al., *Consumer Power: A Comparison of the Old Economy and the Internet Economy*, 29 J. CONSUMER POL'Y 3, 13–14 (2006) (discussing the increase in consumers' ability to search for and review product information).

63. *See* Pitt et al., *supra* note 55, at 8.

sumers.[64] In creating more efficient avenues for consumers to obtain information about products, the internet has granted individuals the ability to make smarter pre-purchase decisions and has strengthened companies' incentives to provide good service.

By catalyzing the collection of consumer knowledge and reducing search costs, the digital revolution has transformed the role that reputational effects have in consumer markets. Businesses in the pre-digital era were not immune to reputational effects; the opinions of those with broad reach (e.g., rating organizations, popular media outlets) could significantly affect a company's bottom line. However, large corporations could ignore the complaints of individual consumers with little risk of substantial repercussions.[65] For instance, a national manufacturer of vacuum cleaners would have little reason to care if an individual was upset by the company's poor product quality and its refusal to recognize its warranty obligations. Unless such a disgruntled consumer's complaints managed to attract larger media attention, his views would have a negligible impact on the company's revenue.

The digital era has increased the likelihood that companies that provide poor service and ignore consumer complaints will be exposed. As noted earlier, social media platforms like Facebook, Yelp, and Twitter have drastically reduced the amount of effort that consumers must exert to protest commercial entities' actions.[66] This reduction in costs has created an environment where the views of individual consumers actually have the potential to affect the commercial behaviors of a substantial number of their peers. The importance of digital consumer reviews has not been lost on firms.[67]

Commentators have also supported their claims about consumer empowerment with anecdotal information about

64. Rezabakhsh et al., *supra* note 62, at 16.

65. *See* Barnes, *supra* note 1, at 683.

66. *See* Farrell, *supra* note 2; Labrecque et al., *supra* note 5, at 263; Rezabakhsh et al., *supra* note 62, at 16.

67. *See* Bernoff & Li, *supra* note 3, at 36–38; Scott McCartney, *The Airlines' Squeaky Wheels Turn to Twitter*, WALL ST. J. (Oct. 26, 2010), http://www.wsj.com/articles/SB10001424052702304173704575578321161564104; Corinne Purtill, *The Turbulent World of Airline Twitter Accounts*, CNN.COM (Aug. 21, 2015), http://www.cnn.com/2015/08/21/travel/airline-twitter-personalities/.

successful consumer protests.[68] One commonly cited example is how consumers started an online campaign that succeeded in getting a national bank to change the terms of use of its debit cards.[69] In 2011, a recent college graduate who was struggling to make ends meet—Molly Katchpole—learned that Bank of America had decided to charge its customers a five dollar monthly fee if they made purchases with one of the bank's debit cards.[70] Frustrated and upset by this news, Katchpole started a petition protesting the fee on Change.org. In an attempt to get others to sign her petition, Katchpole used Facebook and Twitter to reach out to everyone in her social networks and encouraged everyone who signed the petition to do so as well. These efforts alone were sufficient to get over ten thousand individuals to sign the petition. After Katchpole sent a tweet to ABC News, her story got attention from a number of national news outlets, and the number of signatures ballooned to over 300 thousand. Facing what appeared to be an exponentially growing tsunami of bad publicity, Bank of America eventually announced that it would no longer be charging the debit card fee.[71]

There have also been instances where social media has enabled consumers to expose business practices that may have escaped notice in the pre-digital era. In 2000, members of several online communities uncovered that Amazon had covertly been charging its customers different prices based on each customer's personal characteristics.[72] While price discrimination (or "dynamic pricing") in the sale of goods resides in a grey area of legality, many consumers were outraged upon learning about Amazon's practices.[73] This led to digital protests and, eventually, mainstream media coverage of the controversial practice.[74] Because of the potential damage this

---

68. *See, e.g.*, Bernoff & Li, *supra* note 3, at 36–37; Farrell, *supra* note 2.

69. *See, e.g.*, Farrell, *supra* note 2; Howe, *supra* note 1; Ben Rattray, *Victory over Debit Fee Is a Sign of Consumer Power*, CNN.COM (Nov. 4, 2011), http://www.cnn.com/2011/11/04/opinion/rattray-consumers-fight-back/.

70. *See* Howe, *supra* note 1.

71. *Id.*

72. *See* Kucuk & Krishnamurthy, *supra* note 1, at 49; Robert M. Weiss & Ajay K. Mehrotra, *Online Dynamic Pricing: Efficiency, Equity and the Future of E-Commerce*, 6 VA. J.L. & TECH. 1, 1 (2001).

73. *See Amazon.com Varies Prices of Identical Items for Test*, WALL ST. J., Sept. 7, 2000, at B19.

74. *Id.*

could do to the business, a spokeswoman for Amazon issued a statement claiming that the company's use of differential pricing had been merely a test and that the company would no longer be experimenting with such practices.[75] While it is likely that Amazon's pricing scheme would have been uncovered eventually, communications among online consumers undoubtedly accelerated its exposure.

The public controversy concerning Facebook's revision of its terms of service provides a final example of the stories used to support claims of consumer empowerment. In February 2009, Facebook modified the language in its user agreement in ways that diminished users' rights concerning any content that they published on the site.[76] Under the revised agreement, the license granted by the user to the company would no longer automatically expire upon the user's removal of the content—essentially granting Facebook permanent rights to all user content.[77] Websites focused on protecting consumer rights quickly broadcast warnings concerning the revision in Facebook's terms of service, the story spread rapidly on social media sites, and thousands of people began to protest the changes. Discontent spread further as more individuals learned of the issue through blogs, mainstream media broadcasts, and (ironically) their friends' Facebook pages. Facing mounting pressures, the company announced that it would be reverting back to its former terms of service and that it had never intended to use users' content in exploitative or unfair ways.[78] In order to further quell the public uproar, Facebook also established a "Facebook Statement of Rights and Responsibilities," a document outlining what constituted permissible

75. *Id.*

76. *See* Barnes, *supra* note 1, at 675–78. For a discussion of an earlier controversy involving changes in Facebook's terms of services and consumer protest, see Ryan Radia, *Again, Facebook Sparks Controversy then Bows to User Pressure*, TECH. LIBERATION FRONT (Feb. 18, 2009), http://techliberation.com/2009/02/18/again-facebook-sparks-controversy-then-bows-to-user-pressure. Consumers also prevailed in this instance, causing Facebook to allow users to opt out of having their content used for market research. *Id.*

77. Chris Walters, *Facebook's New Terms of Service: "We Can Do Anything We Want with Your Content Forever*,*"* CONSUMERIST (Feb. 15, 2009, 11:14 PM), https://consumerist.com/2009/02/15/facebooks-new-terms-of-service-we-can-do-anything-we-want-with-your-content-forever.

78. Barnes, *supra* note 1, at 677–78.

and impermissible uses of user content by the company.[79] Finally, the company promised to seek public input concerning future changes in its terms of service.

Beyond these incidents, commentators have drawn attention to multitudes of other incidents where digital capabilities have allowed consumers to claim victories over businesses. Consumer protests have forced airline carriers to issue public apologies for poor customer service and make promises of internal reforms.[80] Fear of public relations issues has led companies to create social media accounts specifically for responding to consumer complaints and, in many cases, consumers have been able to use these avenues to obtain relief that would have previously been inaccessible to them.[81]

C. *(De)Regulatory Implications*

Most discussions of consumer rights in the digital marketplace have portrayed technological advancement as having a progressive effect, one that has enabled consumers to have a fighting chance in their battles with businesses. The successes that consumers have had over corporate interests have been celebrated as modern day instantiations of David defeating Goliath, with individuals' digitally enhanced actions assuming a central role in the narrative. Many accounts of digital markets, however, fail to discuss the role that governmental regulation plays (or could play) in these markets.

Certain scholars, however, have questioned the necessity of government intervention in digitally enhanced marketplaces.[82] They have suggested that the shifts in power associ-

79. *Facebook Statement of Rights and Responsibilities*, FACEBOOK, https://www.facebook.com/terms.

80. *See* McCartney, *supra* note 67.

81. *See* Bernoff & Li, *supra* note 3, at 36–40; *see also* Ryan Holmes, *Customer Service as a Spectator Sport Is About To End*, TIME (June 10, 2015), http://time.com/3916355/social-media-customer-service (describing firms' social media public relations efforts); McCartney, *supra* note 67.

82. *See* Barnes, *supra* note 1, at 698 (arguing that digital technologies have provided consumers with remedial options that are superior to legal remedies); Jacquot*, supra* note 4 (arguing that many consumer protection laws are outdated and are unnecessary in the modern economy); Christopher Koopman, Matthew Mitchell & Adam Thierer, *The Sharing Economy and Consumer Protection Regulation: The Case for Policy Change*, 8 J. BUS. ENTREPRENEURSHIP & L. 529, 544–45 (2015); John C. Moorhouse, *Does Information on the Internet Weaken the Case for Consumer Protection Regulation?*, 16 J. PRIV. EN-

ated with technological change have undermined the traditional justification for state regulation of consumer markets.[83] Some of their arguments have focused on reductions in search costs, arguing that state intervention will no longer be needed as technology enables consumers to be fully informed about the content of consumer contracts and the availability of alternative goods and services.[84] Others have focused on how the digital world has made it easier for consumers to protest unfair practices and has exacerbated the consequences for companies that overreach.[85] Essential to these arguments are assumptions that the majority of consumers will actually take advantage of their newly bestowed digital capabilities and that free market forces will be sufficient to police private entities' conduct.

At the core of these anti-regulatory positions is a belief that consumer markets are capable of regulating the conduct of commercial entities with minimal or no state involvement. They posit that, so long as a market is competitive and there is not collusion among businesses, consumers seeking to maximize their utility will create financial incentives that are strong enough to prevent commercial entities from being able to exploit individuals.[86] For instance, they might contend that laws making certain warranties mandatory are unnecessary because, if such warranties are actually that important to consumers, then competitive pressures will force all companies to provide such warranties.[87] If a company were to offer its prod-

---

TERPRISE 138 (2001); Peppet, *supra* note 4, at 684–87; *see also* Richard A. Epstein, *The Neoclassical Economics of Consumer Contracts*, 92 MINN. L. REV. 803, 814–17 (2008) (discussing how the internet has strengthened the case for minimally regulated consumer markets); John C. Moorhouse, *Consumer Protection Regulation and Information on the Internet*, *in* THE HALF-LIFE OF POLICY RATIONALES: HOW NEW TECHNOLOGY AFFECTS OLD POLICY ISSUES 139–40 (Fred E. Foldvary & Daniel B. Klein eds., 2003).

83. *See* sources cited *supra* note 82.

84. Moorhouse, *Does Information on the Internet Weaken the Case*, *supra* note 82; Peppet, *supra* note 4, at 715–25.

85. *See, e.g.*, Barnes, *supra* note 1, at 698.

86. *See* Epstein, *supra* note 82, at 804 (discussing "the neoclassical conclusion that competitive markets . . . will generate a mix of goods and services that is superior to those that can be generated with various forms of government regulation"); *see also* Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 638–39 (1979).

87. *See* Schwartz & Wilde, *supra* note 86, at 638–39.

ucts without important warranties, then consumers would not buy its products and the market would "speak" against its move. If a change in a term of sale does not impact a business's sales, then this should be taken as evidence that the changes are something that consumers do not care about.

It is worth considering how traditional critiques of laissez-faire markets apply to arguments for self-regulation in the digital era. One of the major objections to having private forces as the primary regulator of markets draws upon findings in behavioral economics that demonstrate that individuals do not behave in accordance with the predictions of traditional economic models.[88] A full review of the relevant findings in this field is outside the scope of this paper, but it is worth considering a few examples of consumer biases that could interfere with regulatory duties.[89] Within the realm of consumer insurance, studies have shown that many individuals will purchase low-deductible products over alternatives, even when the low-deductible products are priced inefficiently.[90] Further, consumers' willingness to purchase overly expensive low-deductible policies is inconsistent across different lines of insurance, indicating that consumer biases are stronger in some commercial contexts than others.[91] Additionally, the presence of the potential for a rebate will cause many consumers to purchase a product that is economically inferior to a similar product, even when the post-rebate cost of the former exceeds the latter.[92] If individuals cannot consistently make decisions that maximize their welfare, then it seems fair to question whether they will

88. *See, e.g.*, Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1216–44 (2003); Van Loo, *supra* note 29, at 1326–34.

89. *See generally* Stefano DellaVigna, *Psychology and Economics: Evidence from the Field*, 47 J. ECON. LITERATURE 315 (2009) (providing an overview of behavioral economics empirical studies).

90. Erwann O. Michel-Kerjan & Carolyn Kousky, *Come Rain or Shine: Evidence on Flood Insurance Purchases in Florida*, 77 J. RISK & INS. 369 (2010); Justin Sydnor, *(Over)insuring Modest Risks*, AM. ECON. J: APPLIED ECON., Oct. 2010, at 177.

91. Levon Barseghyan, Jeffrey Prince & Joshua Teitelbaum, *Are Risk Preferences Stable Across Contexts? Evidence from Insurance Data*, 101 AM. ECON. REV. 591 (2011).

92. Eric J. Johnson et al., *Framing, Probability Distortions, and Insurance Decisions*, 7 J. RISK & UNCERTAINTY 35 (1993).

be able to make wise decisions about when to protest firms' conduct.

Another major objection to privatizing regulation contends that modern markets do not possess the type of differentiation needed for consumer demand to effectively police conduct. Whereas traditional economic theory would predict that businesses in competitive markets would attempt to capture greater market share (and, by doing so, maximize income) by offering contractual terms that are more consumer friendly than those of their competitors, data from actual markets indicate that this is typically not the case.[93] There are a number of explanations for why businesses have not acted as traditional economic theory predicted they would. First, it could be the case that, despite antitrust laws proscribing horizontal agreements among competitors, businesses have conspired with one another and agreed to not engage in term experimentation. A second possibility is that market conditions are such that it is in firms' interests to offer consumers one-sided terms.[94] A third, most plausible explanation posits that term uniformity is the result of businesses non-collusively mimicking each other's conduct and being too risk-averse to try new terms.[95] So long as all (or nearly all) of the sellers in a particular market adopt this type of conservative approach, there is little chance that competitive pressures will drive companies to adopt more consumer-friendly practices.[96]

Even if one were convinced that consumers' cognitive limitations and market homogeneity make it a bad idea to allow self-regulation of consumer markets in the pre-digital era, whether this remains true in the digital era must be considered separately. It is possible that modern technology could empower consumers and businesses in ways that would mitigate or eliminate the barriers that prevented effective self-regulation in the past. For instance, flaws in consumer reasoning have become increasingly well documented and information

93. RADIN, *supra* note 29, at 41–42; Mark R. Patterson, *Standardization of Standard-Form Contracts: Competition and Contract Implications*, 52 WM. & MARY L. REV. 327, 341–56 (2010); Slawson, *supra* note 35, at 556–61.

94. *See* Lucian A. Bebchuk & Richard A. Posner, *One-Sided Contracts in Competitive Consumer Markets*, 104 MICH. L. REV. 827, 831–33 (2006).

95. *See* Patterson, *supra* note 93, at 341–56; Slawson, *supra* note 35, at 556–61.

96. *See* Patterson, *supra* note 93, at 357–65.

about these shortcomings is available for free online. Even if the vast majority of the public will not educate themselves about these issues, it is possible that some of the individuals that do will find ways to operationalize this knowledge and create products that will help consumers make better choices.

Similarly, it appears likely that the digital era will lower the costs to companies of experimenting with using different sales contracts or offering consumer-customizable terms of sale.[97] Indeed, legal scholars have described how technology has reduced the economic barriers to more individualized sales practices. While examples of this type of customization in actual consumer markets remain uncommon, it is possible that these practices will become widespread as companies become more technologically adept and consumer expectations evolve.

While it appears obvious that some aspects of the digital revolution have empowered consumers, attempting to quantify this effect seems like a difficult, if not impossible, task. Similarly, conclusively stating whether these effects are strong enough to encourage deregulation of consumer markets appears to be a claim that cannot be justified a priori. Rather than focus on these large, possibly irresolvable issues, the remainder of this Article focuses on a topic that has received insufficient attention—how consumer interests are harmed by the expansion of the internet and social media. It then goes on to analyze how these effects interact with existing regulatory structures and how policy changes could protect consumers and promote healthy markets.

II.
THE LIMITS OF PRIVATE REGULATION AND NEW FORMS OF COMMERCIAL EXPLOITATION

It is clear that the digitization of commerce will confer certain benefits upon consumers. It is equally obvious that modern technological advances have the potential to introduce new threats to consumer welfare. Yet commentators' discussions of digital markets have been dominated by portrayals of empowered consumers and more balanced playing fields.[98] While a handful of academic articles have considered how

97. *See* discussion *infra* Section II.C.
98. *See* discussion *supra* Section I.B.

technological advances could harm consumers' interests, none have attempted to address this issue comprehensively.[99] This Part addresses the deficiencies in the existing literature in two ways. First, it creates a theoretical framework that synthesizes and organizes the concerns identified by others into a coherent whole. Second, and perhaps more importantly, it identifies a class of threats to consumer welfare—the manipulation of digital reputational information—that, until now, has escaped notice.

The remainder of this Part provides an overview of the four ways that the movement towards increasingly digital markets poses a threat to consumer welfare. It begins by describing the concept of digital reputational manipulation, a practice that has flown under the radar of consumer watchdogs, but that could result in businesses having much greater power than they had in pre-digital markets. It goes on to discuss how technological advancements will enhance firms' advertising and negotiating capabilities. Next, it describes how the increases in consumers' bargaining power conferred by technology will be subject to cognitive and social limitations. Finally, it will describe how digital markets will lead to consumer complaints being resolved through less effective private mechanisms, while covertly undermining support for the types of regulatory approaches that maximize consumer welfare.

A. *Manipulation of Digital Reputational Information*

It is surprising that scholars have paid so little attention to the impact that intentional manipulation of online reputational data could have on consumers. This is particularly the case given the importance that consumer generated reviews have assumed in modern commerce. By increasing consumer reliance on review information without taking steps to prevent the corruption of reputational information, the digital era opens the door to businesses exerting new forms of power over consumers.

---

99. *See, e.g.*, Ghirardelli, *supra* note 37, at 733–42 (focusing on threats to consumers in the online contracting process); Allyson W. Haynes, *Online Privacy Policies: Contracting Away Control over Personal Information?*, 111 PENN. ST. L. REV. 587 (2007) (discussing privacy issues); Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429 (2002) (analyzing only how consumers could be affected by the use of boilerplate contracts in online commerce).

As discussed earlier, many have argued that the digital revolution has empowered consumers by increasing their ability to access other individuals' reviews of products and services. These scholars contend that individuals having access to these data enables individuals to make decisions that better maximize their welfare, and helps to ensure that there are financial consequences for bad business practices. While these claims appear to be reasonable on their face, they are premised on several unrealistic assumptions.

The digitization of commerce has fostered consumer reliance on reviews, both those posted by other shoppers (e.g., Yelp and Amazon users) and professional reviewers (e.g., CNET's technology experts). As individuals' access to the internet has expanded, so too has their reliance on digital reputation information.[100] Survey data have shown that an increasing number of consumers view online reputational information as one of the most important factors influencing their commercial behavior.[101] Studies by economists have confirmed that online reviews significantly influence consumers' actual behaviors.[102] The effect of reputational information has become so substantial that one leading business expert has described it as "the single most powerful impetus driving consumer decisions."[103]

The fact that reputational information has started to assume a central role in these markets, however, will not necessarily translate to welfare gains to consumers. Whether this

---

100. *See, e.g.*, Sonja Utz, Peter Kerkhof & Joost van den Bos, *Consumers Rule: How Consumer Reviews Influence Perceived Trustworthiness of Online Stores*, 11 ELEC. COMM. RES. & APPS. 49, 54–55 (2012) (stating that two empirical studies of consumers found online reviews have "more impact on final trustworthiness judgments than other cues"); *Under the Influence: Consumer Trust in Advertising*, NIELSEN (Sept. 17, 2013), http://www.nielsen.com/ us/en/ insights/news/2013/under-the-influence-consumer-trust-in-advertising.html (summarizing survey results showing an increase in consumers' trust of consumer reviews and editorial content).

101. *See, e.g.*, Jonathan Welsh, *The Impact of Online Consumer Reviews*, HUFFINGTON POST (Sept. 27, 2013), http://www.huffingtonpost.co.uk/jonathan-welsh/the-impact-of-online-consumer-reviews_b_3668007.html.

102. *See, e.g.*, Anderson & Magruder, *supra* note 19, at 957–59 (reviewing the findings of other studies and presenting data demonstrating that online review information has large effects on businesses).

103. David C. Edelman, *Branding in the Digital Age: You're Spending Your Money in All the Wrong Places*, HARV. BUS. REV., Dec. 2010, at 65.

change leads to consumer empowerment is highly dependent on the integrity of reviews. Even if it seems likely that easy access to high quality, unbiased reviews would have the salutary effects described earlier,[104] it is not clear that these parameters will be satisfied in the real world. If the data that consumers are relying on is manipulated or contaminated, then consumers' reliance on this type of information could actually make them more vulnerable to exploitation than they were in the pre-digital era.

Another way of thinking about the threat that manipulation of digital reputational information poses to consumer welfare starts by considering how the growth in the importance of reviews will affect businesses' incentives. The increasing importance of reputational information may drive some firms to adopt more consumer-friendly behaviors, as doing so will decrease the odds that they will receive negative reviews.[105] However, it also creates strong incentives for firms to act in ways that do not benefit consumers, namely by encouraging businesses to find ways to manipulate review information to their benefit.[106]

Private firms' interests in manipulating reputational information are likely to manifest in two different ways. First, the businesses that control the platforms containing reputational information will have large incentives to leverage their control to extort money from other companies. Second, firms that are subject to reviews will be driven to explore non-traditional means for controlling how they are portrayed.

1. *Review Firms and Self-Interested Manipulation of Reputational Markets*

The growth in consumer demand for reviews of commercial goods has created a burgeoning market for the provision of such information. While no entity has managed to become the dominant force across the entire commercial field, there are a number of firms that have asserted primacy over particular market sectors, at least with users in particular geographic areas. Examples of sector-dominant companies within the United States include Yelp (for reviews of small businesses and

104. *See* discussion *supra* Part I.
105. *See* Rezabakhsh et al., *supra* note 62, at 26.
106. *See id.* at 14.

restaurants) and TripAdvisor (for reviews of hotels and vacation-related services).

The business models of most firms that collect and provide access to consumer reviews contain highly problematic conflicts of interest. Because such firms typically do not charge users fees to access or post reviews, they tend to rely on advertising contracts with the businesses that are featured on their site to generate revenue.[107] This puts review firms in the difficult position of having to reconcile their obligations to provide consumers with genuine reviews and their interest in providing services that businesses will pay for. Given how important reviews have become for businesses, review firms possess incredible leverage over other companies and could potentially extract large rents in exchange for promises to portray firms positively (or to avoid portraying them negatively). If review firms act in this way, the accuracy and trustworthiness of reviews would plummet and consumers would lose one of the primary advantages they gain from digital marketplaces.

There are indications that review firms are already engaging in this type of behavior. The most well-known lawsuit containing allegations of such conduct is *Levitt v. Yelp! Inc.*[108] In *Levitt*, several small business owners alleged that "Yelp extorted or attempted to extort advertising payments from them by manipulating user reviews and penning negative reviews of their businesses."[109] More specifically, the business owners claimed that Yelp removed favorable reviews from (and added negative reviews to) the profiles of businesses that refused to purchase their services. Additionally, they claimed that Yelp used similar measures to retaliate against business owners who spoke out against the company's practices.[110] While the U.S. Court of Appeals for the Ninth Circuit affirmed the district court's dismissal of these claims, its primary basis for doing so was that the alleged conduct did not constitute a violation of California statutory or common law.[111] The court, notably, did

107. *See* Eric Goldman, *Court Says Yelp Doesn't Extort Businesses*, FORBES (Sept. 3, 2014), http://onforb.es/1lzzTOi (describing review hosting companies' conflict of interests).
108. Levitt v. Yelp!, Inc., 765 F.3d 1123 (9th Cir. 2014).
109. *Id.* at 1126.
110. *See id.* at 1127–29.
111. *Id.* at 1130–37.

not rule as to whether Yelp actually engaged in the alleged conduct.[112]

While Yelp has been the most frequent target for claims of intentional manipulation,[113] other review companies have been accused of engaging in similar behaviors.[114] All of the review companies deny any wrongdoing.[115] For purposes of this paper, whether particular claims of manipulation are true is not as important as the fact that these claims demonstrate how the digital revolution has opened the door to new forms of commercial exploitation. The prevalence of these types of allegations is sufficient to demonstrate how the increased importance of reputational information and the growth of commercial review entities could threaten consumer interests.

2. *Firms' Efforts to Assert Control over Reputational Data*

The importance of online reputational information has also caused companies to explore new ways of affecting how they are portrayed in digital reviews. Savvy business owners have already begun using different tactics—many of which are of questionable legality—to influence their online reputations. Given the extent to which reviews can influence the success of businesses, it would be surprising if the number of firms will-

---

112. *Id.* at 1137 (stating that the "business owners have not alleged a legal theory or plausible facts to support the theories they do argue").

113. *See, e.g.*, Noel K. Gallagher, *Owner of Portland Restaurant Accuses Yelp of Manipulating Reviews*, PORTLAND PRESS HERALD (Sept. 14, 2015), http://www.pressherald.com/2015/09/14/portland-restaurateur-accuses-yelp-of-manipulating-reviews/; Nate C. Hindman, *Kelly Calandro Claims Yelp Deleted Her Restaurant's Positive Reviews After She Refused To Buy Ads*, HUFFINGTON POST (Sept. 14, 2012), http://www.huffingtonpost.com/2012/09/14/kelly-calandro-yelp-verace-restaurant_n_1885576.html.

114. *See, e.g.*, Consumer Cellular, Inc. v. ConsumerAffairs.com, No. 3:15-CV-1908-PK, 2016 WL 3176602 (D. Or. Feb. 29, 2016); The League of Cal. Homeowners v. Better Bus. Bureau, No. E053423, 2012 WL 5836053 (Cal. Ct. App. Nov. 19, 2012); Eric Goldman, *Angie's List Must Defend Fraud Charges over Pay-to-Play Review Manipulation*, FORBES (Aug. 12, 2015), http://onforb.es/1gA9ka1.

115. *See, e.g.*, Goldman, *supra* note 114; Vince Sollitto, *Yelp Extortion Conspiracy Theory Debunked . . . Again*, YELP OFFICIAL BLOG (Feb. 4, 2016), http://officialblog.yelp.com/2016/02/yelp-extortion-conspiracy-theory-debunkedagain.html.

ing to push the boundaries of legality did not increase over time.[116]

Companies have attempted to game online review systems in a variety of ways. Despite the fact that many review sites forbid companies from offering customers incentives to post reviews, it appears as though many firms have engaged in this type of conduct.[117] Similarly, some companies have attempted to get their customers to contractually agree that they will not review the company negatively.[118] Companies have also hired third parties to author glowing reviews of themselves and make disparaging comments about their competitors.[119] While the prevalence of such practices is difficult to gauge, a consent decree entered into between the New York Attorney General and nineteen businesses in 2013 indicates that these behaviors are not all that uncommon.[120]

116. *See, e.g.*, Dina Mayzlin et al., *Promotional Reviews: An Empirical Investigation of Online Review Manipulation* (Nat'l Bureau of Econ. Research, Working Paper No. 18340, 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2128860 (reviewing data indicating that hotels engage in the creation of fake reviews); Press Release, Gartner, Gartner Says by 2014, 10–15 Percent of Social Media Reviews to Be Fake, Paid for by Companies (Sept. 17, 2012), http://www.gartner.com/newsroom/id/2161315.

117. *See, e.g.*, Ric Romero, *Yelp Cracking Down on Businesses that Reward Reviewers*, ABC7 (Feb. 12, 2015), http://abc7.com/business/yelpcrackingdownonbusinessesthatrewardreviewers/515035; Kim Severson, *Yelp Them, They'll Help You*, N.Y. TIMES: DINER'S J. BLOG (Aug. 31, 2009), http://dinersjournal.blogs.nytimes.com/2009/08/31/yelp-them-theyll-help-you/.

118. *See, e.g.*, Pamela Brown, *Couple Fined for Negative Online Review*, CNN.COM (Dec. 26, 2013), http://www.cnn.com/2013/12/02/tech/couple-fined-for-negative-review/; Noah Feldman, *Congress Ponders Law Banning Companies from Blocking Customers' Internet Reviews*, REGISTER-GUARD (July 1, 2016), http://registerguard.com/rg/business/34531541-63/congress-ponders-law-banning-companies-from-blocking-customers-internet-reviews.html.csp.

119. *See, e.g.*, Patrick Clark, *New York State Cracks Down on Fake Online Reviews*, BLOOMBERG (Sept. 23, 2013), http://www.bloomberg.com/bw/articles/2013-09-23/new-york-state-cracks-down-on-fake-online-reviews; David Streitfeld, *The Best Book Reviews Money Can Buy*, N.Y. TIMES, (Aug. 25, 2012), http://www.nytimes.com/2012/08/26/business/book-reviewers-for-hire-meet-a-demand-for-online-raves.html; Todd Bishop, *Amazon Files First-Ever Suit over Fake Product Reviews, Alleging Sites Sold Fraudulent Praise*, GEEKWIRE (Apr. 8, 2015), http://www.geekwire.com/2015/amazon-files-first-ever-suit-over-fake-reviews-alleging-calif-man-sold-fraudulent-praise-for-products/.

120. *See* Press Release, A.G. Schneiderman Announces Agreement with 19 Companies To Stop Writing Fake Online Reviews and Pay More than $350,000 in Fines, N.Y. State Office of the Atty. Gen., Sept. 23, 2013, http://

Firms have also engaged in reputation-management behaviors that, while completely legal under existing laws, have the potential to mislead consumers and reduce the effectiveness of consumer reputational policing. For instance, firms have begun to enter into non-traditional endorsement or advertisement contracts with groups that consumers rely on for advice.[121] One example of such groups is web celebrities—individuals who produce original content on personal blogs, YouTube channels, and other social media sites, that is regularly viewed by hundreds of thousands (or millions) of subscribers. The content that these personalities create varies widely, but a substantial portion contains some form of product review. Another group that firms have targeted is websites that host content dedicated to certain niche interests and that regularly review consumer products and services.

Marketers have stated that endorsements from web celebrities and specialized sites hold immense value.[122] Hence, there are large economic incentives encouraging companies to actively reach out to these groups and agree to pay them to ensure positive reviews. While the parties recommending products will suffer reputational losses if they regularly publish inaccurate reviews, it is unclear whether these consequences

---

www.ag.ny.gov/press-release/ag-schneiderman-announces-agreement-19-companies-stop-writing-fake-online-reviews-and (describing the consent decree and the over $350 thousand in fees that were assessed).

121. *See, e.g.*, Tad Friend, *Hollywood and Vine*, NEW YORKER (Dec. 15, 2014), http://www.newyorker.com/magazine/2014/12/15/hollywood-vine; Nathan Grayson, *The Messy Story Behind YouTubers Taking Money for Game Coverage*, KOTAKU (Oct. 8, 2014), http://kotaku.com/the-messy-story-behind-youtubers-taking-money-for-game-1644092214; Simon Parkin, *Blurred Lines: Are YouTubers Breaking the Law?*, EUROGAMER.NET (July 16, 2014), http://www.eurogamer.net/articles/2014-07-16-blurred-lines-are-youtubers-breaking-the-law; Jennifer Van Grove, *YouTube Stars To Endorse Carl's Jr. Burgers*, MASHABLE (June 1, 2009), http://mashable.com/2009/06/01/youtube-stars-in-carls-jr-ads/#ltqO1K4LAmq0.

122. *See, e.g.*, Andrea Chang, *YouTube's Biggest Stars Are Cashing in Offline*, L.A. TIMES (Aug. 7, 2014), http://www.latimes.com/business/la-fi-youtube-stars-20140808-story.html. The marketing world has already created applications that make it easier for firms to identify the individuals they should attempt to capture. Klout, Kred, and PeerIndex are applications that analyze social media activity and generate influence scores for individuals that have a web presence. *See* Solis, *supra* note 1.

create a strong enough deterrent to prevent the publication of false endorsements.[123]

Traditional product promotion contracts are typically considered unobjectionable, but the FTC has expressed concern that secret endorsements may mislead consumers.[124] It has issued regulations prohibiting product endorsements (like those offered by web celebrities or review websites) that fail to disclose the existence of "a connection between the endorser and the seller of the advertised product that might materially affect the weight or credibility of the endorsement."[125] It is unclear, however, how actively these regulations have been enforced.[126]

B. *Consumer Activism's Inherent Costs*

As reviewed in Part I, commentators have supported their claims that the digital era will empower consumers by identifying different ways that technology has expanded consumers' capabilities. There are reasons to believe, however, that structural barriers will prevent even technologically enhanced consumers from being able to regulate consumer markets adequately. First, regulatory efforts through consumer actions impose large cognitive costs on individuals. Additionally, consumers and businesses are likely to have concerns about the legitimacy of online consumer actions that will impair their effectiveness. Finally, the decentralized nature of these types of consumer efforts will exacerbate collective action problems and prevent consumers from allocating their resources effectively.

Cognitive fatigue may present a large barrier to effective private regulation. If society were to rely on individuals to keep commercial entities' behaviors in check, there would need to be a drastic increase in consumer policing of businesses' conduct. But, despite how it may appear to frequent users of social media, there is a finite limit to the energy that users of the

---

123. *But see* sources cited *supra* note 116 (providing examples of reviewers secretly agreeing to endorse specific products).

124. *See* FED. TRADE COMM'N, THE FTC'S ENDORSEMENT GUIDES: WHAT PEOPLE ARE ASKING (2015), https://www.ftc.gov/tips-advice/business-center/guidance/ftcs-endorsement-guides-what-people-are-asking#social.

125. *See* FTC Disclosure of Material Connections, 16 C.F.R. § 255.5 (2016).

126. *See, e.g.*, Parkin, *supra* note 121 (discussing the prevalence of such deals in the gaming industry).

internet can muster in response to exploitative commercial practices. If consumer protests began to flood the web, the number of complaints could overwhelm individuals' cognitive and emotional capacities. The costs associated with actively policing businesses' conduct are substantial—individuals must become aware of the existence of a controversy, expend energy to learn about the issue(s), decide where they stand on the matter, and then take action that demonstrates their views. Even in the least demanding scenario—where an individual is presented with issues, immediately decides to support efforts without learning much about them, and is able to join causes via a single click of her mouse—there will be a point where boredom and exhaustion will cause participation rates to drop off.

Consumer protests in the digital era could also be undermined by concerns about the legitimacy of consumer complaints. It is already the case that consumers use the internet and social media to engage in rent-seeking behavior—most typically, by publicizing criticisms of a company on the web in the hopes that the business will respond by giving them something of value.[127] As more consumers engage in these types of rent-seeking behaviors, the messages they send to businesses will become noisier, diluting the effectiveness of legitimate complaints and protests.

Legitimacy concerns will become more prevalent for consumers debating whether to join actions as well. The central issue here will be the prevalence of consumer–activists engaging in shirking behaviors. The effectiveness of socio-commercial movements like boycotts and negative publicity campaigns depends on supporters' commitment to refrain from financially enabling targeted businesses. Digitally based consumer movements are likely to experience particularly high levels of shirking behavior, given how easy it is for individuals to subscribe to a cause and avoid being held accountable for inconsistent behaviors. While decreases in the costs associated with joining a protest will boost the number of people who are will-

---

127. *See, e.g.*, Holley Simmons, *How Some Yelpers Are Holding Restaurants Hostage*, WASH. POST (Apr. 22, 2015), https://www.washingtonpost.com/express/wp/2015/04/22/how-some-yelpers-are-holding-restaurants-hostage/; Amy McKeever, *ReviewerCard Takes Extorting Restaurants to a New Level*, EATER (Jan. 22, 2013), http://www.eater.com/2013/1/22/6492215/reviewercard-takes-extorting-restaurants-to-a-new-level.

ing to sign on to a cause, the individuals constituting the marginal gain group will be composed of people who are less committed to the movement and more likely to act inconsistently with its tenets.[128]

Finally, private regulation of markets may be undermined by the fact that, absent a centralized decision-making body, consumer actions are likely to focus on policing the behaviors that are most widely recognized as egregious. Activist bodies are likely to prioritize targeting the commercial behaviors that are most salient to their constituents. Typically, factors relating to how a commercial practice has affected consumers will be the largest determinants of saliency—e.g., the extent to which a practice has actually harmed individuals, the likelihood that it will harm individuals in the future, whether the practice diverges from generally held expectations about commercial practices, whether it violates widespread societal norms, etc. Saliency, however, can diverge significantly from impact.[129] For instance, issues that are presented in particularly clever, catchy, or shocking manners will receive attention that is disproportionate to the actual welfare losses they impose on consumers.[130] Similarly, it is possible that a commercial practice that severely injures the interests of consumers could, through luck or the concerted efforts of the commercial entities that benefit from it, avoid activists' crosshairs.[131]

---

128. *See* Bridget M. Blodgett, *And the Ringleaders Were Banned: An Examination of Protest in Virtual Worlds*, *in* C&T '09 PROCEEDINGS OF THE FOURTH INTERNATIONAL CONFERENCE ON COMMUNITIES AND TECHNOLOGIES 135–49 (2009) (stating that the lower effort needed to engage in online activism results in lower activist commitment levels); Max Halupka, *Clicktivism: A Systematic Heuristic*, 6 POL'Y & INTERNET 115, 119 ("Generally speaking, clicktivism is a disposable and noncommittal act."); Malcolm Gladwell, *Small Change: Why the Revolution Will Not Be Tweeted*, NEW YORKER (Oct. 4, 2010), http://www.newyorker.com/magazine/2010/10/04/small-change-malcolm-gladwell (arguing that internet activists showcase lower levels of commitment to causes).

129. Anthony Heyes, Thomas P. Lyon & Steve Martin, *Salience Games: Keeping Environmental Issues in (and out) of the Public Eye* 1–3 (Ross School of Business, Working Paper No. 1318, 2016), http://ssrn.com/abstract =2796047 (summarizing studies showing that issue saliency is not wholly determined by the impact the issue could have on an individual); *see also* Stefano DellaVigna, *supra* note 89, at 315.

130. *See* Heyes, Lyon & Martin, *supra* note 129, at 23.

131. *Id.* at 23–25 (describing firms' incentives to manipulate the public's perception of the saliency of different issues).

These types of saliency effects will impede private regulatory efforts in several ways. First, it is likely that most individuals will be motivated to react to the same, relatively small set of commercial behaviors. While this will have the beneficial effect of concentrating efforts on what could be considered to be the worst practices, it creates a risk that too many resources will be focused on certain issues, leaving other problems unaddressed. Put differently, having individual perceptions of saliency drive collective efforts could result in regulatory allocations that are too heavily concentrated on some issues and not concentrated enough on others.

Second, it is questionable whether individuals' assessments of issue saliency is a good criterion for determining which market behaviors are targeted. Behavioral psychology and economics studies have established that it is common for consumers to act in ways that do not maximize their welfare.[132] For instance, factors that have little to do with actual welfare effects—e.g., how an issue is framed, attention fatigue, current emotional states—will often influence the importance that an individual assigns to an issue.[133] Finally, allowing consumer saliency to guide the policing of markets will cause disproportionate amounts of attention to be paid to novel commercial practices instead of practices that are well-established, even if the latter impose much larger welfare reductions.[134]

C. *Firms' Enhanced Advertising and Transactional Capabilities*

Just as it has with consumers, the maturation of the internet and social media will drastically increase firms' capabilities. Because these expansions will grant businesses new means for taking advantage of consumers, they threaten to offset (or overwhelm) the gains that technological advances provide to consumers. Of particular importance to consumers are the ways in which firms' marketing and transactional practices are evolving.

---

132. *See* DellaVigna, *supra* note 89 (providing a comprehensive overview of the findings of leading papers in the field).

133. *Id.* at 347–53, 359–60.

134. *See* Pedro Bordalo, Nicola Gennaioli & Andrei Shleifer, *Salience and Consumer Choice*, 121 J. POL. ECON. 803 (2013) (describing how the connection between novelty and saliency can interfere with consumer judgment).

Technological advances have given businesses new advertising capabilities. The most well-known development on this front has been the growing ability of businesses to ensure that their advertisements are shown to individuals who are most likely to be interested in their products.[135] Selective exposure of this type has generally not been regarded as exploitative and has become common throughout the digital world.[136]

Advertisers, however, have moved beyond this point and are beginning to engage in persuasion profiling.[137] Researchers are rapidly developing algorithms capable of creating consumer profiles that contain information about the types of advertisements that are most likely to cause them to purchase a product.[138] While the data in these profiles can be generalized to personality trait information that would be unobjectionable to most people—for example, John likes quirky commercials and Jane cares primarily about low prices—it can also be highly sensitive information about individuals' cognitive vulnerabilities.[139]

It is a small leap from these types of insights to the ability to identify individuals' vulnerabilities to different types of persuasion. Examples of this type of information include "Jack is 20% more likely to purchase a product at *X* price if *X* is portrayed as being a 50% discount off the retail price than he would be if *X* is portrayed as the retail price," or "Jackie will often make a purchase that she would not normally make if an ad claims the product is rapidly selling out."[140] As research and development in this area advances, it is likely that some commercial firms will go well beyond the relatively benign uses of profiling to other uses that exploit consumer irrationalities. Once they do so, firms will be able to take advantage of indi-

---

135. *See, e.g.*, Jennifer Valentino-Devries & Jeremy Singer-Vine, *They Know What You're Shopping for*, WALL ST. J. (Dec. 7, 2012), http://online.wsj.com/news/articles/SB10001424127887324784314441327362l4.

136. *Id.*

137. For a general introduction to persuasion, see Maurits Kaptein, Dean Eckles & Janet Davis, *Envisioning Persuasion Profiles: Challenges for Public Policy and Ethical Practice*, 18 INTERACTIONS 66 (2011), and Eli Pariser, *Welcome to the Brave New World of Persuasion Profiling*, WIRED (Apr. 26, 2011), http://www.wired.com/2011/04/st_essay_persuasion_profiling/.

138. *See* Calo, *supra* note 15, at 1016–18.

139. *See* Maurits Kaptein & Dean Eckles, *Heterogeneity in the Effects of Online Persuasion*, 26 J. INTERACTIVE MARKETING 176 (2012); Pariser, *supra* note 137.

140. *See* Calo, *supra* note 15, at 1017–18.

viduals' weaknesses in ways that were impossible in the pre-digital era.

Price discrimination provides another example of how technology will enhance businesses' capabilities.[141] As described earlier, price discrimination occurs when a business varies the price of its products or services from one customer to another where the differential in price is not based on any additional costs incurred by the business, but rather is due to the business's belief that some customers will be willing to pay more than others. Some online retailers are either engaging in price discrimination already or are in the process of experimenting with doing so.[142] While varying the price of consumer goods in this way could be considered a violation of the Robinson–Patman Act,[143] governmental bodies have not shown any interest in challenging such conduct.[144] Indeed, the federal government recently published a report on price discrimination stating that it does not view the practice as posing a danger to consumers.[145]

The same techniques that enable price discrimination also enable term discrimination. At present, businesses tend to offer their goods and services to consumers with an unalterable package of terms that does not vary from customer to customer.[146] This pattern is likely to change as technological advances reduce the costs to businesses of tailoring their contracts. While there are reasons to believe that increased

141. *Id.*, at 1025–27.

142. *See* Robert M. Weiss & Ajay K. Mehrotra, *Online Dynamic Pricing: Efficiency, Equity and the Future of E-Commerce*, 6 VA. J.L. & TECH. 11 (2001), http://www.vjolt.net/vol6/issue2/v6i2-a11-Weiss.html; Anita Ramasatry, *Web Sites Change Prices Based on Customers' Habits*, CNN.COM (June 24, 2005), http://www.cnn.com/2005/LAW/06/24/ramasastry.website.prices/.

143. *See* Robinson–Patman Act, 15 U.S.C. § 13(a) (2014). *But see* Douglas M. Kochelek, *Data Mining and Antitrust*, 22 HARV. J.L. & TECH. 515, 524–26 (2009) (arguing that the Act would not apply to Amazon's conduct).

144. *See* HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAWS OF COMPETITION AND ITS PRACTICE 571–73 (2d ed. 1999) (noting the federal government's limited enforcement of the Act).

145. *See* EXECUTIVE OFFICE OF THE PRESIDENT, BIG DATA AND DIFFERENTIAL PRICING 2 (2015).

146. To the extent that the terms are modifiable, this tends to be with regard to a few select provisions—warranties, for instance. While academics have argued that businesses should offer consumers the ability for other forms of customization—most commonly with regard to arbitration provisions—few firms have adopted these practices.

customization of these contracts could be beneficial to consumers, it will also open the door to greater exploitation. As consumer profiling becomes more detailed and widespread across industries, customization will create an environment where firms will be better able to predict which terms an individual is willing to accept. This information will allow businesses to engage in term discrimination and ensure that they have maximally beneficial terms in each of their contracts.

The following example should help demonstrate how price and term discrimination harm consumers. In the pre-digital era, consumers were often able to capture surplus from their transactions with very little effort. Consider a consumer that is looking to purchase a vacuum cleaner who goes to a brick-and-mortar store, browses their selection, and settles on purchasing a mid-range ninety dollar model that comes with a two-year limited warranty. As long as it had inventory, the store would likely sell this model of vacuum to anyone who was willing to pay ninety dollars. Different individuals would derive varying levels of utility from this vacuum and, because of this differential, customers' willingness to pay for the item would differ. Some would only be willing to purchase it for fifty dollars, others for ninety dollars, and still others would be willing to pay an amount over the asking price. If the store holds the price for the vacuum static at ninety dollars, then only those with thresholds that are ninety dollars or greater will purchase it. Upon completing the purchase, every individual whose price threshold was above ninety dollars would experience a welfare gain, capturing a surplus equal to the difference between their reservation price and the actual price.

In a world of digitally enhanced businesses, consumers' abilities to capture these types of surpluses will be diminished significantly, if not eradicated. If price discrimination techniques become sufficiently advanced, businesses will be able to determine consumers' threshold prices, adjust their prices, and capture some (or all) of the surplus they would have lost if they utilized static pricing. In the context of the example above, this means that consumers with price thresholds that are greater than ninety dollars would no longer be able to purchase the vacuum for ninety dollars, but would have to pay

a price that is closer to (or is) their reservation price.[147] The degree to which firms will be able to determine consumers' threshold prices is not yet known, as there have only been a few firms that have experimented with dynamic pricing, and data related to their trials has not been released publically.

Once firms learn how to take advantage of the opportunities presented by the digital era, they will be able to maximize their capture of surplus in consumer deals. By combining big data-informed consumer profiling and deal-customizing technologies, they will be in a better position than ever to extract maximal value from consumer sales. As firms develop the ability to estimate consumers' reservation prices and implement automated price discrimination practices, the frequency with which they are able to sell their products at an optimal price and for optimal terms will increase.

D. *Limits on Private Actions' Regulatory Effects*

Structural limitations inherent to private approaches to regulation will prevent consumer actions from being effective regulators of firms' conduct. First, the effectiveness of protest-driven regulatory efforts is subject to a self-limiting principle, with the power of an action bearing an inverse relationship to the prevalence of similar actions. Second, even when such actions succeed in provoking concessions from businesses, they are incapable of obtaining the types of relief that best advance consumers' interests. Finally, greater reliance on private actions will reinforce societal norms against state intervention and provide further support to firms' deregulatory efforts.

One of the primary reasons that private communities on their own cannot regulate markets is the self-limiting nature of consumer actions. As the frequency of consumer protests increases, firms' incentives to reform their practices will decrease. This may seem counterintuitive initially, but can be understood by using a simple model to analyze companies' incentives to respond to complaints.

Consider a business that is receiving requests from customers to refund the purchase price of allegedly defective merchandise. The business will have the greatest incentive to act when (1) it has received a low to moderate number of com-

147. For further discussion of the potential harms associated with price and term discrimination, see Calo, *supra* note 15, at 1025–27.

plaints and (2) its competitors have received significantly fewer complaints than it has. In such an environment, the business can pay a relatively small cost to resolve the complaining individuals' problems and doing so will help it to head off negative press and prevent a loss in market share.

The business's incentives to refund change dramatically when either of these conditions is not satisfied. When the first condition is not met—i.e., the company has received a large number of complaints—the costs of resolving the problem will increase significantly. If the number of requests reaches a certain threshold, responding will require the company to institute a change that will affect *all* of its consumers instead of ad hoc solutions targeted at a small subset of its customers. When the second condition is not met—i.e., the business's competitors have received a large number of complaints—the company's economic incentive to respond decreases dramatically. A company that is being targeted for its uniquely bad treatment of consumers must be concerned that inaction will cause it to lose customers to its competitors. If all of its competitors are receiving a large number of consumer complaints, however, there is a significantly smaller chance that the company will suffer substantial economic losses by ignoring consumer complaints.[148]

The ability of private consumer actions to regulate commercial entities' conduct will also be limited by the fact that even successful protests rarely succeed in getting businesses to commit to completely abandoning exploitative conduct. When consumers get a reaction from a business, the typical response is for the company to provide the complaining individuals with some form of post-loss compensatory relief. It is much less common for a firm to respond by making permanent changes to its policies. While compensatory relief is a boon to customers that have already suffered injuries, it does little to advance consumers' larger interests.

Analysis of the examples that commentators have used to support claims about digital empowerment establishes just

148. While it is possible that one of the firm's competitors could break rank and attempt to gain customers by changing its practices, examples of this type of behavior are relatively uncommon compared to industry-wide inaction. *See* RADIN, *supra* note 29, at 41–42; Patterson, *supra* note 93, at 341–56; Slawson, *supra* note 35, at 556–61.

how limited businesses' responses to consumer actions have been. While there are a few instances where consumer efforts have resulted in policy changes that benefit all consumers—for example, the Bank of America and Facebook situations discussed earlier[149]—these are the exception, not the rule. In the more typical scenario, successful customer complaints result in compensatory offers being made to the complaining individuals.[150] For instance, when a musician's negative experience with United Airlines' luggage handling services gained notoriety on the web, the company offered to pay for the damage done to his equipment.[151] Even though the widespread support his story received indicated that there were systemic problems with United's baggage policies, it is unclear whether it caused the company to change its operating procedures.

These instances raise questions about whether, in general, social media approaches are capable of inducing behavioral changes that are broad enough to achieve regulatory goals. Responses to successful social media protests have generally been quite limited in scope—a single company in a large industry might change its terms of use, or, more commonly, companies might simply compensate complaining individuals and continue imposing questionable terms on its other customers. Even when companies indicate that they are going to make policy changes that will benefit all consumers, such promises are not legally binding and do little to prevent them from changing their minds or reverting to less consumer-friendly policies in the future. For example, while Amazon's CEO has made promises about the company's use of dynamic pricing,[152] there is no way to force the firm to stand by his guarantee.

The prevalence of exploitative pre-dispute mandatory arbitration clauses in consumer contracts showcases this limitation. One empirical study has shown that a large number of

149. *See* discussion *supra* Section I.B.

150. *See, e.g.*, Abby Ellin, *Seeking Redress When Air Travel Goes Awry*, N.Y. TIMES (May 3, 2012), http://www.nytimes.com/2012/05/03/business/seeking-redress-when-air-travel-goes-awry.html (describing the individualized compensation that airlines offer to upset customers).

151. *See* Barnes, *supra* note 1, at 683–88; McCartney, *supra* note 67.

152. *See Bezos Calls Amazon Experiment 'A Mistake,'* PUGET SOUND BUS. J. (Sept. 28, 2000), http://www.bizjournals.com/seattle/stories/2000/09/25/daily21.html.

social networking sites include provisions in their terms of service agreements that divest individuals of basic consumer rights.[153] The terms in these agreements not only force users to arbitrate claims against the companies, but often strip them of the ability to seek relief as part of a class of similarly situated consumers and deny them discovery rights as well as other procedural protections.[154] Given how harmful these clauses can be to consumers, one would expect to see consumer activists attempting to dissuade companies from using them. While there have been occasional efforts to mobilize the public to take a stand against these types of arbitration provisions, their continued prevalence is testament to how little they have accomplished.[155]

The final problem with relying on private consumer actions to regulate markets is that doing so will encourage firms to invest in tactics that will undermine traditional public mechanisms for policing market conduct.[156] The economic explanation for how technological advances could have this effect is relatively straightforward. In the pre-digital era, it was very difficult for a company to identify which of its customers were likely to take actions—e.g., organize a class action lawsuit, tell a sympathetic story to news outlets, prompt an administrative body to investigate commercial behavior—that would hurt its interests. By the time a company gained this knowledge, it was typically after the company had suffered substantial damage. Further, once a disgruntled customer had filed a suit against a company or gone public with his story, the time and effort the customer had invested in taking action made it more expensive for the targeted company to appease him or buy him off.

As a whole, businesses' pre-digital options for maintaining brand reputation through active management of customer relationships were very limited. While it was obvious that

---

153. *See* Michael L. Rustad et al., *An Empirical Study of Predispute Mandatory Arbitration Clauses in Social Media Terms of Service Agreements*, 34 U. ARK. LITTLE ROCK L. REV. 643, 643 (2012).

154. *Id.* at 671, 673.

155. *See* Daniel D. Barnhizer, *Escaping Toxic Contracts: How We Have Lost the War on Assent in Wrap Contracts*, 44 SW. L. REV. 215, 215–16 (2015) (describing why consumer-led efforts have been unable to get firms to stop using arbitration clauses).

156. For an overview of how businesses have attempted to achieve this goal in traditional markets, see RADIN, *supra* note 29, at 33–55.

preventing public relation fiascos would greatly benefit a company, the only mechanisms for doing so were resource-intensive. Identifying the customers that were most likely to take harmful actions ahead of time was prohibitively expensive. The main alternative to targeting such individuals was to attempt to keep *every* consumer happy enough that they would not take action against the company. While an admirable goal, such a tactic would require an immense dedication of resources and be uncertain to succeed.

Technological advances have ushered in significant changes to the economics of customer management. As described above, it will become increasingly easy for businesses to identify individuals who are likely to pose threats to company interests.[157] Early identification will enable companies to resolve disgruntled individuals' problems at lower cost and with less damage to their reputation. These changes will make targeted attempts to placate the subset of consumers who foment class action law suits, media stories, regulatory proposals, and legislative efforts a realistic business tactic. Obviously, companies providing disgruntled customers with satisfactory responses to their problems is not a problematic practice. What is questionable, however, is intentionally ignoring the concerns of those who are unlikely to pursue legal or political recourse.

If firms are able to resolve the complaints of their most litigious customers proactively, they will strongly reduce the regulatory efficacy of class action litigation. Class-based litigation has been viewed as one of the modern era's most powerful checks on companies' conduct.[158] The ability of such suits to combat exploitative conduct, however, depends on the existence of individuals who are willing to do what many aggrieved consumers are unwilling to do—take on the significant agency costs associated with pursuing such claims in court.[159]

Identifying and appeasing the individuals who are most likely to foment a class action suit will be in firms' financial

---

157. *See* discussion *supra* Section II.C.

158. *See* Max N. Helveston, *Promoting Justice Through Public Interest Advocacy in Class Actions*, 60 BUFF. L. REV. 749, 750–53 (2012).

159. *See* Samuel Issacharoff, *Litigation Funding and the Problem of Agency Cost in Representative Litigation*, 63 DEPAUL L. REV. 561, 568–70 (2014); Tyler W. Hill, Note, *Financing the Class: Strengthening the Class Action Through Third-Party Investment*, 125 YALE L.J. 487, 495–506 (2015).

interests, as preventing such a suit will likely mean that they will not have to compensate the customers who would have been part of the class. The digital era provides firms with new tools for getting around the procedural mechanisms that were put into place to prevent firms from engaging in these behaviors. For example, the settlement approval requirement for classes seeking monetary damages only limits companies' conduct after a suit has commenced, but does nothing to prevent firms from acting prior to the filing of a compliant.[160]

Companies may be able to employ similar tactics to suppress grassroots regulatory movements. While it is unclear whether new technologies will help companies influence the bureaucrats that directly control legislative and regulatory agendas, it is plausible that digital innovations could help firms weaken populist demands for greater state involvement in markets.[161] Like class action litigation, grassroots efforts are one of the ways that individuals can harness the power of the state to control market conduct. They are also similar in that these types of movements are often instigated and maintained by the efforts of a handful of individuals. If technology helps companies identify the individuals that are critical to these actions, it will give firms opportunities to reach out and dissuade them from organizing public opposition to their practices.

Additionally, firms' successes in preventing class action litigation and other pro-consumer market interventions will have second order anti-regulatory effects. Renowned contract scholar Margaret Jane Radin has described the idea that private entities could promote the growth of anti-regulatory norms in the populace as democratic degradation.[162] Minimizing consumer litigation and weakening pro-regulation grassroots movements will contribute to the removal of consumer rights from the realm of public law issues.[163] To the extent that companies are able to prevent consumers' problems from being addressed by governmental bodies, they foster support for the idea that state involvement in consumer markets is un-

---

160. *See* FED. R. CIV. P. 23(e).

161. While the digital era will likely increase the number of consumer complaints (due to decreases in the consumer costs of complaining), it will remain the case that a small percentage of complaining consumers will be likely to exert the energy needed to instigate a larger consumer movement.

162. *See* RADIN, *supra* note 29, at 33–46.

163. *Id.*

necessary or, at the extreme, that it constitutes an inappropriate use of governmental power.[164]

By acknowledging the variety of ways that the digital revolution will work against, rather than for, consumers' interests, the preceding Part has filled a gap in the existing literature. Recognizing how technology has opened the door to new forms of reputational manipulation is of particular importance, as it is a threat that has, until now, flown under commentators' radars. Additionally, even if the benefits to consumers described by some commentators materialize, they are likely to have an impact that is much smaller than has been forecast. Limitations inherent to digitally based consumer protests, actions taken by businesses, and competitive market failures will impair consumers' power gains.

It is becoming increasingly clear that the growth of the internet and social media will enhance companies' abilities to exploit individuals. The digital world offers businesses unprecedented opportunities to reach out to individuals, craft their image, and actively manage their relationships with consumers. When combined with data about consumers and advanced analytics, the malleable nature of online sales transactions provides firms with new opportunities for exercising power over consumers.

III.
Regulating Commerce in a Digital Economy

Recent technological breakthroughs should not be viewed as eroding the basis for market regulation, but rather as changing regulatory priorities and enabling the creation of better mechanisms for protecting consumers. It is clear that the digital revolution will not be an unqualified boon to consumers. As established earlier, while the growth of the internet and social media will grant consumers power that they did not previously have, there are a number of countervailing factors.

Acknowledging this point allows one to avoid reaching the mistaken conclusion that private actors will be capable of regulating consumer markets in the digital era. State involvement will still be necessary to prevent consumer exploitation.

---

164. *Id.*

What is not clear, however, is what forms of regulation are best suited for today's markets.

This Part outlines some ways that regulation could address the problems that may arise in consumer markets in the digital era. It begins by providing a brief overview of the different ways the state currently intervenes in consumer markets. It then describes a number of novel reforms that could be used to prevent consumer exploitation.

A. *The Status Quo*

In the United States, measures that aim to protect consumers exist at every level of government. While actions taken by municipal bodies can have substantial effects,[165] the primary forces regulating markets can be found at the federal and state levels. One way of conceptualizing consumer protection law is to imagine consumer markets as a very large area, with different types of markets inhabiting separate regions of this space. Consumer protection statutes, regulations, and agencies each control different zones, often overlapping with one another. Hence, most segments of consumer markets fall within the jurisdiction of multiple governmental bodies and are subject to a unique constellation of rules.

Mapping the entire topography of consumer protection law would be a massive undertaking, but it is possible to succinctly describe its general structure. The FTC is the most important entity at the federal level, with the Department of Justice (DOJ), other agencies, and sector-specific legislation also having large roles. At the state level, market regulation occurs via consumer protection acts, suits brought by attorneys general, state agencies' actions, and sector-specific laws and regulations.

The FTC was created in 1914 as a result of the passage of the Federal Trade Commission Act (FTCA) and is the agency that exercises the broadest oversight over consumer markets. The FTCA authorizes the FTC to investigate commercial entities and promulgate regulations that prohibit anticompetitive, unfair, and deceptive business practices. Examples of the types of conduct that the FTC has proscribed include endorsement

---

165. *See* Steven J. Cole, *State Enforcement Efforts Directed Against Unfair or Deceptive Practices*, 56 ANTITRUST L.J. 125, 131 (1987) (discussing local consumer protection efforts).

of a product without disclosing material connections the endorser has with the seller of the product,[166] and upselling goods and services to consumers over the phone without making certain disclosures.[167] The FTC is the sole entity that can enforce the FTCA and the Agency's regulations. It uses both civil suits and administrative actions to achieve this end.

The Antitrust Division of the DOJ also plays an important role in the federal government's regulation of markets. Antitrust laws are regularly viewed as a form of consumer protection, as they ensure that markets are competitive and "that a meaningful range of options is made available to consumers, unimpaired by practices such as price fixing or anticompetitive mergers."[168] The DOJ shares enforcement authority over the federal antitrust laws with the FTC.[169] Both entities can bring suits to challenge the legality of private firms' commercial actions. The DOJ has also been willing, in limited circumstances, to advise firms as to the Department's views concerning the legality of proposed business conduct.

Beyond the FTCA and antitrust laws, which govern conduct in consumer markets generally, there are an incredible number of federal statutes and agencies that regulate specific sectors of commerce.[170] Examples of such laws are the Consumer Product Safety Act;[171] the Food, Drug, and Cosmetic Act;[172] the Dodd-Frank Wall Street Reform and Consumer Protection Act;[173] and the Patient Protection and Affordable Care Act.[174] Each of these laws controls firms' behaviors in different sectors of commerce. Many authorize the creation of federal administrative agencies and empower them to promulgate further regulations for the purposes of policing market conduct. For instance, the Food and Drug Administration, the

---

166. 16 C.F.R. § 255.5.

167. 16 C.F.R. § 310.

168. Neil W. Averitt & Robert H. Lande, *Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law*, 65 ANTITRUST L.J. 713, 713 (1997).

169. *See id.* at 713–14.

170. *See* Crane, Eichenseer & Glazer, *supra* note 21, at 305 ("Federal Consumer protection law reflects piecemeal Congressional efforts to protect consumers.").

171. 15 U.S.C.A. § 2053 (West 2011).

172. 21 U.S.C.A. § 301 (West 1938).

173. 12 U.S.C.A. § 5301 (West 2010).

174. Pub. L. No. 111–148, 124 Stat. 119 (2010).

Consumer Product Safety Commission, and the Consumer Financial Protection Bureau were formed in the wake of the passage of large consumer protection statutes.[175]

These sector-specific statutes and administrative bodies utilize a variety of regulatory approaches. While some focus on mandating disclosure, others directly prohibit certain types of conduct or impose administrative approval requirements on companies. Enforcement mechanisms also vary widely. Some statutes vest this authority in specific administrative actors, others task the FTC with ensuring that private entities comply with their rules, and still others create private causes of action that enable enforcement through consumer suits.[176]

State consumer protection efforts bear a strong resemblance to their federal counterparts.[177] Every state has enacted statutes that broadly prohibit deceptive commercial practices. The scope of each state's law varies considerably, but they generally target the same types of conduct that the FTCA proscribes and are often referred to as "mini-FTC" acts.[178] Unlike the federal law, almost every state statute creates a private cause of action, allowing individuals to sue businesses if they engage in proscribed acts.[179] It is common for these statutes to also authorize the state's attorney general and the state's consumer protection agency (if one exists) to bring enforcement actions.[180]

In many states these mini-FTC acts are the primary laws that regulate general commercial activity, with the remainder of regulation occurring through means that are focused on specific industries. For instance, state departments of insurance are usually responsible for protecting consumers from exploitation by insurance firms.[181] Sector-specific laws and

175. *See* Crane, Eichenseer & Glazer, *supra* note 21, at 309–19.
176. *See id.*
177. *See id.* at 305–06 (describing state consumer protection law as "no less complex" than federal law).
178. *See id.*
179. *See* Carter, *supra* note 22, at 7–10, 18–23.
180. *See id.* at 16–18.
181. *See* Kenneth S. Abraham, Insurance Law & Regulation 107–08 (4th ed. 2005).

agency actions are often used to regulate businesses in agriculture, consumer credit, and utility markets.[182]

Reviewing the structure of consumer protection reveals two facts that are relevant to the regulation of commerce in the digital era. First, neither federal nor state governments have enacted laws or created agencies specifically tailored to address the impact of technological advances on consumer markets. While there have been preliminary indications that the federal government may take action on this front,[183] the regulations currently in place were all designed to address the problems of pre-digital markets. While some of the existing regulatory mechanisms could be stretched to combat new exploitative behaviors, they will not be able to address all of the threats to consumer welfare that the digital era will introduce.

Second, while there are some mechanisms for addressing issues throughout commercial markets, the standard way the government has handled consumer problems is to address them on an industry-specific level. This balkanization is notable because the threats to consumer welfare identified earlier will be present in most, if not all, sectors of commerce. In order to prevent the degradation of markets, federal and state governments will have to go beyond their default responses and create new rules that will apply to all market sectors.

B. *Necessary Reforms*

This Section discusses some of the ways that the state could counteract the issues identified in Part I. It begins by discussing two issues that have received scarce attention—first, how the state could address the problems posed by the intentional manipulation of digital reputational information and, second, how governmental entities could bolster private regulatory forces by providing consumer activist movements with infrastructure, financial support, and other resources. After

182. *See, e.g.*, *ICC at a Glance*, ILL. COMMERCE COMM'N (2016), https://www.icc.illinois.gov/downloads/public/en/ICCAtAGlance.pdf; *About*, ILL. DEP'T OF AGRIC. (2014), https://www.agr.state.il.us/aboutus/; *Consumer Credit*, ILL. DEP'T OF FIN. & PROF'L REGULATION, http://www.idfpr.com/ dfi/ccd/ccd_main.asp.

183. *See* EXECUTIVE OFFICE OF THE PRESIDENT, BIG DATA: SEIZING OPPORTUNITIES, PRESERVING VALUES (2014); EXECUTIVE OFFICE OF THE PRESIDENT, REPORT TO THE PRESIDENT—BIG DATA AND PRIVACY: A TECHNOLOGICAL PERSPECTIVE 22–24 (2014).

discussing these reforms, the remainder of the Section focuses on discussing how consumer protection proposals that scholars have proposed in other contexts could address the problems introduced by digital marketplaces.

All of the reforms discussed in this Section could be adopted at either state or federal levels. At least at the theoretical level, however, national reforms appear to be optimal. Not only would federal action protect consumers across the nation, it would also help minimize firms' compliance costs by eliminating interstate regulatory variances.

There is also flexibility as to enforcement mechanisms. Given the size of consumer markets, ensuring that firms comply with these regulations could prove to be difficult. Staffing an administrative agency with the number of employees needed to police and prosecute violations of these laws could prove to be prohibitively expensive. An alternative (or supplementary) approach would be to model these reforms after state mini-FTC acts and grant private individuals the right to bring actions against companies.[184] If needed, statutory damages could be authorized as well. Pairing administrative regulatory actions and private rights of action could create financial incentives sufficient to prevent firms from engaging in proscribed activities. To the extent that there are concerns about burdening the dockets of state and federal courts, primary jurisdiction over these claims could be vested in the FTC or state administrative courts.

It is also worth noting that the regulatory responses described below will not address every issue identified in Part I. This is by design. It is difficult to imagine how the state could proscribe certain conduct without severely disrupting markets. Given that the ultimate aim of regulation is to encourage healthy markets, enacting regulations that would hurt markets would be counterproductive. The better way to limit the impact these practices have on consumers is to implement measures that lead to an acceptable degree of parity between consumer power and firm power.

---

184. *See* Schwartz & Silverman, *supra* note 22, at 3–5 (discussing the two different models of enforcement).

1. *Requiring Disclosure for Review Sites and Prohibiting Deceptive Reviews*

In the digital market era, it will be vital for the state to institute rules that protect consumers' access to reputational information that has not been unduly biased by private firms. Given the increased importance of reviews, there will be large economic incentives pushing companies to try and influence how they are portrayed on websites and applications. These pressures will lead to a variety of different behaviors—firms posting duplicitous reviews, inappropriately incentivizing third parties to say favorable things, paying reviewing entities to filter out negative comments, etc.[185]

One method of addressing these problems would be adopting stronger disclosure of financial interest rules and increasing enforcement of existing regulations. While regulations already prohibit anyone from endorsing a product without disclosing any pecuniary interests, the application of these rules to online review information is not entirely clear.[186] For instance, does a review-hosting website like Yelp need to disclose its financial relationship with companies that subscribe to its advertising services? Revised rules could require that companies that host the product reviews of third parties disclose any pecuniary relationships that they have with the businesses that are reviewed. Such disclosures could be made available to the public on a governmental regulatory body's website. Alternatively, the state could require that reviewing entities prominently display such information on whatever platform contains the review information.

The largest problems with this type of approach are defining which entities would have to make these disclosures and which types of interests would trigger the duty to disclose. First, regulators would have to decide which types of reviewing bodies would be subject to these requirements. While there are some entities that would be obvious targets for this type of disclosure requirement (e.g., Yelp, Amazon.com), matters are much less clear for other types of sites (e.g., unmoderated message boards, blogs that only occasionally review products, or sites where product reviews are not a core part of their functionality).

185. *See* discussion *supra* Section II.A.
186. *See* 16 C.F.R. § 255.5 (2009).

Defining which types of relationships trigger a covered entity's duty to disclose would also prove to be problematic. Drawing this line would be difficult given that most review-hosting entities derive some of their revenue from the businesses and products they review and the fact that there is nothing inappropriate about certain financial relationships between reviewing companies and the firms they review. Indeed, disclosure requirements only make sense for certain types of relationships—e.g., those where a company can pay to have the site manipulate its reviews. Drawing a line that clearly and logically distinguishes permissible pecuniary interests from those that must be disclosed may prove to be so difficult that it forecloses this type of regulation.

Another way that the state could act would be through legislation proscribing individuals from posting reviews containing disingenuous and deceptive information. Again, while existing federal and state laws could be interpreted as prohibiting this behavior, their application to online reviews is not clear. Given this ambiguity, the main forces currently deterring businesses from manipulating online reviews are the potential repercussions associated with violating a site or app's terms of use and reputational effects.[187] While these penalties could be significant—for example, a company or user being barred from the site or bad press—they may not be sufficiently strong to prevent misconduct.

State-imposed sanctions could bolster private deterrents to these types of behaviors. Laws prohibiting such uses of review sites could resemble or add to the deceptive trade practices that are prohibited through most states' consumer protection acts.[188] While properly tailoring the scope of proscribed conduct would be difficult, defining the types of self-promoting (or competitor-sabotaging) behaviors that threaten consumer welfare does not seem as though it would be an insurmountable obstacle.[189] For instance, a regulation could

187. Some review sites have taken action against private actors who post false reviews. *See, e.g.*, Romero, *supra* note 117.

188. Some states have already punished the manipulation of digital reputation data under their existing laws. *See, e.g.*, Press Release, A.G. Schneiderman Announces, *supra* note 120.

189. First Amendment concerns are commonly raised in this context. First, to the extent that existing laws proscribing deceptive speech are legal, the reforms discussed should also be so. Second, the Supreme Court has

prohibit companies and their employees from posting reviews of their own business, posting negative reviews about competitors, or offering pecuniary incentives to third parties to induce them to do these things. Severe financial sanctions, especially if paired with a private right of action, could significantly increase the costs of being caught and could deter disingenuous behavior.

2. *Supporting Grassroots Consumer Protection Movements*

Another way that the state could protect consumers is by taking steps to facilitate private activism. Many of the factors preventing private actions from serving as an effective check against exploitative practices can be attributed to the fact that there is not a centralized body coordinating individuals' efforts. This observation suggests one way the state could bolster consumer efforts to change businesses' practices—by providing grassroots efforts with infrastructural support, funding, or other resources.

There are a variety of approaches that the state could use to help consumer–activists in this way. The state itself could create a centralized portal (e.g., a website and mobile application) that individuals could use to communicate with one another about consumer welfare issues, start movements against the practices of specific businesses, and search for movements that they would be interested in joining. Perhaps more feasibly, the government could provide grant funding to an existing consumer rights non-profit organization to perform these tasks.

The state could use the portal itself to inform users about issues that it feels would be of interest to them. Alternatively, it could take a passive role, allowing users to produce their own content and subscribe to updates concerning particular issues. The state could also, as an alternative to creating a portal or in addition to one, encourage consumer rights organizations to

held that the First Amendment does not protect deceptive or misleading commercial speech. *See* Peel v. Att'y Registration & Disciplinary Comm'n, 496 U.S. 91 (1990); Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 561–64 (1980); Rebecca Tushnet, *It Depends on What the Meaning of "False" Is: Falsity and Misleadingness in Commercial Speech Doctrine*, 41 LOY. L.A. L. REV. 227 (2007).

develop their own portals.[190] By providing them with resources and a governmental endorsement, the state would be able to take advantage of existing social networks and focus on expanding their reach.

This kind of governmental facilitation, if successful, would help ameliorate some of the problems that have plagued consumer actions. First, designating a central portal would decrease the amount of effort consumers must expend to procure information and join causes. Such a portal would also reduce consumer fatigue by making it easier to consolidate duplicative consumer actions. Further, consumer-led efforts organized through a government-backed site could reduce some individuals' concerns about the legitimacy of consumer actions. Finally, a governmental portal could reduce the impact of saliency biases as centralization would help prevent disproportionate amounts of attention being paid to any particular issue.

Beyond run-of-the-mill concerns about the proper execution and maintenance of a portal, the largest potential problem is that its success will depend heavily upon its ability to gain purchase with a substantial number of consumers. If the government-backed platform fails to draw in a sufficiently large number of individuals, then it will be unable to obtain the critical mass that is crucial to the success of consumer actions. Indeed, if the government site does not become one of the primary places that consumers turn to with their problems, it risks simply adding to the cacophony that has traditionally impeded this type of activism. Partnering with existing consumer organizations would be particularly helpful in two regards—it would give the state's platform a solid base of initial users and reduce the number of consumer assistance mechanisms competing for individuals' attention.

---

190. There are a number of national consumer rights organizations that would be strong candidates for such support. *See, e.g.*, *About CFA*, CONSUMER FED'N AM., http://consumerfed.org/about-cfa/; *About NACA*, NAT'L ASS'N CONSUMER ADV., http://www.consumeradvocates.org/about-naca; *About Us*, NAT'L CONSUMER L. CTR., https://www.nclc.org/about-us/about-us.html.

3. *Increasing Substantive Regulation of Firms' Relationships with Consumers*

While attempts to address the problems associated with intentional manipulation of reputational information and the lack of dedicated support for consumer activism are absent in the literature, commentators and academics have proposed solutions to the other threats to consumer welfare. Increased regulation of the terms used in consumer contracts, for example, has been a common proposal for cabining the growth in firms' power. Similarly, some have argued that healthy markets require a complete prohibition on price and term discrimination or restriction of firms' consumer data collection practices.

Many consumer-oriented commentators have argued, in a variety of contexts, that laws prohibiting the use of certain contract terms should be enacted to protect consumer welfare.[191] The need for such rules will only increase in the future, as the expansion in power that companies will experience will push them to insist that consumers agree to terms that heavily favor the firm's interests. As firms gain the ability to tailor consumer contracts they will force increasingly onerous terms on consumers, for instance, by substituting heavily restricted private dispute resolution mechanisms for public ones. Whenever competitive forces fail to check this type of conduct, consumers will have no choice but to abstain from certain markets entirely or agree to potentially unconscionable terms.

Passing statutes or promulgating regulations that bar businesses from including certain terms in consumer contracts is a simple and direct way to limit firm power. Several such prohibitions exist in the status quo. For example, the Uniform Commercial Code proscribes disclaiming the obligation of good faith and fair dealing in the sale of goods,[192] the FTC has barred certain terms from consumer-oriented financial products,[193] and many state legislatures have imposed statutory limits on non-compete provisions in employment agreements.[194]

---

191. *See* sources cited *supra* notes 46–48.

192. U.C.C. § 1-302 (Am. Law Inst. & Unif. Law Comm'n 2011).

193. *See, e.g.*, Fair Credit and Charge Card Disclosure Act, 15 U.S.C. § 1637(c)–(g); Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111–24, 123 Stat. 1734 (codified in sections of 16 U.S.C.).

194. *See, e.g.*, Ala. Code § 8-1-190 (2001); Cal. Bus. & Prof. Code § 16600 (Dearing 2007); Colo. Rev. Stat. Ann. §§ 8-2-113, 8-2-113(3) (West 2002);

Future prohibitions might target terms that consumer advocates have already raised concerns about, such as arbitration agreements that do not allow the consumer to seek class-wide relief[195] and liability waivers.[196]

The biggest limitations to this regulatory approach concern identifying the terms that deserve to be barred and keeping up with evolving market practices.[197] Distinguishing acceptable and exploitative market conduct is one of the most difficult tasks that governments have had to perform when it comes to protecting consumer welfare. Courts, in particular, have struggled mightily to provide coherent explanations for what makes a contractual term unconscionable.[198] Legislatures and administrative bodies, on the other hand, have not come up with a reliable methodology for forecasting whether a law will generate welfare gains for consumers that are sufficient to offset any potential damage they cause to markets.[199] These difficulties will not disappear in the digital era and will continue to constrain this type of regulatory response. Making the task of policing specific terms even more difficult is the ever-evolving nature of consumer markets. A regulatory bar on certain terms is likely to inspire firms to create new provisions that allow them to recapture the benefits that the now-banned terms granted them.

MICH. COMP. LAWS ANN. § 455.774a (West 2002); OR. REV. STAT. § 653.295 (2013).

195. *See, e.g.*, Leslie, *supra* note 45.

196. *See, e.g.*, Albert H. Choi & Kathy E. Spier, *Should Consumers Be Permitted To Waive Products Liability? Product Safety, Private Contracts, and Adverse Selection*, 30 J.L. ECON. & ORG. 734 (2014).

197. Political capital constraints are also a very real barrier to these types of laws being passed. Such concerns are outside the scope of this Article, which is focused on identifying the structural limitations of different regulatory measures.

198. *See* David. S. Schwartz, *Enforcing Small Print To Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 105–15.

199. Some have argued that substantive regulation of this type can harm markets by restricting firms' abilities to create maximally efficient contracts. As a whole, these arguments seem underwhelming because, even if a law forces firms to bear certain costs, there will usually be nothing preventing businesses from adjusting their prices to account for these additional costs. Unless there are reasons to believe that it costs more for firms to bear these costs, the increase in cost to consumers should simply reflect a contingent or tacit cost they would bear absent regulation.

The digital revolution could help regulatory bodies overcome some of the traditional difficulties associated with prohibiting the use of certain terms in consumer contracts. For instance, if the state created a platform for consumer activism, it could use it to collect information from citizens about abusive terms at minimal cost. While individuals' opinions may not be a foolproof means for identifying every problematic commercial practice, they would give regulators data on whom their actions would benefit and on public support for different reforms.

Another way the state could prevent firms from wielding disproportionate power over consumers is by barring price and term discrimination. As described above, digital technologies will allow businesses to tailor their sales to individual consumers.[200] While customized deals are not inherently bad for consumers, firms' economic interests will lead them to use their abilities to extract the greatest possible amount of value from consumers. The shift from uniformity to customization will inflict significant welfare losses on many consumers.

The most obvious way to prevent these problems would be to enact laws that directly prohibit businesses from engaging in this type of conduct. Federal laws already proscribe price discrimination in certain commercial contexts.[201] The scope of existing prohibitions, however, is limited and the federal government has shown little interest in prosecuting firms that violate these laws.[202] Laws could be passed that unambiguously proscribe companies from charging customers different prices for the same products.

Because customization of the terms of a deal can be beneficial to consumers, a similar prohibition against firms offering customers different contractual terms would be a bad idea.[203] Hence, the state would have to implement different types of reforms to prevent exploitative term discrimination. One way

---

200. *See* discussion *supra* Section II.C.

201. *See* Robinson–Patman Act of 1936, 15 U.S.C. § 13(a) (2016).

202. HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAWS OF COMPETITION AND ITS PRACTICE § 14.6 (4th ed. 2011) (noting the federal government's limited enforcement of the Act).

203. There are many legitimate, non-exploitative reasons that the terms of sale might vary from one customer to another—varying levels of interest in extended warranties, different preferences concerning willingness to arbitrate claims, etc.

of achieving this reform would be to bar companies from using certain types of personal information to vary the terms of their offers. Others would be to require that businesses disclose the methodology they use to tailor their offers, provide customers with both tailored and standardized offers, or obtain consumers' consent for every term that varies from deal to deal.

While these types of reforms could prevent firms from discriminating among customers in exploitative ways, it will be difficult for governmental bodies to create rules that prohibit undesirable behaviors without being overbroad. While proscribing price discrimination would be relatively uncomplicated in certain contexts—like a flat prohibition on charging customers different prices for a standardized commercial good—it would be difficult in many others. For instance, how could one determine when a company is engaging in illicit price discrimination by charging different prices for customized goods or personal services? In these types of commerce, it is possible that there are legitimate justifications for price differentials. Price variances could reflect differences in the costs a business incurs in performing its end of a bargain. Laws that cannot adequately distinguish between legitimate and illegitimate forms of price discrimination would have deleterious effects on markets.

A final approach to restraining commercial entities focuses on limiting the extent to which businesses can collect and use consumer data. The digital era will drastically expand companies' access to consumer data. This data, along with advances in analytics and hardware, will allow businesses to profile individuals, and tailor their marketing and sales practices to take advantage of consumers' psychological vulnerabilities.[204]

While barring specific terms from consumer contracts or restricting companies' abilities to vary their terms of sale across consumers addresses these concerns in the sales context, these actions would not affect exploitative advertising practices. One way the state could protect consumers in this area is by limiting the types of consumer information that companies are allowed to possess. Curtailing their access to this data could prevent firms from learning about individuals' cognitive weak-

204. *See* discussion *supra* Section II.C.

nesses and would undermine companies' efforts to prey on these vulnerabilities. Rather than attempt to define classes of consumer data that are off limits, it would make sense for the government to specify narrow categories of information that firms can collect and use.[205] Demographic data like age and sex, for instance, might be permitted, while data that would allow businesses to draw conclusions about individuals' psychological characteristics would not.[206]

The primary difficulty that this form of regulation would have to overcome is drawing the line between permissible and impermissible forms of data collection and analysis. Even though some uses of consumer data enable unfair exploitation of individuals' vulnerabilities, other uses confer benefits on consumers. For example, a company could use profiling in advertising to selectively present consumers with pitches tailored to their subconscious preferences or, alternatively, to ensure that consumers only see advertisement for products that they might actually be interested in. The former strikes most as objectionable, but the latter does not. It is unclear whether one could design a rule that prohibits the former without impeding the latter. Further complicating this issue is the fact that the types of information that support beneficial innovation likely vary across industries, limiting the usefulness of across-the-board rules about the types of information companies can possess.

The balkanized way that federal and state governments have traditionally approached consumer protection issues is poorly suited to preventing consumer exploitation in the digital era. Technological advances have created a panoply of new ways for firms to take advantage of individuals. Most of these tactics are not unique to individual industries and could be employed by businesses in most, if not all, fields. Hence, optimal regulatory responses will affect consumer markets as a whole, with sector-specific laws and regulations playing a secondary role.

---

205. Such an approach resembles the community rating rules imposed on health insurers in the Patient Protection and Affordable Care Act of 2010. *See* 42 U.S.C. § 300gg (2015).

206. Some have argued that restrictions on the types of data that firms can collect and analyze constitute violations of the First Amendment. For an overview of these contentions and reasons why such laws should not be considered unconstitutional, see Calo, *supra* note 15, at 1034–40.

Although uncommon in the modern era, market-wide regulatory measures are not unprecedented. The FTCA, states' mini-FTC acts, and many of the regulations promulgated by federal and state consumer protection agencies have prohibited conduct across all industries. The reforms needed to keep consumer markets healthy in the digital era should be modeled after these laws and will need to draw upon the same sources of political support that enabled their enactment.

While it will be impossible to completely stop firms from using technological advances to gain power over consumers, there are a number of actions that the government should take to preserve market health and protect individuals. First, the state should prohibit conduct that unfairly disadvantages consumers. Companies should be barred from intentionally manipulating consumer review information, proscribed from using commercially unreasonable contractual terms, and limited in the extent to which they can collect and use individuals' data. Second, the government should take steps to bolster consumers' power. This could occur through providing infrastructure or other resources to consumer activist movements and by helping to ensure that the mechanisms by which reputational forces check business practices are not compromised. By enacting these types of reforms, the state could help ensure that technological change does not lead to massive consumer disempowerment and, by doing so, prevent market instability.

Conclusion

Once one recognizes the extent to which the digital revolution will change commercial markets, the need for regulatory changes becomes apparent. Preoccupation with the ways in which technological advances enhance consumers' capabilities might lead one to think that governmental interventions will be less necessary in the world of online markets. Actual consumer and firm behavior during the current transitional period, however, does not appear to support this conclusion. While technological advances have granted individuals new means for combatting certain forms of exploitative behavior, their extent to which they have empowered consumers has been limited. These innovations have also enhanced firms' ca-

pabilities and, in doing so, introduced new threats to consumers' interests.

While scholars and policymakers have studied the tactics businesses use to gain leverage over consumers, too little attention has been paid to analyzing how larger societal developments will affect these practices. As digital worlds become more central to individuals' lives, it becomes increasingly likely that new forms of exploitative conduct will emerge. For example, increased access to information has caused consumers to grow increasingly dependent on reputational information and created strong incentives for private firms to manipulate such data.

Businesses must constantly adopt new practices to remain competitive in markets. Similarly, regulatory bodies and those concerned about individuals' welfare must also look to evolve and innovate. As markets enter into the digital era, there must be a greater emphasis on tracking private sector efforts to exploit consumers and implementing regulatory responses that foster healthy markets.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 13 FALL 2016 NUMBER 1

DISREGARDING THE CORPORATE FORM: WHY JUDGES, NOT JURIES, SHOULD DECIDE THE QUIDDITS AND QUILLETS OF VEIL PIERCING

BRIAN D. KOOSED,
ANTHONY P. BADARACCO, AND
ERICA R. IVERSON*

INTRODUCTION 96
I. THE RIGHT TO TRIAL BY JURY 97
A. *Statutory Jury Rights* 98
B. *The Seventh Amendment* 100
1. *Nature of the Issue* 101
2. *The Second Inquiry* 104
a. Historical Practice 105
b. Practical Considerations 106
II. PIERCING THE CORPORATE VEIL 107
III. TO JURY OR NOT TO JURY? 113
A. *Juries: The Second Circuit Rule* 114
B. *Juries: The Fifth (and Eleventh) Circuits' Contradictory Applications of Legal Standards* 119
C. *Juries: The First Circuit* 121
D. *Judges: The Seventh Circuit Rule* 122
E. *The Split in Other Circuits* 125
F. *The Split Among the States* 125

* Copyright © 2016 by Brian D. Koosed, Anthony P. Badaracco, and Erica R. Iverson. Brian D. Koosed is a partner, Anthony P. Badaracco is an associate, and Erica R. Iverson is a former associate with the law firm of K&L Gates LLP. The views expressed in this Article are those of the authors alone, and not of K&L Gates LLP or any of its clients. The authors gratefully acknowledge the invaluable research assistance contributed by Chelsea Stevens, Blaise Niosi, Peter Seel, and Patrick Jamieson.

IV. JUDGES, NOT JURIES, SHOULD DECIDE VEIL-PIERCING CLAIMS 128
A. *Veil Piercing Is an Equitable Remedy* 129
B. *Juries Are Ill-Equipped to Parse Veil-Piercing Facts* 131
C. *Consistency in Decisions* 133
D. *Efficiency Considerations* 134
CONCLUSION 135

INTRODUCTION

Corporate entities are generally treated as distinct from their shareholders; a judgment recovered against a corporation cannot be enforced against its shareholders, whether those shareholders are individuals or corporate entities themselves. But *generally* is an important qualifier. In some circumstances, such as when the corporate form has been used to commit fraud and the corporation has no assets to satisfy a judgment, a creditor may "pierce the corporate veil" and hold otherwise immune shareholders personally liable for the corporation's debts. As one notable commentator rather whimsically characterized it, veil piercing is "the refusal of the courts to allow quiddits and quillets to stand in the way of justice."[1]

The nature of a veil-piercing action is vexing. It is not truly a "claim," and not quite a remedy, either. Closer to the latter than to the former, it can perhaps best be described as a legal mechanism that allows a creditor to enforce a judgment against a party able to satisfy it.[2] The historical roots of veil piercing are tangled as well, reaching into the jurisprudence of courts of law and also of courts of equity. As the highest court of the State of New York once observed, the concept of veil piercing is "still enveloped in the mists of metaphor."[3]

This conceptual and historical murkiness has at least one important practical consequence for practicing litigators to-

1. I. MAURICE WORMSER, DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS 44 (1927).

2. Piercing the corporate veil is nevertheless frequently referred to as a "claim" in legal vernacular and in many court opinions. For the sake of convenience, we will similarly use the term "claim" in this Article.

3. Berkey v. Third Ave Ry. Co., 155 N.E. 58, 61 (N.Y. 1926); *see also* Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1036 (1991) ("Piercing the corporate veil is the most litigated issue in corporate law and yet it remains among the least understood.").

day: federal and state courts have not been able to settle on *who* should decide veil-piercing actions. Both the federal circuits and the appellate courts of various states have split widely, some determining that judges should decide whether to pierce the corporate veil and others assigning the task to juries.[4]

This Article attempts to make sense of that confusion and proposes a way forward. Part I focuses generally on the circumstances under which a civil plaintiff in federal court is entitled to a trial by jury, as opposed to by judge—an inquiry that requires an examination of English legal history and a comparison of the relative capacity of each type of fact-finder. Part II explains the function of veil piercing and examines its historical roots. Next, Part III analyzes the existing case law and the reasoning various courts have applied in determining who should adjudicate veil-piercing actions. Finally, Part IV argues that, because the corporate person is, itself, a legal fiction, judges, not juries, are best suited to decide whether the corporate veil should be pierced in a particular case.

I.
THE RIGHT TO TRIAL BY JURY

Not every civil litigant in the United States is entitled to have her claims heard and decided by a jury. Some claims, instead, may only be brought before a judge sitting as the fact-finder.[5] The distinction lies in a combination of statutory language, eighteenth century English legal history, more recent American precedent, and sometimes a court's practical evaluation of which fact-finder is better suited to decide a given issue.

---

4. *See, e.g.*, *In re* G-I Holdings, Inc., 380 F. Supp. 2d 469, 476 (D.N.J. 2005) ("A circuit split exists as to whether the nature of the relief in an action to pierce the corporate veil is legal or equitable.").

5. Every criminal defendant, by contrast, is entitled to a trial by jury. U.S. CONST. amend. VI. ("In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the state and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the assistance of counsel for his defense.").

A. *Statutory Jury Rights*

There is one threshold matter: a court must look first to whether a statutory right to jury trial is implicated.[6] Some federal and state statutes explicitly guarantee the right to trial by jury for any claims brought pursuant to certain provisions. Examples in federal law include claims brought by seamen pursuant to the Jones Act,[7] actions on bonds and special instruments,[8] admiralty and maritime cases,[9] and original actions at law brought in the Supreme Court against citizens of the United States.[10] Examples in state law include New York divorce actions,[11] New Jersey worker's compensation claims,[12] Maryland real property actions,[13] and Wisconsin disputes re-

6. *See* City of Monterey v. Del Monte Dunes at Monterey, Ltd., 526 U.S. 687, 707 (1999).

7. 46 U.S.C. § 30104 ("A seaman injured in the course of employment or, if the seaman dies from the injury, the personal representative of the seaman may elect to bring a civil action at law, with the right of trial by jury, against the employer.").

8. 28 U.S.C. § 1874 ("In all actions to recover the forfeiture annexed to any articles of agreement, covenant, bond, or other specialty, wherein the forfeiture, breach, or nonperformance appears by default or confession of the defendant, the court shall render judgment for the plaintiff for such amount as is due. If the sum is uncertain, it shall, upon request of either party, be assessed by a jury.").

9. 28 U.S.C. § 1873 ("In any case of admiralty and maritime jurisdiction relating to any matter of contract or tort arising upon or concerning any vessel of twenty tons or upward, enrolled and licensed for the coasting trade, and employed in the business of commerce and navigation between places in different states upon the lakes and navigable waters connecting said lakes, the trial of all issues of fact shall be by jury if either party demands it.").

10. 28 U.S.C. § 1872 ("In all original actions at law in the Supreme Court against citizens of the United States, issues of fact shall be tried by a jury.").

11. N.Y. DOM. REL. § 173 ("In an action for divorce there is a right to trial by jury of the issues of the grounds for granting the divorce.").

12. N.J. STAT. ANN. § 34: 19-5 ("Upon a violation of any of the provisions of this act, an aggrieved employee or former employee may, within one year, institute a civil action in a court of competent jurisdiction. Upon the application of any party, a jury trial shall be directed to try the validity of any claim under this act specified in the suit.").

13. M.D. CODE ANN., REAL PROP. § 8-332(b) ("On appeal [from any final order or judgment in an action of distress to the circuit court of the county] the case shall be tried de novo. On the application of any party to the action for a prompt hearing of the appeal, it shall be set for trial as soon as possible. Any party has the right to a jury trial on application in accordance with the rules adopted by the appellate court.").

garding motor vehicle accidents.[14] Other statutes, such as the Fair Labor Standards Act[15] and the Age Discrimination in Employment Act,[16] are less explicit but have been found, on grounds of statutory context or stare decisis, to carry a right to a jury as well. In such cases, the court will avoid any constitutional inquiry and simply enforce the statutory right to a jury.[17]

14. WIS. STAT. § 345.425 ("The defendant shall be informed of his or her right to a jury trial in circuit court on payment of fees required by § 345.43(1). If both parties, in a court of record, request a trial by the court or if neither demands a trial jury, the right to a trial by jury is waived.").

15. 29 U.S.C. § 217, discussed in Lorillard v. Pons, 434 U.S. 575, 580, n.7 (1978) (citing, *inter alia*, Wirtz v. Jones, 340 F.2d 901, 904 (5th Cir. 1965) ("[I]t was well established that there was a right to a jury trial in private actions pursuant to the FLSA. Indeed, every court to consider the issue has so held.").

16. 29 U.S.C. § 621, discussed in *Lorillard*, 434 U.S. at 580 ("Looking first to the procedural provisions of the statute, we find a significant indication of Congress' intent in its directive that the ADEA be enforced in accordance with the 'powers, remedies and procedures' of the Fair Labor Standards Act. 29 U.S.C. § 7(b). Long before Congress enacted the ADEA, it was well established that there was a right to a jury trial in private actions pursuant to the FLSA. Indeed, every court to consider the issue has so held.").

17. *See, e.g.*, Feltner v. Columbia Pictures Television, Inc., 523 U.S. 340, 345 (1998) (reaching the Seventh Amendment question only after determining that there existed no statutory right to have the jury assess the amount of statutory damages); Bentley v. Arlee Home Fashions, Inc., 861 F. Supp. 65, 68 (E.D. Ark. 1994) (avoiding the Seventh Amendment question based on the court's finding that the right to jury trial is guaranteed under the Worker Adjustment and Retraining Notification Act). The authors have not been able to find a case in which a court has enforced a *contractual* guarantee of a right to trial by jury; judicial determination of such a right is likely unnecessary in most cases because breach of contract claims were historically heard by juries and therefore subject to the Seventh Amendment preservation of the right to jury trial, as explained below. On the other hand, there is a more substantial body of law on the enforceability of *waivers* by contract of the right to trial by jury. The federal courts generally enforce such waivers. *See, e.g.*, Leasing Serv. Corp. v. Crane, 804 F.2d 828, 832 (4th Cir. 1986) ("The Seventh Amendment right is of course a fundamental one, but it is one that can be knowingly and intentionally waived by contract."); Nat'l Equip. Rental, Ltd. v. Hendrix, 565 F.2d 255, 258 (2d Cir. 1977) ("It is elementary that the Seventh Amendment right to a jury is fundamental and that its protection can only be relinquished knowingly and intentionally.").

But there are exceptions—waivers are not enforced unless they are made voluntarily, knowingly, or intentionally. *See generally* Brian D. Weber, Note, *Contractual Waivers of a Right to Jury Trial—Another Opinion*, 53 CLEV. ST. L. REV. 717, 720 (2005–06); Amanda Szuch, Note, *Reconsidering Contractual Waivers of the Right to a Jury Trial in Federal Court*, 79 U. CIN. L. REV. 435, 438 (2011) (addressing the "ambiguous federal standard"). The Second Circuit,

Where there is no such statutory guarantee of a right to trial by jury—either because the relevant statute is silent or because the cause of action derives from the common law or another non-statutory source—a court will look to the Seventh Amendment to determine whether the claimant has a constitutional right to a jury trial.

B. *The Seventh Amendment*

The Seventh Amendment to the United States Constitution preserves the right to jury trial "[i]n Suits at common law, where the value in controversy shall exceed twenty dollars."[18] It does not "create" a right to a jury; rather, it preserves that right as it "existed under the English common law when the Amendment was adopted."[19] Actions brought at English common law were "suits in which legal rights were to be ascertained and determined, in contradistinction to those where equitable rights alone were recognized, and equitable remedies were administered."[20] Thus, the Seventh Amendment "may . . . be well construed to embrace all suits which are not of equity and admiralty jurisdiction."[21]

In other words, the Seventh Amendment protects a litigant's right to a trial by jury for those matters traditionally brought before eighteenth century English courts of law that resolved legal (as opposed to equitable) issues, or for those that seek legal—i.e., not injunctive or declaratory—relief. Eighteenth century English juries were permitted to decide matters of fact in cases involving money damages, as well as some "extraordinary" remedies such as writs of habeas

---

for example, found that it would be against public policy to enforce a "provision literally buried in the eleventh paragraph of a fine print, sixteen clause agreement, [e]mbedded [with] the crucial words: 'Lessee hereby waives a trial by jury,' and deny the claimant a trial by jury." *Nat'l Equip. Rental*, 565 F.2d at 258.

And state courts vary in their view of the enforceability of jury trial waivers. The Supreme Court of Georgia, for example, holds contractual jury waivers generally unenforceable. *See* Bank S., N.A. v. Howard, 444 S.E. 2d 799, 800 (Ga. 1994) (barring the contractual waiver of the "valuable rights" to jury trial to prevent "the probability of abuse that exists").

18. U.S. CONST. amend. VII.

19. Baltimore & Carolina Line, Inc. v. Redman, 295 U.S. 654, 657 (1935).

20. Parsons v. Bedford, Breedlove & Robeson, 28 U.S. (3 Pet.) 433, 447 (1830).

21. *Id.*

corpus.[22] English courts of equity "handled nearly everything else, including injunctions, accountings, trusts, reformation of contracts, and some forms of restitution."[23] Several decades ago, the United States Supreme Court clarified that "[t]he Seventh Amendment question depends on the nature of the issue to be tried rather than the character of the overall action."[24] Thus, the Seventh Amendment requires that a jury "be available if the action involves rights and remedies of the sort typically enforced in an action at law," regardless of whether the overall cause of action was traditionally heard in English courts of law or of equity.[25]

To determine whether the right to a jury attaches to a given issue, the Supreme Court has applied a two-part historical test. First, a court must assess whether the issue was tried at law or equity at the time the Seventh Amendment was adopted in 1791.[26] To that end, the court must examine the nature of the claim and the nature of the relief sought. Second, if the issue is legal in nature and thus potentially susceptible to trial by jury, the court must determine whether the issue was historically considered fundamental enough to require determination by a jury. This second inquiry involves, if necessary, an examination of the relative capabilities of judges and juries.[27]

1. *Nature of the Issue*

Under the first inquiry, a court must determine whether the action is more analogous to a common-law cause of action,

---

22. *See* Ellen E. Sward, *The Seventh Amendment and the Alchemy of Fact and Law*, 33 SETON HALL L. REV. 573, 577–78 & n.25 (2003).

23. *Id.* at 577–78.

24. Ross v. Bernhard, 396 U.S. 531, 538 (1970) (holding that, even though the plaintiff's cause of action, a shareholder's derivative suit, was traditionally brought in courts of equity, the Seventh Amendment preserved the plaintiff's right to jury trial with respect to the legal issues presented).

25. Curtis v. Loether, 415 U.S. 189, 195 (1974).

26. City of Monterey v. Del Monte Dunes at Monterey, Ltd., 526 U.S. 687, 708 (1999) ("[W]e ask, first, whether we are dealing with a cause of action that either was tried at law at the time of the founding or is at least analogous to one that was." (quoting Markman v. Westview Instruments, Inc., 517 U.S. 370, 376 (1996)).

27. *Id.* ("If the action in question belongs in the law category, we . . . ask whether the particular trial decision must fall to the jury in order to preserve the substance of the common-law right as it existed in 1791.") (quoting *Markman*, 517 U.S. at 376).

as opposed to an action in equity, by examining the nature of the cause of action and the nature of the remedy sought.[28] With respect to the cause of action, the Supreme Court has maintained that the Seventh Amendment "applies not only to common-law causes of action, but also to 'actions brought to enforce statutory rights that are analogous to common-law causes of action ordinarily decided in English law courts in the late 18th century.' "[29] This means that the Court does not limit its definition of "actions at law" in the jury context only to those causes of action that existed at English common law. Instead, courts are instructed to look to the underlying nature of the right being asserted—particularly those rights created by statutory regimes not contemplated by the English courts—to determine whether it is more similar than not to legal actions in the English system. Of course, this "rule" is not a paradigm of clarity and there is no strict guidance on *how* courts should determine whether to find that a right is more similar to an English legal remedy rather than an equitable one. Two Supreme Court decisions demonstrate the Court's willingness to find an analogy between English common law and a newly created statutory right.

To illustrate, the Supreme Court early on rejected the argument that the Seventh Amendment was inapplicable to an action brought under the Civil Rights Act of 1968 on the ground that it was a "new cause[ ] of action created by congressional enactment."[30] Where the statutory claim was unknown at common law, the right to jury trial nonetheless inures "so long as the claims can be said to 'soun[d] basically in tort,' and seek legal relief."[31] A claim sounds in tort if it "provide[s] redress for interference with protected personal or property interests."[32] Relying on this precedent, the Supreme Court determined that a real estate developer's suit for money damages under 28 U.S.C. § 1983—based on a constitutional violation of the developer's due process and equal protection rights by the municipality, which repeatedly rejected the developer's proposals for a parcel of land—is an action at law. The

28. Tull v. United States, 481 U.S. 412, 417–18 (1987).
29. Feltner v. Columbia Pictures Television, Inc., 523 U.S. 340, 348 (1998) (quoting Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 42 (1989)).
30. *Curtis*, 415 U.S. at 193–94.
31. *City of Monterey*, 526 U.S. at 709 (quoting *Curtis*, 415 U.S. at 195–96).
32. *Id.* at 709.

Supreme Court reached this conclusion, even though there existed no precise equivalent at English common law to a statutory claim for damages based on a constitutional violation, because, the Court found, section 1983 "provides relief for invasions of rights protected under federal law."[33]

The Court reached a similar conclusion with respect to the Labor Management Reporting and Disclosure Act (LMRDA).[34] In *Woodell v. International Brotherhood of Electrical Workers Local 71*,[35] a union member made claims against the local union and its officers for violation of the LMRDA. To answer the question of whether such claims were subject to a jury trial right, the Court reiterated the general principle that "we examine the remedy sought and determine whether it is legal or equitable in nature."[36] In this particular case, the Court found that "actions under the LMRDA are closely analogous to personal injury actions . . . [which] is of course a prototypical example of an action at law, to which the Seventh Amendment applies."[37] The Court therefore permitted the action to proceed to a jury trial.

However, the Supreme Court has refused to "rest [its] conclusion on what has been called an 'abstruse historical' search for the nearest 18th-century analog,"[38] and has repeatedly emphasized that characterizing the remedy sought is more important to the analysis than locating a "precisely analogous common-law cause of action."[39] For example, the *Tull* Court based its Seventh Amendment ruling on the nature of the relief sought, finding that although the Government's suit under the Clean Water Act was analogous to both equitable and legal claims, the defendant was entitled to a jury trial because a "civil penalty was a type of remedy at common law that could only be enforced in courts of law."[40] This premise holds

---

33. *Id.*
34. 29 U.S.C. § 401.
35. 502 U.S. 93 (1991).
36. *Id.* at 97.
37. *Id.* at 98 (finding that a union member's claim against local union and its officers for violation of LMRDA was entitled to jury trial).
38. Tull v. United States, 481 U.S. 412, 421–22 (1987).
39. *Id.* at 421.
40. *Id.* at 422; *see also* Wm. Passalacqua Builders, Inc., v. Resnick Developers S., Inc., 933 F.2d 131, 136 (2d Cir. 1991).

true even where the Supreme Court has found that the cause of action is more analogous to an equitable claim.[41]

In characterizing the relief sought, the Supreme Court has adopted the general rule that "monetary relief is legal."[42] Historically, actual and punitive damages were the form of relief issued by English law courts.[43] Damages were traditionally equitable only if they were restitutionary, "such as in action[s] for disgorgement of improper profits."[44] Where a party seeks both legal and equitable remedies, "[t]he right to jury trial is not eliminated . . . by virtue of the fact that, under our modern unified system," an equitable remedy is also sought.[45]

2. *The Second Inquiry*

Although an action may be a "Suit at common law," such that the plaintiff is entitled to a jury trial, the Seventh Amendment right does not extend to *every* issue presented by the suit. The Seventh Amendment guarantees a jury "'[o]nly [for] those incidents which are regarded as fundamental, as inherent in and of the essence of the system of trial by jury.'"[46] Accordingly, the Supreme Court has determined that, if an action falls into the legal category, the trial court must then determine "whether the particular trial decision must fall to the jury in order to preserve the substance of the common-law right as it existed in 1791."[47] This second inquiry demands that the court look to "history to determine whether the particular issues, or analogous ones, were decided by judge or by jury in suits at common law at the time the Seventh Amendment was

41. *See, e.g.*, Chaffeurs, Teamsters and Helpers, Local No. 391 v. Terry, 494 U.S. 558, 569–71 (1990) (regarding the first stage of the analysis as only preliminary, even though the Court found that the respondent's duty of fair representation claim was more analogous to an eighteenth century equitable cause of action).

42. Feltner v. Columbia Pictures Television, Inc., 523 U.S. 340, 352 (1998).

43. Curtis v. Loether, 415 U.S. 189, 196 (1974); *see Tull*, 481 U.S. at 422 ("Remedies intended to punish culpable individuals . . . were issued by courts of law, not courts of equity.").

44. *Teamsters*, 494 U.S. at 570.

45. City of Monterey v. Del Monte Dunes at Monterey, Ltd., 526 U.S. 687, 730 (1999) (Scalia, J., concurring).

46. *Tull*, 481 U.S. at 426 (quoting Colgrove v. Battin, 413 U.S. 149, 157 (1973)).

47. Markman v. Westview Instruments, Inc., 517 U.S. 370, 376 (1996).

adopted."[48] And where an analysis of history "does not provide a clear answer," the court must look to "precedent and functional considerations."[49]

a. Historical Practice

Component issues within a legal claim are properly submitted to the judge or jury if those particular issues were traditionally heard by the judge or jury prior to the adoption of the Seventh Amendment. For example, the Supreme Court has held that determining liability in a regulatory takings case requires complex factual inquiries and that "[i]n actions at law predominantly factual issues are in most cases allocated to the jury."[50] Although the overall action is legal, not every issue presented is proper for the jury to decide. The historical analysis may reveal that an issue was traditionally heard by a judge, even in a suit in which the jury must determine liability. In *Tull*, for example, the Court held that the jury must determine liability, but found no Seventh Amendment guarantee to having a jury fix the amount of civil penalties to the government under the Clean Water Act because the calculation of civil penalties is highly discretionary and was traditionally performed by judges.[51]

Conversely, bringing a traditionally equitable claim does not defeat the Seventh Amendment's guarantee to have a jury resolve the underlying legal issues. For example, in *Ross*, the Court held that although a shareholder's derivative suit was traditionally brought in courts of equity, the claim comprised legal issues, including breach of contract and gross negligence, for which a jury trial was guaranteed.[52] Where legal claims have been joined with equitable claims, "the right to jury trial on the legal claim, including all issues common to both claims, remains intact."[53] In the same vein, the U.S. Court of Appeals for the Third Circuit has held that "if the

48. *City of Monterey*, 526 U.S. at 718.
49. *Id.*
50. *Id.* at 720; *see also* Feltner v. Columbia Pictures Television, Inc., 523 U.S. 340, 355 (1998) (finding direct historical evidence that juries set the amount of damages awarded to successful plaintiffs in copyright cases).
51. *Tull*, 481 U.S. at 427.
52. Ross v. Bernhard, 396 U.S. 531, 542 (1970).
53. *Tull*, 481 U.S. at 425 (quoting Curtis v. Loether, 415 U.S. 189, 196 n.11 (1974)).

issues related to both the legal and equitable claims can be resolved in one lawsuit, then the right to a jury trial attendant to the legal claims will prevail."[54]

b. Practical Considerations

Where neither history nor existing precedent provides a clear answer, the Supreme Court has determined that a court must look to practical considerations in deciding whether "as a matter of the sound administration of justice, one judicial actor is better positioned than another to decide the issue in question."[55] To make this determination, a court must "consider both the relative interpretive skills of judges and juries and the statutory policies that ought to be furthered by the allocation."[56] For example, the Supreme Court has found that judges are better suited to construe patent claims because of their greater training and expertise and because "[t]he construction of written instruments is one of those things that judges often do and are likely to do better than jurors unburdened by training in exegesis."[57]

At bottom, the analysis tends to focus on whether resolving the issue requires an intensive factual inquiry.[58] For example, the U.S. District Court for the Southern District of Alabama has held that juries are better suited to fix the amount of punitive damages because that assessment requires a "fact-sensitive undertaking," which tends to include a determination of the amount of harm suffered and the mental state of the defendant.[59] In another case, the U.S. Court of Appeals for the Tenth Circuit held that a jury would be better suited to determine a reasonable price for medical imaging devices under Colorado's version of the Uniform Commercial Code because that determination required the weighing of numerous facts, as evidence going toward a reasonable price "may include the

54. Newfound Mgmt. Corp. v. Lewis, 131 F.3d 108, 116 (3d Cir. 1997).
55. Markman v. Westview Instruments, Inc., 517 U.S. 370, 388 (1996).
56. *Id.* at 384.
57. *Id.* at 388–90.
58. *See* Hartford Fire Ins. v. First Nat'l Bank of Atmore, 198 F. Supp. 2d 1308, 1312 (S.D. Ala. 2002).
59. *Id.*

parties' course of dealing, course of performance, usage of trade, or the fair market value of the goods."[60]

But the need for factual inquiry alone does not guarantee that a jury is better suited to decide an issue. The patent context is instructive here. For example, a federal magistrate judge in the Northern District of Illinois concluded that, "[f]rom a functional perspective," a judge is "better suited to find the acquired meaning of patent terms" because judges "construe written instruments all the time, while jurors do not," and because "patent specifications are specialized documents, which require special training and practice to construe."[61] In an older decision from the Eastern District of Pennsylvania, the judge concluded that, because patents are specialized documents whose construction requires technical training and experience, a "judge, from his training and discipline, is more likely to give a proper interpretation of such instruments than a jury; and he is, therefore, more likely to be right, in performing such a duty, than a jury can be expected to be."[62] In such cases, even where the resolution of a matter turns on a fact-intensive inquiry, judges are often better suited to decide the claims at issue.

II.
Piercing the Corporate Veil

Before proceeding, in Part III, to analyze the existing decisions in which courts have determined whether a judge or a jury should decide veil-piercing actions, this Article will pause to examine the nature of veil piercing in a bit more detail.

Typically, corporate entities are treated as distinct from their shareholders such that any claims against the corporation will not result in liability for individual shareholders.[63] This holds true even for majority or sole shareholders of a corporation, which provides an important measure of security.

60. Fischer Imaging Corp. v. Gen. Elec. Co., 187 F.3d 1165, 1173 (10th Cir. 1999).

61. Midtronics, Inc. v. World Energy Labs (2), Inc., No. 06 C 1685, 2008 WL 6137126, at *6 (N.D. Ill. Feb. 4, 2008).

62. *Markman*, 517 U.S. at 388–89 (quoting Parker v. Hulme, 18 F. Cas. 1138, 1140 (C.C.E.D. Pa. 1849) (No. 10,740)).

63. *See* Walkovszky v. Carlton, 18 N.Y.2d 414, 417 (1966) ("The law permits the incorporation of a business for the very purpose of enabling its proprietors to escape personal liability.").

Unless a member of a corporate entity is liable on some independent legal basis, he or she will traditionally be protected from liability for any corporate debts or obligations.[64] This concept is quite old; "[i]ncarnations of limited liability can be found in early Byzantine, Islamic, and Roman law."[65]

The principle of corporate separateness is fundamental to a capitalist, free-market economy; it reduces shareholders' potential risks and liabilities and thereby encourages investment.[66] When an individual knows that she will not be personally liable for the failures of a business, she will be more likely to participate freely in new business endeavors.

However, in certain circumstances when a corporation is unable to fully meet its creditors' demands for payment, a creditor may seek to "pierce the corporate veil" and hold otherwise immune corporate shareholders personally liable for the corporation's debts.[67] There is a long history of litigation surrounding the circumstances under which the principle of corporate separateness should be discarded and a shareholder or shareholders should be held liable for the corporation's actions.[68] When veil piercing is sought, the onus is on the plaintiff to prove that the corporation has been used, as various courts have written, as a "dry shell," a "puppet," a "stooge," a

---

64. *See* Elizabeth S. Miller, *Are There Limits on Limited Liability? Owner Liability Protection and Piercing the Veil of Texas Business Entities*, 43 TEX. J. BUS. L. 405, 405–06 (2009).

65. Peter B. Oh, *Veil-Piercing Unbound*, 93 B.U. L. REV. 89, 90 n.1 (2013) (citing Timothy P. Glynn, *Beyond "Unlimiting" Shareholder Liability: Vicarious Tort Liability for Corporate Officers*, 57 VAND. L. REV. 329, 336–37 & nn.20–24 (2004) (delineating origins and citing sources)).

66. *See, e.g.*, Stephen B. Presser, *Thwarting the Killing of the Corporation: Limited Liability, Democracy, and Economics*, 87 NW. U. L. REV. 148, 160 n.43 (1992) (citing David H. Barber, *Piercing the Corporate Veil*, 17 WILLAMETTE L. REV. 371, 371 (1981)) ("The purpose of limited liability is to promote commerce and industrial growth by encouraging shareholders to make capital contributions to corporations without subjecting all of their personal wealth to the risks of the business.") (additional citation omitted).

67. *See* BLACK'S LAW DICTIONARY (9th ed. 2009) (defining piercing the corporate veil as the "judicial act of imposing personal liability on otherwise immune corporate officers, directors, or shareholders for the corporation's wrongful acts"); Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 CORNELL L. REV. 99, 105 (2014).

68. *See* Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036 (1991).

"conduit," or perhaps a "marionette."[69] More prosaically, a plaintiff must show that the corporation and its shareholder(s) have functioned as one and the same entity; that is, that the legal fiction of the corporation ought to be set aside so as to unmask the true actors responsible for the corporation's alleged wrongs, who should correspondingly be held responsible for the corporation's debts.

The exact origins of corporate veil piercing are difficult to pin down.[70] During his time as a sitting judge on New York's Court of Appeals, future U.S. Supreme Court Justice Benjamin Cardozo wrote that veil piercing is "enveloped in the mists of metaphor."[71]

The concept made its first appearance in American jurisprudence in 1809 with the U.S. Supreme Court's decision in *Bank of the United States v. Deveaux.*[72] And indeed, the United States is the historical "cradle of veil-piercing."[73] Yet despite its deep domestic historical reach, American courts and commentators "rarely address the historic origins of the piercing doctrine at length."[74]

As a result, there is no consensus on the question of whether the doctrine's roots are primarily legal or equitable.[75] The best answer from the case law seems to be a bit of both. After all, enforcement of shareholder liability for corporate obligations began as "a crude system in which any creditor with an unsatisfied judgment against the corporation sued any shareholder at common law."[76] This system developed into an

69. Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 83 n.7 (2010) (quoting several cases).

70. *Id.* at 83 n.1 (2010) (quoting STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL § 1:3 (2004) ("The precise reach of corporate shareholder limited liability in the early United States is . . . uncertain.").

71. Berkey v. Third Avenue Ry. Co., 244 N.Y. 84, 94 (1926).

72. Bank of the United States v. Deveaux, 9 U.S. 61, 75 (1809) ("[I]t is said that you may raise the veil which the corporate name interposes and see who stand behind it.").

73. KAREN VANDEKERCKHOVE, PIERCING THE CORPORATE VEIL 76 (2007).

74. Wm. Passalacqua Builders, Inc. v. Resnick Developers S., Inc., 933 F.2d 131, 135 (2d Cir. 1991).

75. *See, e.g.*, *In re* G-I Holdings, Inc., 380 F. Supp. 2d 469, 476 (D.N.J. 2005) ("[A] circuit split exists as to whether the nature of the relief in an action to pierce the corporate veil is legal or equitable.").

76. PHILLIP BLUMBERG, THE LAW OF CORPORATE GROUPS: TORT, CONTRACT, AND OTHER COMMON LAW PROBLEMS IN THE SUBSTANTIVE LAW OF PARENT AND SUBSIDIARY CORPORATIONS § 2.02 (1987).

equitable procedure known as a "creditor's bill," which involved both a proceeding in equity "instituted by any creditor with an unsatisfied judgment, usually on behalf of all creditors, against the corporate debtor" and then an action "at common law against the shareholders individually to collect the amount owed."[77] This process allowed for liability to be properly apportioned among the outstanding shares through the action in equity and then imposed on each of the shares' owners through individual actions at law.[78]

In more modern days, some courts have emphasized the doctrine's equitable roots.[79] Others have focused on its legal origins.[80] Regardless of the precise source of the remedy, veil piercing has roots in, and has been applied by, courts of both law *and* equity.[81] One poetic commentator has somewhat aptly dubbed it "Our Lady of the Common Law."[82]

In any event, there is still no single uniform test for determining when a corporate veil should be pierced. The most common veil-piercing analysis requires a plaintiff to demonstrate that a corporation is an "alter ego" or "mere instrumen-

---

77. Passalacqua, 933 F.2d at 136 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 308 cmt. e (AM. LAW INST. 1971); BLUMBERG, *supra* note 76, § 2.02; Edwin H. Abbot, Jr., *Conflict of Laws and the Enforcement of the Statutory Liability of Stockholders in a Foreign Corporation*, 23 HARV. L. REV. 37, 43–45 (1909)).

78. Abbot, *supra* note 77, at 45.

79. *Passalacqua*, 933 F.2d at 135 (citing Bangor Punta Operations, Inc. v. Bangor & A.R. Co., 417 U.S. 703, 713 (1974); Int'l Fin. Servs. Corp. v. Chromas Techs. Can., Inc., 356 F.3d 731, 737 (7th Cir. 2004); Golden Acres, Inc. v. Sutton Place Corp., 879 F.2d 857 (3d Cir.1989); United States v. Golden Acres, Inc., 684 F. Supp. 96, 103 (D. Del. 1988), *aff'd sub nom*; Schultz v. Gen. Elec. Healthcare Fin. Servs. Inc., 360 S.W.3d 171, 175–76 (Ky. 2012); 1 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41 (perm. ed. 1990)).

80. *Id.* (citing Am. Protein v. A.B. Volvo, 844 F.2d 56, 59 (2d Cir. 1988); FMC Fin. Corp. v. Murphree, 632 F.2d 413, 421 n.5 (5th Cir. 1980); Iantosca v. Benistar Admin. Servs., Inc., 843 F. Supp. 2d 148, 152–54 (D. Mass. 2012); United States v. Vacante, No. 1:08-CV-1349, 2010 WL 2219405, at *4 (E.D. Cal. June 2, 2010); *In re G-I Holdings, Inc.*, 380 F. Supp. 2d at 476; *In re* Kollel Mateh Efraim, LLC, 406 B.R. 24, 29 (Bankr. S.D.N.Y. 2009); Magers v. Bonds (*In re* Bonds Dist. Co.), No. 98-6044, 2000 WL 33682815, at *8 (Bankr. M.D.N.C. Nov. 15, 2000)).

81. *Id.* at 135–36 (citing I. Maurice Wormser, *Piercing the Veil of the Corporate Entity*, 12 COLUM. L. REV. 496, 497–99, 513–14 (1912)).

82. WORMSER, *supra* note 1, at 84.

tality" of its shareholder(s).[83] This is evidenced by complete control and domination of a corporate entity by a shareholder to perpetuate a fraud, wrong, or injustice that proximately caused unjust loss or injury to the plaintiff.[84] In addition, courts will entertain "reverse piercing" actions, where a party seeks to hold a corporation liable for the debts of its owners.[85] However, the precise factors that courts weigh in any piercing analysis—whether reverse or standard—vary across U.S. jurisdictions.[86]

In what one federal district court referred to as the "leading case"[87] on the issue of veil piercing, *William Passalacqua Builders, Inc. v. Resnick Developers South, Inc.*, the U.S. Court of Appeals for the Second Circuit, applying New York law, held that liability through veil piercing may be predicated upon *either* (1) a showing of fraud *or* (2) upon complete control of the corporation that led to a wrong against a third party.[88] Importantly, the New York Court of Appeals later clarified in *Morris v. New York State Department of Taxation and Finance*[89] that under New York law, veil piercing requires *both* a showing of "complete domination" as well as "some showing of a wrongful or

83. Oh, *supra* note 69, at 84.

84. *Id.* (citing FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS: LIABILITY OF A PARENT CORPORATION FOR THE OBLIGATIONS OF ITS SUBSIDIARY § 3 (1931)).

85. *E.g.*, State v. Easton, 647 N.Y.S.2d 904, 909 (Sup. Ct. 1995). "Reverse piercing" claims also arise where a corporation seeks to pierce its own corporate veil in order to disregard the corporate form. *See, e.g.*, Michael J. Gaertner, *Reverse Piercing the Corporate Veil: Should Corporation Owners Have It Both Ways?*, 30 WM. & MARY L. REV. 667, 667 (1989) ("A reverse pierce of the corporate veil refers to an attempt by shareholders, or the corporation itself, to pierce the corporate veil existing between the corporation and its shareholders. This definition encompasses all shareholder claims that a court should treat the corporation and its shareholders as a single, identical being.").

86. Oh, *supra* note 65, at 90 (There is "no uniform test for veil-piercing").

87. Thrift Drug v. Prescription Plan Serv. Corp., 890 F. Supp. 319, 320 (S.D.N.Y. 1995), *aff'd in part, vacated in part sub nom.* Thrift Drug, Inc. v. Universal Prescription Adm'rs, 131 F.3d 95 (2d Cir. 1997).

88. Wm. Passalacqua Builders, Inc., v. Resnick Developers S., Inc., 933 F.2d 131, 138 (2d Cir. 1991) (emphasis added) (citing Itel Containers Int'l Corp. v. Atlanttrafik Exp. Serv. Ltd., 909 F.2d 698, 703 (2d Cir. 1990); Gartner v. Snyder, 607 F.2d 582, 586 (2d Cir. 1979)).

89. *In re* Morris v. N.Y. State Dept. of Taxation & Fin., 82 N.Y.2d 135, 141–42 (1993).

unjust act toward the plaintiff."[90] The Court of Appeals thus made clear in *Morris* that equity considerations—that is, a showing of fraud or wrong—are key to the piercing analysis. *Passalacqua*'s conclusion that juries are better suited to handle piercing claims therefore holds less weight in a post-*Morris* world, particularly considering *Morris*'s holding that "[t]he party seeking to pierce the corporate veil must establish that the owners, through their domination, abused the privilege of doing business in the corporate form to perpetrate a wrong or injustice against that party such that *a court in equity will intervene.*"[91]

As to the question of complete domination and control leading to a wrong against a third party, the Second Circuit in *Passalacqua* offered ten factors for evaluation.[92] These factors are as follows:

1. the absence of the formalities and paraphernalia that are part and parcel of the corporate existence, i.e., issuance of stock, election of directors, keeping of corporate records and the like;
2. inadequate capitalization;
3. whether funds are put in and taken out of the corporation for personal rather than corporate purposes;
4. overlap in ownership, officers, directors, and personnel;
5. common office space, address and telephone numbers of corporate entities;
6. the amount of business discretion displayed by the allegedly dominated corporation;
7. whether the related corporations deal with the dominated corporation at arms length;
8. whether the corporations are treated as independent profit centers;

90. *Id.*
91. *Id.* at 142 (emphasis added).
92. *Passalacqua*, 933 F.2d 131, 139 (citing Director's Guild of Am. v. Garrison Prod., 733 F. Supp. 755, 760–61 (S.D.N.Y. 1990); U.S. Barite Corp. v. M.V. Haris, 534 F. Supp. 328, 330 (S.D.N.Y. 1982); Barber, *supra* note 66, at 398).

9. the payment or guarantee of debts of the dominated corporation by other corporations in the group; and
10. whether the corporation in question had property that was used by other of the corporations as if it were its own.

Courts across the country have compiled various lists of similar considerations to be weighed in actions to pierce a corporate veil.[93] Indeed, at least one state appellate court settled on *twenty* relevant factors to be weighed in evaluating whether or not the shareholder exerted complete domination and control of the corporation.[94]

Yet even with just ten factors, the Second Circuit acknowledged that piercing demands are not easy to adjudicate because whether or not to disregard corporate separateness is a fact-specific inquiry that "differs with the circumstances of each case."[95] Specifically, when presented with a piercing demand, the fact-finder must determine if, based on the "totality of the evidence" in a specific case, the "policy behind the presumption of corporate independence and limited shareholder liability—encouragement of business development—is outweighed by the policy justifying disregarding the corporate form—the need to protect those who deal with the corporation."[96]

III.
To Jury or Not To Jury?

As discussed in Part II, veil piercing can be a complex issue. The test for veil piercing varies widely depending on the jurisdiction. As Jonathan R. Macey and Joshua Mitts noted in a

---

93. *See* Oh, *supra* note 65, at 90 (citing Associated Vendors, Inc. v. Oakland Meat Co., 26 Cal. Rptr. 806, 813–15 (Ct. App. 1962) (twenty factors); Cathy S. Krendl & James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 Denver L.J. 1, 52–55 (1978) (thirty-one factors)); *see also* Keffer v. H.K. Porter Co., 872 F.2d 60, 65 (4th Cir. 1989) (six factors).

94. *See Associated Vendors*, 210 Cal. App. 2d at 838–40 (citing Automotriz etc. De California v. Resnick, 47 Cal. 2d 792, 796 (1957); H.A.S. Loan Serv., Inc. v. McColgan, 21 Cal. 2d 518, 523 (1943); Stark v. Coker, 20 Cal. 2d 839, 846 (1942)).

95. Am. Protein v. A.B. Volvo, 844 F.2d 56, 60 (2d Cir. 1988).

96. *Passalacqua*, 933 F.2d at 139 (citing William Wrigley, Jr. Co. v. Waters, 890 F.2d 594, 601 (2d Cir. 1989); Blumberg, *supra* note 76, § 6.01).

recent article, "courts are inarticulate to the point of incoherent in their reasoning in particular 'piercing' cases."[97] This Article takes a step back from the myriad theories and rationales for veil piercing and asks a more fundamental question: who is best suited to evaluate piercing demands brought under any theory—judges or juries?

As with many other aspects of veil piercing, courts are split on the judge/jury question. In order to fully flesh out our answer, we first review the major decisions that address whether juries or judges are best suited to hear and decide piercing demands. This Part begins with an analysis of those federal court opinions that have followed the "jury" rule and then proceeds to an analysis of their "judge" rule counterparts before concluding with an examination of a similarly wide split among state court decisions.

A. *Juries: The Second Circuit Rule*

The Second Circuit's *Passalacqua* decision is the leading case finding that juries should decide veil-piercing claims. In *Passalacqua*, the plaintiffs—the Passalacqua entities—brought suit in the Southern District of New York against various Resnick entities to recover the balance of a partially satisfied arbitration award that had previously been rendered against the Resnick defendants and enforced in the courts of Florida.[98] Two claims in the federal suit in New York sought equitable relief in the form of veil piercing and alleged that certain Resnick entities should be pierced and held liable for another Resnick corporation's debt under either an "equitable instrumentality" or "alter ego" theory.[99]

After consolidating the two claims seeking equitable relief into a new amended complaint and dismissing the remaining counts against the defendants, the district court next rejected the Resnick defendants' motion to strike the plaintiffs' jury demand. A trial was held, at the conclusion of which the district judge charged the jury with using a special form with questions drafted by the court. In essence, the jury was charged with de-

---

97. Jonathan R. Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 CORNELL L. REV. 99, 100 (2014).

98. Passalacqua, 933 F.2d at 131.

99. *Id.* at 134.

termining whether the entity "Jack Resnick & Sons" was the alter ego of the entity "Resnick Developers South." The jury returned judgment in favor of the defendants, "rendering the balance due on the [ ] judgment uncollectable."[100]

On appeal, the Resnick entities argued that the piercing question should not have been submitted to the jury, but instead determined by the district judge. Their single argument was that the entirety of the piercing question was equitable in nature—that is, the claim involved only a challenge to the Resnick entities' corporate structure, with no attendant claim for money damages. Accordingly, they argued that the claim should never have been submitted to a jury. The Second Circuit engaged in a rather lengthy discussion of the jury trial right before holding that piercing is an action that involves a mix of equity and law and, under the facts of this case, the law elements were significant enough to justify a jury determination. Moreover, because the issue of whether corporate veil-piercing claims should be decided by a jury had never been raised in the Second Circuit, the court chose to engage in a lengthy de novo review.[101]

The *Passalacqua* court fleshed out its reasoning by looking first to the history of the right to a jury trial in civil actions.[102] After citing the Seventh Amendment directly, the court explained that the key to answering the judge/jury question is to follow the Supreme Court's two-step formulation: "'First, we compare the statutory action to 18th-century actions brought in the courts of England prior to the merger of the courts of law and equity. Second, we examine the remedy sought and determine whether it is legal or equitable in nature.'"[103]

The court focused on the second prong of this test, noting the difficulty in applying it considering the lack of case law analyzing the history of the piercing remedy. Nevertheless, the *Passalacqua* court cited several authorities that each parsed the

---

100. *Id.*

101. *Id.* at 134–35 ("Because we have never addressed whether a right to a jury trial exists in a case where a judgment-creditor seeks to pierce the corporate veil and enforce a judgment—obtained against a subsidiary—against the parent corporation or individual shareholders alleged to have controlled the subsidiary, we revisit this area.").

102. *Id.* at 134–37.

103. *Id.* at 135 (quoting Tull v. United States, 481 U.S. 412, 417–18 (1987)).

veil-piercing remedy to determine whether it is primarily equitable or legal in nature.[104]

The court concluded that there is no clear consensus on whether the piercing remedy is equitable or legal, but that the origin of the remedy as a legal one best suited for jury determination "appears to have the greatest historical support."[105] The Second Circuit referenced the fact that "shareholder liability for corporate obligations began as 'a crude system in which any creditor with an unsatisfied judgment against the corporation sued any shareholder at common law.'"[106] As such claims evolved, the courts created an equitable remedy known as a creditor's bill. The creditor's bill involved both an action in equity instituted by the creditor against the corporate debtor as well as an action in law for damages against each individual shareholder. In light of this backdrop, the court was particularly interested in the precise nature of the remedy sought under the facts of the case before it. In *Passalacqua*, the plaintiffs sought "enforcement of a money judgment"[107] already obtained against the defendants, which the court found "indicates a legal action."[108] The court went on to reject the plaintiffs' argument that because they had already secured the monetary award, "their claim for money is merely incidental to their equitable piercing claim and . . . does not require a jury trial."[109]

Rather, the key was that the relief sought—enforcement of a money judgment—was of the kind usually "achieved in an action at law."[110] Since there was nothing in the court's survey

---

104. To support the contention that piercing is an equitable remedy, the court cited Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R. Co., 417 U.S. 703 (1974); United States v. Golden Acres, Inc., 684 F. Supp. 96 (D. Del. 1988); and FLETCHER, *supra* note 79, at § 41. For the proposition that piercing is of legal origin "or so touches on the determination of legal issues that it is for the jury to decide," *Passalacqua*, 933 F.2d at 135, the court cited another Second Circuit case, Am. Protein Corp. v. AB Volvo, 844 F.2d 56 (2d Cir. 1988), discussed *infra*, as well as FMC Fin. Corp. v. Murphree, 632 F.2d 413 (5th Cir. 1980), discussed *infra*, and I. Maurice Wormser, *Piercing the Veil of the Corporate Entity*, 12 COLUM. L. REV. 6, 496–518 (1912).

105. *Passalacqua*, 933 F.2d at 135.

106. *Id.* at 135–36.

107. *Id.* at 136.

108. *Id.*

109. *Id.*

110. *Id.*

of the history of the piercing remedy to suggest that it was only an equitable remedy, the Second Circuit ruled that the district court had properly submitted the piercing issue to the jury.

Despite the *Passalacqua* court's relatively lengthy analysis of the history of veil piercing and the nature of the remedy as sounding in equity or law, it is the final paragraph of the piercing discussion that is frequently cited by lower courts to support sending piercing issues to the jury:

> [A]s a practical matter separate from Seventh Amendment considerations, whether or not those factors—discussed later in our analysis—that will justify ignoring the corporate form and imposing liability on affiliated corporations or shareholders are present in a given case is the sort of determination usually made by a jury because it is so fact specific.[111]

This "practical" consideration underlies many of the decisions that follow *Passalacqua* and was even quoted by a bankruptcy court in the Southern District of New York to support its holding that a party is entitled to a jury on the piercing question even if that party seeks only declaratory (i.e., equitable) relief. *In re Kollel Mateh Efraim, LLC* involved the bankruptcy proceedings of a debtor, Mateh Efraim LLC, and the relationship between the debtor and a religious corporation styled as "Kolel Mateh Efraim."[112] During the course of the bankruptcy proceedings, a debtor in possession account was established, in part to fund "[c]ourt-ordered adequate protection to"[113] the plaintiff in *In re Kollel.* The plaintiff subsequently filed a complaint seeking a declaration that Kollel Mateh Efraim was the alter ego of Mateh Ephraim LLC and therefore liable for the latter's debts.[114] The religious corporation demanded a jury trial on the alter-ego issue, and the plaintiff moved to strike that demand, arguing "that because he is seeking declaratory relief, the claim is equitable in nature and not triable by a jury."[115]

111. *Id.* at 137.
112. Geltzer v. Kollell Mateh Efraim, LLC (*In re* Kollel Mateh Efraim, LLC), 406 B.R. 24 (S.D.N.Y. Bankr. 2009).
113. *Id.* at 26.
114. *Id.* at 27.
115. *Id.*

The *Kollel* court examined the Seventh Amendment jury trial right in detail, beginning with the two-step analysis set forth in *Tull* and *Passalacqua*. After noting *Passalacqua*'s analysis in detail, the *Kollel* court rejected the plaintiff's argument that *Passalacqua* was distinguishable on the grounds that the relief sought in *Kollel* was declaratory in nature.[116]

Following the *Tull* framework, the *Kollel* court examined the history of declaratory judgments, beginning with the Declaratory Judgment Act, which does not explicitly provide for a jury trial right but which courts have interpreted to provide for such a right.[117] Quoting *Gulfstream Aerospace Corp. v. Mayacamas Corp.*,[118] the *Kollel* court found that "[a]ctions for declaratory judgments are neither legal nor equitable, and courts have therefore had to look to the kind of action that would have been brought had Congress not provided the declaratory judgment remedy."[119]

Following this analysis, the *Kollel* court determined that the declaratory judgment action at issue was "legal in nature" and therefore triable by jury. If the plaintiff had not sought declaratory relief, it would have instead needed to file an action against the religious corporation to recover the amounts needed to satisfy the balance of the damages awarded against the estate in bankruptcy. Were the plaintiff to prevail in its alter ego action, the court reasoned, the defendant would "be limited to contesting the amount of the deficiency in the estate's assets, i.e., the amount of the money judgment."[120]

The *Kollel* court then reiterated the "practical" consideration leading to its decision to send the alter ego theory to the jury: it is an issue that is so fact-specific that the determination is generally made by a jury.[121]

---

116. *Id.*
117. *Id.* at 28; *see also* Beacon Theatres, Inc. v. Westover, 359 U.S. 500 (1959).
118. 485 U.S. 271 (1988).
119. *In re Kollel*, 406 B.R. at 28.
120. *Id.*
121. *Id.* at 29 (quoting Wm. Passalacqua Builders, Inc., v. Resnick Developers S., Inc., 933 F.2d 131, 137 (2d Cir. 1991)).

B. *Juries: The Fifth (and Eleventh) Circuits' Contradictory Applications of Legal Standards*

The Fifth Circuit has addressed the veil-piercing judge/jury issue twice, including once prior to the 1981 split of the former Fifth Circuit into the new Fifth and Eleventh Circuits,[122] finding in both cases that the right to a jury exists, albeit following different theories. In *FMC Finance Corp. v. Murphree*,[123] a closely held company primarily owned by the defendant Murphree entered into a lease agreement with a subsidiary of FMC Finance, which covered six buses that Murphree's company intended to be used for a shuttle service. At some point during the lease, Murphree's company returned the buses and filed for bankruptcy. FMC Finance attempted to collect on Murphree's personal guaranty. Murphree then counterclaimed, seeking, in part, to show that FMC Finance and its parent company were one and the same entity.

After the parties presented their evidence, the district court granted a directed verdict in FMC Finance's favor, finding that it was separate from its parent company under the "piercing the corporate veil" doctrine.[124] On appeal, the Fifth Circuit reversed, holding that "because there was sufficient evidence to create a jury question on this issue, the district court erred in granting FMC Finance's directed verdict."[125]

The Fifth Circuit applied federal law to the issue, noting in a footnote that despite sitting in diversity and therefore being obligated to follow the *Erie* doctrine, the question of whether to allow a jury decision implicated Federal Rule of Civil Procedure 39(a)(2).[126] Under the Supreme Court's decision in *Hanna v. Plumer*,[127] if a valid Federal Rule of Civil Procedure applies, that Rule controls despite contrary state law.[128]

---

122. In Bonner v. City of Prichard, 661 F.2d 1206, 1209 (11th Cir. 1981) (en banc), the new U.S. Court of Appeals for the Eleventh Circuit adopted as binding precedent all decisions of the former Fifth Circuit handed down prior to October 1, 1981.
123. 632 F.2d 413 (5th Cir. 1980).
124. *Id.* at 416.
125. *Id.* at 421.
126. *Id.* at 421 n.5.
127. 380 U.S. 460 (1965).
128. FMC Fin. Corp. v. Murphree, 632 F.2d 413, 421 n.5 (5th Cir. 1980); *see also Hanna*, 380 U.S. 460 at 473 ("Erie and its offspring cast no doubt on the long-recognized power of Congress to prescribe housekeeping rules for

The *FMC Finance* court noted that Rule 39(a)(2) states that after a jury demand has been made, "[t]he trial on all issues so demanded must be by jury unless . . . (2) the court, on motion or on its own, finds that on some or all of those issues there is no federal right to a jury trial."[129] Accordingly, the court found that the issue of whether the jury right exists is governed by federal and not state law, "with no *Erie* analysis problems."[130] Citing to a string of older Fifth Circuit cases, but without engaging in its own Seventh Amendment analysis, the *FMC Finance* court decided that "the issue of corporate entity disregard is one for the jury."[131]

The Fifth Circuit subsequently sent a piercing case arising under Mississippi law to a jury in *General Motors Acceptance Corp. v. Bates* (hereinafter *GMAC*), making its decision against the backdrop of *Erie* on the basis that the substantive law of Mississippi applied to the doctrine of piercing the corporate veil.[132] The court looked to the Mississippi Supreme Court's decision in *Gray v. Edgewater Landing*[133] to articulate a three-pronged piercing analysis.[134] Finally, the Fifth Circuit in *GMAC* quoted the *Gray* decision's mandate regarding a jury decision: "'[A] party must present some credible evidence on each of these points' before the issue of whether to pierce the corporate veil may go to the jury."[135]

The *GMAC* court went on to survey the evidence presented to the trial court regarding the piercing issue, ultimately deciding that enough evidence existed to bring the is-

---

federal courts even though some of those rules will inevitably differ from comparable state rules.").

129. FED. R. CIV. P. 39(a)(2).

130. *FMC Fin.*, 632 F.2d at 421 n.5.

131. *Id.*

132. Gen. Motors Acceptance Corp. v. Bates, 954 F.2d 1081, 1085 (5th Cir. 1992).

133. Gray v. Edgewater Landing, 541 So. 2d 1044 (Miss. 1989).

134. The Mississippi court held that "[t]o cause a court to disregard the corporate entity and justify shareholder liability, the complaining party must demonstrate: (a) some frustration of contractual expectations regarding the party to whom he looked for performance; (b) the flagrant disregard of corporate formalities by the defendant corporation and its principals; (c) a demonstration of fraud or other equivalent misfeasance on the part of the corporate shareholder." *GMAC*, 954 F.2d at 1085 (citing *Gray*, 541 So. 2d at 1047).

135. *GMAC*, 954 F.2d at 1085 (quoting *Gray*, 541 So. 2d at 1047).

sue before the jury. Interestingly, the court quoted *FMC Finance* to support its decision, albeit without noting that court's decision to apply federal law. The *GMAC* court instead bolstered its decision by citing to another Mississippi case and finding that "under Mississippi law the issue of piercing the corporate veil is for the jury to decide."[136] Despite these conflicting analyses, in each of these cases the Fifth Circuit concluded that veil piercing is a jury question.

C. *Juries: The First Circuit*

In the Employee Retirement Income Security Act (ERISA) context, the First Circuit cited in *Crane v. Green & Freedman Baking Co.*[137] to *Passalacqua*'s "fact-specific" rationale in holding that piercing is a jury determination.[138] In *Crane*, a dispute arose over a collective bargaining agreement and payments that were supposed to have been made to a fund related to the agreement. The corporations charged with making the payments conceded liability; however, the corporations' principals denied personal liability for the corporate debts and the issue of corporate disregard was tried before a jury.[139] After presentation of the evidence, the district court entered judgment as a matter of law, finding that the corporate principals were not the alter egos of the defendant corporations.[140]

On appeal, the First Circuit addressed the judge/jury question in the context of the ERISA action being brought, in this case 29 U.S.C. §§ 1132(a)(1), (3). The sections authorize "only injunctive or 'other appropriate *equitable* relief,'"[141] and the *Crane* court confirmed that "[c]ourts have interpreted this cause of action as providing no right to a jury trial, even when the relief sought is monetary."[142] Accordingly, none of the ERISA precedents contained an explanation regarding the "separate responsibilities of judge and jury in the applying of veil-piercing criteria."[143]

---

136. *Id.* (citing T.C.L., Inc. v. Lacoste, 431 So. 2d 918 (Miss. 1983)).
137. Crane v. Green & Freedman Baking Co., 134 F.3d 17 (1st Cir. 1998).
138. *Id.* at 22 (citing Wm. Passalacqua Builders, Inc., v. Resnick Developers S., Inc., 933 F.2d 131, 137 (2d Cir. 1991)).
139. *Crane*, 134 F.3d at 19–21.
140. *Id.* at 21.
141. *Id.* at 22 (quoting 29 U.S.C. § 1132(a)(1), (3)).
142. *Crane*, 134 F.3d at 22.
143. *Id.*

The *Crane* court decided that "it is principally the jury's function, and not the court's, to decide whether or not the . . . veil-piercing standards were met."[144] The court reasoned that veil piercing is "fact-intensive," citing *Passalacqua* and *FMC Finance* as well as Massachusetts and Texas state court decisions, and that such factual determinations should be sent to the jury, even if they stem from "equitable" remedies.[145]

The court was also influenced by the fact that the parties jointly agreed to proceed before a jury pursuant to Federal Rule of Civil Procedure 39(c). That choice, the court concluded, would be utterly meaningless were the court to allow the only contested claim to be decided by a judge. "The point of Rule 39(c)'s jury-by-consent provision has been said to be to allow parties who so wish to have disputed facts, including ultimate facts, resolved by a jury."[146]

In the summary judgment context, a district court in Puerto Rico cited *Crane* for the proposition that veil piercing, which "requires an extremely fact-sensitive analysis, [ ] is a question best suited for a jury."[147]

D. *Judges: The Seventh Circuit Rule*

The leading "pro-judge" case comes out of the Seventh Circuit, where the panel in *International Financial Services Corp. v. Chromas Technologies Canada, Inc.* (hereinafter *IFSC*) issued a lengthy opinion that ultimately vacated a jury determination on the piercing issue.[148] In *IFSC*, the underlying dispute involved a breach of contract claim regarding printing presses as well as a fraud claim. The plaintiff alleged that it was misled into making payments to a manufacturer called Didde Web Press when it had believed that it was doing business with Chromas Technologies Canada.

---

144. *Id.*

145. *Id.* ("Even where veil-piercing is decided by judge rather than jury, the courts have held that the question, while equitable, is one of fact.").

146. *Id.* at 23.

147. Rivera v. Reed, No. 09-cv-1160(GAG), 2010 WL 683406, at *3 (D.P.R. Feb. 22, 2010). After the defendant moved for summary judgment on the veil-piercing issue, the court denied the motion on the basis that the plaintiffs "have created a triable issue of material fact" as to whether the corporate entity was misused to the point where it should be disregarded. *Id.*

148. Int'l Fin. Servs. Corp. v. Chromas Techs. Can., Inc., 356 F.3d 731, 737 (7th Cir. 2004).

Both Didde Web Press and Chromas Technologies Canada were owned by the same parent corporation and, as part of its claim, International Financial Services alleged that "the separate corporate status between Chromas and Didde Web Press was invalid."[149] At the trial level, the piercing issue was submitted to the jury, which found that Chromas was the alter ego of Didde Web Press and that Chromas was liable for breach of contract, but not fraud.[150] On appeal, the court took up the question of whether the judge or jury should decide the veil-piercing issue.

The *IFSC* court first noted that the question was controlled by "federal procedural law" even though it would apply substantive Illinois law regarding the contours of veil piercing itself. Accordingly, the court looked to the Seventh Amendment to find that International Financial Services "was entitled to demand a jury trial on its breach of contract claim."[151] However, the district court was still required to "make an independent judgment as to any equitable issue."[152] The *IFSC* court therefore turned to veil piercing to assess whether it was equitable or legal in nature.

As *Passalacqua* did, the *IFSC* court began with the two-pronged analysis outlined in *Tull* and *Granfinanciera*. At the outset, the court addressed the futility of comparing veil piercing to eighteenth-century actions brought prior to the merger of courts of law and equity because "[p]iercing the corporate veil, after all, is not itself an action; it is merely a procedural means of allowing liability on a substantive claim, here a breach of contract."[153] Despite the problematic approach of the first prong of *Tull* in the piercing context, the court went on to agree with the Second Circuit that because piercing has roots in both law and equity, the second prong of *Tull* would be the deciding factor.

Turning to an examination of whether piercing is an equitable or legal remedy, the *IFSC* court examined the piercing doctrine under Illinois law to determine whether it was more like a legal remedy, which "traditionally involve[s] money

149. *Id.* at 734.
150. *Id.*
151. *Id.* at 735.
152. *Id.*
153. *Id.* at 736.

damages,"[154] or more like an equitable remedy, which is "typically coercive, and enforceable directly on the person or thing to which [it is] directed."[155]

In Illinois, the piercing test involves a two-pronged analysis that requires a showing that: "(1) there is such a unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist; and (2) circumstances are such that adhering to the fiction of a separate corporate existence would promote injustice or inequity."[156] The fact that piercing in Illinois requires a showing of injustice or inequity led the *IFSC* court to conclude that "veil-piercing must be an exercise of equitable power."[157]

Turning directly to *Passalacqua*, the *IFSC* court disagreed with the Second Circuit that the fact that the underlying action is one for a monetary remedy automatically entitles the plaintiff to a jury trial on both the merits and the question of veil piercing. "A jury trial does not have to include all or nothing."[158] The *IFSC* court went on to provide examples of various ways that a plaintiff's Seventh Amendment right could be preserved, while still allowing the judge to "decide independently the equitable question of whether to disregard the corporate entity."[159]

Such possibilities include: a post-judgment motion to pierce pursuant to Rule 69(a)[160] and treating the jury's piercing determination as advisory.[161] Although the *IFSC* court admitted that veil-piercing analysis requires grappling with questions of fact, the court held that it was still primarily an equitable remedy. Moreover, any factual findings resolved by the jury that implicated the judge's equitable finding would remain binding on the court.

---

154. *Id.*
155. *Id.*
156. *Id.* (quoting Melko v. Dionisio, 582 N.E.2d 586, 594 (Ill. App. Ct. 1991)).
157. *Id.* at 737.
158. *Id.*
159. *Id.*
160. Aioi Seiki, Inc. v. JIT Automation, Inc., 11 F. Supp. 2d 950, 954 (E.D. Mich. 1998).
161. 11 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 2887 (3d ed. 2016).

E. *The Split in Other Circuits*

More recently, the U.S. Court of Appeals for the Sixth Circuit likewise found that, as a matter of Kentucky state law, "the doctrine of piercing the corporate veil arises in equity."[162]

And lower courts outside of the First, Second, Fifth, and Seventh Circuits have cited both *Passalacqua* and *IFSC* and come out on both sides of the issue. A district court in the Third Circuit, for example, acknowledged the "circuit split" between *Passalacqua* and *IFSC*, while holding that because the plaintiff ultimately sought to recover damages and because New Jersey law does not specify that piercing is discretionary, piercing "is a legal remedy entitling Defendants to a jury trial."[163] One district court in the Ninth Circuit agreed with *IFSC* and held that there is no right to a jury trial of a veil-piercing claim because "whether a corporation is an alter ego of its corporate sibling rests, in the end, on an exercise of *discretion*, not of compulsion."[164] But just two years later, another district court in the Ninth Circuit found "the reasoning of *Passalacqua* persuasive" and held that the plaintiff was entitled to a jury trial because its ultimate goal was to recover a money judgment.[165]

The panoply of recent federal court decisions reaching contrary conclusions on this issue underscores that the question of whether juries or judges should decide veil-piercing claims is ripe for resolution by the U.S. Supreme Court.

F. *The Split Among the States*

Furthermore, state courts are split no less widely than the federal courts on whether the decision to pierce a corporate veil should be made by judges or juries.

The most thoroughly reasoned recent opinion was issued by the Supreme Court of Kentucky in 2012 in *Schultz v. General*

---

162. CNH Capital Am. LLC v. Hunt Tractor, Inc., 568 F. App'x 461, 467 (6th Cir. 2014) (citing Schultz v. Gen. Elec. Healthcare Fin. Servs. Inc., 360 S.W.3d 171, 175 (Ky. 2012)).

163. *In re* G-I Holdings, Inc., 380 F. Supp. 2d 469, 475–78 (D.N.J. 2005); *see also* Iantosca v. Benistar Admin. Servs., Inc., 843 F. Supp. 2d 148, 153–54 (D. Mass. 2012).

164. Siegel v. Warner Bros. Entm't Inc., 581 F. Supp. 2d 1067, 1075 (C.D. Cal. 2008).

165. United States v. Vacante, No. 1:08cv1349 OWW DLB, 2010 WL 2219405, at *4 (E.D. Cal. June 2, 2010).

Electric Healthcare Financial Services Inc.[166] There, in a decision already cited by the highest courts of at least two other states, the Kentucky court came down squarely in favor of judges. Thomas Schultz had served as the president and sole shareholder of Intra–Med, a Kentucky corporation that entered into a contract to lease medical equipment from General Electric and subsequently defaulted on the contract by failing to make required payments.[167] General Electric filed a complaint against Intra–Med in circuit court and although a judgment on the pleadings was entered in favor of General Electric for over $4.7 million, it was only able to collect approximately $700,000 of that judgment.[168] When General Electric learned of documents produced in another lawsuit demonstrating that Schultz had used Intra–Med for his own private purposes, General Electric intervened and filed a third-party complaint against Schultz seeking to pierce the corporate veil and hold him personally liable for the judgment against Intra–Med.[169] The trial court entered judgment on the pleadings in favor of General Electric, and the court of appeals affirmed.[170]

While the Kentucky Supreme Court ultimately remanded the decision because it felt that the circumstances of the case did not warrant a decision to pierce the veil solely on the pleadings, it found that the doctrine of piercing the corporate veil arises in equity.[171] As a result, the court concluded that "because the very act of piercing the corporate veil requires the decision-maker to set aside a legal fiction based upon notions of fairness and hardship, we would have to stretch the boundaries of common sense and engage in linguistic gymnastics to describe veil piercing as anything but an equitable action."[172] In a companion decision issued the same day as *Sch-*

166. *Schultz,*, 360 S.W.3d 171.
167. *Id.* at 173.
168. *Id.*
169. *Id.*
170. *Id.* at 173–74.
171. *Id.* at 175 (citing Daniels v. CDB Bell, LLC, 300 S.W.3d 204, 213 (Ky. Ct. App. 2009)). The U.S. Court of Appeals for the Sixth Circuit recently relied on *Schultz* while finding that, as a matter of Kentucky state law, "the doctrine of piercing the corporate veil arises in equity." CNH Capital Am. LLC v. Hunt Tractor, Inc., 568 F. App'x 461, 467 (6th Cir. 2014) (citing *Schultz*, 360 S.W.3d at 175).
172. *Id.* at 176.

ultz, the court reaffirmed that piercing "remains an equitable doctrine to be applied by the courts."[173]

The highest court of two other states took notice, relying on *Schultz* in reaching the conclusion that judges, not juries, should hear veil-piercing demands. In 2013, the Supreme Court of Alaska, citing *Schultz*, held that "[v]eil-piercing is an equitable doctrine, premised on the court's ability to look past the 'legal fiction' to do equity."[174] The Supreme Court of Idaho followed suit a year later, as it recently resolved a confusing split in authority and reversed two of its older decisions while holding that "issues of alter ego and veil-piercing claims are equitable questions. . . . In these cases, the trial court is responsible for determining factual issues that exist with respect to this equitable remedy and for fashioning the equitable remedy."[175]

Numerous appellate courts in various states have reached the same conclusion, finding that the decision to pierce the corporate veil belongs in the hands of a judge, rather than a jury.[176] But several appellate courts in other states have concluded just the opposite. The Tennessee Supreme Court, relying on authority from the highest courts of California and Georgia, found that:

> The conditions under which the corporate entity will be disregarded vary according to the circumstances present in each case and the matter is particularly within the province of the trial court. Moreover, a determination of whether or not a corporation is a

---

173. Inter-Tel Techs., Inc. v. Linn Station Props., LLC, 360 S.W.3d 152, 165 (Ky. 2012) (citing *Schultz*, 360 S.W.3d at 171).

174. Brown v. Knowles, 307 P.3d 915, 928 & n.43 (Alaska 2013) (citing *Schultz*, 360 S.W.3d at 176).

175. Wandering Trails, LLC v. Big Bite Excavation, Inc., 329 P.3d 368, 373 (Idaho 2014).

176. *See, e.g.*, Peetoom v. Swanson, 778 N.E.2d 291, 295 (Ill. App. Ct. 2002) ("The doctrine of piercing the corporate veil is an equitable remedy. . . .") (citing *In re* Rehab. of Centaur Ins. Co, 606 N.E.2d 291, 296 (Ill. App. Ct.), *aff'd*, 632 N.E.2d 1015 (Ill. 1994); Reed v. Reid, 980 N.E.2d 277, 301 (Ind. 2012) (referring to piercing as an "equitable doctrine")). The Pennsylvania Superior Court went so far as to reject a party's assertion, based on *Passalacqua*, that it had a federal constitutional right to a jury trial and held that the Pennsylvania Constitution does not guarantee a jury on a veil-piercing claim. Advanced Tel. Sys., Inc. v. Com-Net Prof'l Mobile Radio, LLC, 846 A.2d 1264, 1275–76 (Pa. Super. Ct. 2004).

> mere instrumentality of an individual or a parent corporation is ordinarily a question of fact for the jury.[177]

Tennessee is not alone: in 2002, the Georgia Court of Appeals reaffirmed that the decision to pierce the corporate veil is "normally a question for jury determination."[178] The Texas Court of Appeals agreed, stating that determining whether a corporate fiction should be disregarded is a question of fact which, except in "very special circumstances," should be determined by the jury.[179] When paired with the split between the federal circuits, this disparity among the states with regard to the issue of who should decide whether a corporate veil should be pierced further demonstrates the need for guidance from the U.S. Supreme Court on this question.

IV.
JUDGES, NOT JURIES, SHOULD DECIDE VEIL-PIERCING CLAIMS

As Parts I through III make clear, the state of the law on the veil-piercing remedy—and particularly the question of who should award it, judge or jury—is muddled. This is due, at least in part, to the as-yet unresolved circuit split that was created over a decade ago by the Second Circuit's decision in *Passalacqua* (shared by the First and Fifth Circuits) and the Seventh Circuit's decision in *IFSC*. A Supreme Court resolution of that split would certainly provide clarity, particularly from the standpoint of the Seventh Amendment right to a jury trial and its application in federal court. Regardless of whether or how the question is ultimately resolved by the Court, the authors' position is that in any venue—state or federal—piercing demands should be decided by a judge, rather than a jury.

This Part details the four main rationales underscoring that position. First, despite its roots in both law and equity,[180] veil piercing remains an inherently equitable remedy. As such,

177. Elec. Power Bd. v. St. Joseph Valley Structural Steel Corp., 691 S.W.2d 522, 526 (Tenn. 1985) (citing Alexander v. Abbey of the Chimes, 163 Cal. Rptr. 377 (Ct. App. 1980); Trans-Am. Commc'ns v. Nolle, 214 S.E.2d 717 (Ga. Ct. App. 1975)).

178. Hayes v. Collins, 538 S.E.2d 785, 787 (Ga. Ct. App. 2000).

179. Howell v. Hilton Hotels Corp., 84 S.W.3d 708, 714 (Tex. App. 2002) (citing Castleberry v. Branscum, 721 S.W.2d 270, 277 (Tex. 1986); Coleman Cattle Co. v. Carpentier, 10 S.W.3d 430, 435 (Tex. App. 2000, no pet.)).

180. *See supra* Part II.

there is no danger of running afoul of the Seventh Amendment by confining piercing claims to the realm of bench decisions. Second, while it is commonly believed that juries are best suited to decide fact-intensive issues, this principle does not apply with equal force in the veil-piercing context. Unlike, say, personal injury claims, ordinary citizens are not as well-equipped as trained lawyers and judges to examine and weigh the policy, legal, and business considerations that accompany the concept of corporate separateness and any attendant facts.[181] Third, permitting judges rather than juries to decide whether to disregard the corporate veil should lead to greater consistency in any resulting decisions. Lastly, placing the veil-piercing question squarely in the hands of judges should lead to increased efficiency. Each of these considerations is discussed in more depth below.

A. *Veil Piercing Is an Equitable Remedy*

To be sure, the doctrine of piercing the corporate veil has some legal roots and is at times used to further recovery on claims of an otherwise legal nature, such as the breach of contract claims at issue in *IFSC*. Indeed, as the history of the remedy discussed in Part II indicates, veil piercing may implicate both law and equity. But piercing itself is an inherently equitable mechanism. For example, the creditor's bill mechanism

---

181. This is not to say that judges are infallible, or that all judges possess the business acumen necessary to decide piercing claims. Nevertheless, the authors submit that, in the absence of special masters or other specially appointed adjudicators to decide these complex "veil-piercing" claims, it is better on balance to place such claims in front of practiced judges with extensive legal experience with legal fictions such as corporate separateness, rather than ordinary laypeople without such background or knowledge. This is in accord with certain studies that have shown, for example, that "judges are less prone [than jurors] to suffering from various forms of hindsight bias." Joni Hersch & W. Kip Viscusi, *Punitive Damages: How Judges and Juries Perform* (John M. Olin Ctr. for Law, Econ. & Bus., Harvard Law Sch., Discussion Paper No. 362, 2002). Another study demonstrated that jurors' "damages assessments were also more prone to error than were responses by a sample of state judges. Judges were less prone to erroneous risk beliefs [than jurors] and less subject to the zero-risk mentality." W. Kip Viscusi, *Jurors, Judges, and the Mistreatment of Risk by the Courts*, 30 J. LEGAL STUD. 107 (2001). These kinds of differences are likely attributable to the difference in legal training received by judges as opposed to lay jury members, and further suggests that judges are better equipped, on balance, to handle issues such as veil piercing than lay juries.

was used to provide those plaintiffs who had secured a judgment against a corporate entity a means of proceeding in equity against the insolvent corporation and in law against its shareholders or directors to recover sums from the individuals responsible for the corporate wrong. But this two-part system for recovery itself originally sounded purely in equity, with a judgment creditor permitted to proceed in equity against *both* the corporation and its shareholders.[182]

Moreover, numerous commentators have suggested that the remedy is "equitable in nature."[183] And despite some court commentary to the contrary, the equitable "guts" of the veil-piercing mechanism are reflected in the fact that nearly every state universally requires a showing of "fraud" or "injustice"[184] or "inequity"—all themselves terms of equity and, in fact, equitable claims in the case of fraud—to justify piercing the corpo-

182. *See, e.g.*, Edwin H. Abbot, *Conflict of Laws and the Enforcement of the Statutory Liability of Stockholders in a Foreign Corporation*, 23 HARV. L. REV. 37, 42–43 (1909).

183. Int'l Fin. Servs. Corp. v. Chromas Techs. Can., Inc., 356 F.3d 731, 737 (7th Cir. 2004) ("[U]nder Illinois law, piercing the corporate veil is an equitable remedy to be determined by the court."); Baillie Lumber Co. v. Thompson, 391 F.3d 1315, 1321 (11th Cir. 2004) ("In Georgia, alter ego and veil-piercing actions are based on equitable principals."); AG Servs. of Am., Inc. v. Nielsen, 231 F.3d 726, 729 (10th Cir. 2000) (noting trial court's bifurcation of legal and equitable—including piercing—claims, though ultimately overturning lower court decision for failure to abide by jury findings of fact common to both legal and equitable claims); Institut Pasteur v. Cambridge Biotech Corp., 186 F.3d 1356, 1376 (Fed. Cir. 1999) ("The concept of piercing the corporate veil is equitable in nature . . . .") (internal quotations omitted); Kinney Shoe Corp. v. Polan, 939 F.2d 209, 211 (4th Cir. 1991) ("Piercing the corporate veil is an equitable remedy . . . ."); Comm'r of Envtl. Prot. v. State Five Indus. Park, Inc., 304 Conn. 128, 141 (2012) ("Finally, because veil piercing is an equitable remedy, it should be granted only in the absence of adequate remedies at law."); Inter-Tel Techs., Inc. v. Linn Sta. Props., LLC, 360 S.W.3d 152, 155 (Ky. 2012) ("Piercing the corporate veil is an equitable doctrine invoked by courts . . . ."); Daniels v. CDB Bell, LLC, 300 S.W.3d 204, 213 (Ky. Ct. App. 2009) ("We believe that the decision as to whether to pierce the corporate veil is an equitable one to be decided by the trial court and not the jury."); *see also In re* Morris v. N.Y. State Dept. of Taxation & Fin., 82 N.Y.2d 135, 142 (1993).

184. There is some authority to suggest that juries are meant to decide the question of whether "an injustice would result if the corporate form were left intact." 1 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41.25 (revised ed. 2015). However, as noted above, such determinations are typically made by a judge while legal fact issues are typically made by a jury.

rate veil and imposing liability on shareholders.[185] Thus, no matter how much courts may dress up the veil-piercing mechanism in legal clothes, equity has always been, and continues to be, the sine qua non of veil piercing.

This, of course, makes logical sense when the many layers of the veil-piercing doctrine are stripped bare and the ultimate goal of piercing is exposed: the mechanism exists to prevent shareholders from abusing the corporate form. There is no question that this is an equitable endeavor.[186]

Because veil piercing is plainly an equitable remedy, there is no convincing historical basis for claiming that juries, instead of judges, should be the ones deciding it. Accordingly, the Supreme Court need not upset existing Seventh Amendment precedent to resolve the existing circuit split in favor of the Seventh Circuit's decision in *IFSC*. Nor do state courts need to violate any historical norms to find that judges should properly be deciding whether to pierce the corporate veil. If anything, taking the decision to pierce the corporate veil out of jurors' hands will be consistent with, not run afoul of, historical conceptions of veil piercing dating back to the creditor's bill as an equitable remedy determined by judges, not juries.

B. *Juries Are Ill-Equipped to Parse Veil-Piercing Facts*

While most decisions finding that a jury should decide a veil-piercing claim rely on the fact that juries are generally

---

185. *See* Wachovia Sec., LLC v. Banco Panamericano, Inc., 674 F.3d 743, 751–52 (7th Cir. 2012) ("Illinois law permits veil piercing when two separate prongs are met . . . (2) 'circumstances must be such that adherence to the fiction of separate corporate existence would sanction a fraud or promote injustice.'") (citations omitted); NetJets Aviation, Inc. v. LHC Commc'ns, LLC, 537 F.3d 168, 176 (2d Cir. 2008) ("To prevail under the alter-ego theory of piercing the veil, a plaintiff need not prove that there was actual fraud but must show a mingling of the operations of the entity and its owner plus an 'overall element of injustice or unfairness.'") (citations omitted); Southeast Tex. Inns, Inc. v. Prime Hosp. Corp., 462 F.3d 666, 679 (6th Cir. 2006) ("More importantly, these conclusory allegations, couched in terms of a contractual breach, are not tantamount to the fraud or injustice required to pierce the corporate veil."); NLRB v. Greater Kan. City Roofing, 2 F.3d 1047, 1052 (10th Cir. 1993) ("We require an element of unfairness, injustice, fraud, or other inequitable conduct as a prerequisite to piercing the corporate veil.").

186. *See supra* Part II.

considered to be better suited to resolving "fact-intensive" inquiries, the authors submit that this reliance is misplaced in the veil-piercing context. To be sure, there are contexts where juries are essential to determining the credibility of eyewitnesses and weeding through potentially conflicting accounts of everyday occurrences. In personal injury claims involving vehicles, for instance, juries are often asked to decide the proverbial "was the light green, yellow, or red?" Indeed, many jurors conduct their own "investigations" in these types of cases[187]—visiting accident sites, for example.[188] Still other jurors rely on personal experience with their own driving patterns to make factual judgment calls in these types of cases.[189]

But this is simply not so in the veil-piercing context, which is not as intuitive or straightforward as other civil claims sounding in tort or breach of contract. The potentially conflicting evidence often involves matters far beyond the everyday knowledge of a lay juror. After all, "[t]he issue of corporate governance is complicated."[190] And, more critically, all of the conflicting evidence revolves around one core legal issue: the legal fiction of corporate separateness. Similarly, in patent validity cases, judges are tasked with making a determination, which—while it may also be fact-intensive—remains at its core a legal issue. While jurors may have experience that renders them invaluable in determining witness credibility in a breach of contract or personal injury setting, it is judges—not jurors—who have the training and experience necessary to answer the only

---

187. *See, e.g.*, Simmons v. Christus Schumpert Med. Ctr., 71 So. 3d 407, 426 (La. Ct. App. 2011) (determining that a juror conducted his own internet research, printed some of the results, and shared it with other jurors); Stebner v. Assoc. Materials, Inc., 234 P.3d 94, 96 (Mont. 2010) (concluding that a juror researched the definition of "preponderance" on the internet).

188. *See, e.g.*, Campbell v. Hankins, 324 S.W.3d 358, 361 (Ark. Ct. App. 2009) (finding that a juror had visited the scene of car accident during a lunch break and "reported the results of his investigation and his opinions regarding the same to the other jurors during deliberations"); Franzen v. Buseman, No. 02-0378, 2003 WL 1524509, at *2 (Iowa Ct. App. Mar. 26, 2003) (determining that a juror drove by scene of car accident "because he was curious," and then "relayed his observations to the jury").

189. *See, e.g.*, *Franzen*, 2003 WL 1524509, at *2 (describing that a juror driving by scene of accident "wanted to refresh his recollection of the stretch of highway upon which he traveled numerous times before").

190. Minger Constr., Inc. v. Clark Farms, Ltd., No. 14–1404, 2015 WL 7019046, at *6–7 (Iowa Ct. App. Nov. 12, 2015) (McDonald, J., concurring) (arguing that veil-piercing claims should be decided by judges, not juries).

question that matters on a veil-piercing claim: whether the legal fiction of corporate separateness should be honored or disregarded.

To take but one example, judges are trained from the start of law school to understand that legal fictions exist for specific policy reasons, and, similarly, to recognize when the policies underlying those legal fictions would be flouted by applying those fictions in a particular case. Jurors have no such training and often do not understand the policy rationale for the existence of legal fictions such as corporate separateness. This makes jurors ill-equipped to make these kinds of determinations, particularly where, as in the veil-piercing context, the determinations require analysis of other, secondary legal fictions, such as the observance of corporate formalities. Judges, on the other hand, are trained to understand such legal fictions and make these kinds of determinations from the start.

In this regard, the case law's overzealous focus on the "fact-intensive" nature of a veil-piercing claim is a bit of a red herring. Certainly, veil piercing may require an assessment of a variety of facts relevant to a corporation's day-to-day business and its relationship to its shareholders. But those facts are only relevant to a veil-piercing analysis insofar as they speak to whether the legal fiction of corporate separateness—and secondary legal fictions like corporate formalities—should be honored or, instead, disregarded. Judges understand that; jurors generally do not (unless they themselves happen to be lawyers).

C. *Consistency in Decisions*

While there is no way to predict the future, consistently placing veil-piercing determinations in the hands of judges rather than juries should lead to more consistency in veil-piercing law, at both the state and federal levels. It is "exceedingly difficult to craft instructions that provide meaningful guidance to the jury" tasked with assessing a veil-piercing claim.[191] And at least one scholar has recently argued that veil-piercing procedure, including the question of whether claims are resolved by judges or juries, may affect the variance in the aggre-

191. *Id.* at *17. The *Minger* court also noted that the factors juries are instructed to consider in deciding whether to pierce the corporate veil vary widely from court to court and "are not exclusive" in any event. *Id.* at *18.

gate results of veil-piercing claims across various jurisdictions as much as, if not more than, variations in the states' substantive law of piercing.[192]

At the appellate level, inconsistency in jury decision-making on piercing claims is readily apparent. Courts of appeal are regularly tasked with evaluating piercing decisions rendered by juries and often overturn such decisions. While there exist innumerable reasons why an appellate court might overturn a jury verdict in the piercing context, several cases focus on the fact that the jury failed to grapple with a particular aspect of the admittedly complex tests involved in such claims. For example, while a jury might make a factual determination regarding corporate domination or control, that same jury might fail to fully consider the fraudulent or equitable impact of such control.[193] Allowing judges to make those determinations should, over time, lead to more consistent results that will permit businesses (and lawyers) to have greater certainty as to what kinds of conduct will—or will not—lead to a piercing of the corporate veil.

D. *Efficiency Considerations*

Placing the veil-piercing determination in the hands of judges should also be more efficient than having those same claims tried before a jury. As a general matter, bench trials tend to be more efficient than jury trials, as both courts and commentators have recognized.[194] Moreover, jury trials on the

---

192. Sam F. Halabi, *Veil-Piercing's Procedure*, 67 RUTGERS L. REV. 1001, 1058–59 (2015) ("While [other scholars] associate North Dakota's high veil-piercing rate with its attitude toward 'undercapitalization' as a legal basis to pierce, it may be just as likely that its liberal pleading standards, lower burden of proof, and access to a jury on veil-piercing claims matter more.").

193. *See, e.g.*, Connolly v. Malkamaki, No. 2001-L-124, 2002 WL 31813040, at *6 (Ohio Ct. App. Dec. 13, 2002) (setting aside jury verdict where jury failed to grapple with facts related to inequitable conduct or harm to plaintiff); Sloan v. Thornton, 249 Va. 492, 499 (1995) (setting aside jury verdict where, despite evidence of corporate disregard, there was no evidence demonstrating that shareholder had used the corporation "to disguise a wrong or obscure a fraud he committed").

194. *See, e.g.*, Data Compass Corp. v. Datafast, Inc. (*In re* Data Compass Corp.), 92 B.R. 575, 583 (Bankr. E.D.N.Y. 1988) ("The Court does not suggest that it is too busy to conduct jury trials, but jury trials are, by nature, more time consuming than bench trials, and one could conclude that the Court's docket and case pace demands do not accommodate jury trials.")

issue of veil piercing often need to focus on every aspect of the corporation's operations and relationship to shareholders in order to give the jury as much information as possible to make a decision. A judge, by contrast, is far more likely to know, by virtue of having managed a case since its inception and through the discovery process, what facts are critical, or irrelevant, to the veil-piercing determination. This should ultimately lead to a more streamlined and efficient trial process on veil-piercing issues than would be possible with juries making the determination.

Conclusion

This Article has traced the historical roots of veil piercing in courts of both law and equity, which helps to explain the wide variety of conclusions reached by modern courts on the question of whether veil-piercing claims should be decided by judges or juries. In addressing that question, both the federal circuit courts and the state appellate courts have diverged into several distinct lines of reasoning and arrived at disparate results. The result is a clear and irreconcilable split in authority between the federal circuits and the highest appellate courts in several states, a muddled mess of precedent from which it is very difficult to draw clear guidance, and a controversy ripe for resolution by the U.S. Supreme Court.

This Article has attempted to make sense of that confusion and to propose a common sense solution. Part I addressed the circumstances under which a civil plaintiff in federal court is entitled to a trial by jury, without focusing specifically on veil piercing. Part II examined the historical roots of veil piercing in an attempt to explain why courts have reached such widely divergent results on the judge/jury question. Part III analyzed the existing case law and the reasoning various federal and state courts have applied in determining who should adjudicate veil-piercing claims. Finally, Part IV argued

(quoting Weeks v. Kramer (*In re* G. Weeks Sec., Inc.), 89 B.R. 697, 710 (Bankr. W.D. Tenn. 1988)); Christian N. Elloie, *Are Pre-Dispute Jury Trial Waivers a Bargain for Employers over Arbitration? It Depends on the Employee*, 76 DEF. COUNS. J. 91, 95 (2009) ("Compared to jury trials, bench trials are less costly and less time consuming."); *see also* THOMAS H. COHEN & STEVEN K. SMITH, BUREAU OF JUSTICE STATISTICS, U.S. DEP'T OF JUSTICE, NJC 202803, CIVIL TRIAL CASES AND VERDICTS IN LARGE COUNTIES, 2001 (2004), http://www.bjs.gov/content/ pub/pdf/ctcvlc01.pdf.

that judges, not juries, are best suited to decide in each case whether the corporate veil should be pierced, for four reasons: (1) veil piercing is an inherently equitable remedy that judges are better equipped to decide; (2) veil-piercing inquiries require a weighing of legal fictions and concepts that lay jurors simply are not trained to perform; (3) decisions by judges are likely to produce more consistent results in similar cases; and finally (4) judges can likely make veil-piercing decisions more efficiently than juries can. For these reasons, the authors respectfully submit that, if it is so inclined, the U.S. Supreme Court should resolve the existing circuit split and muddied waters surrounding this issue by conclusively deciding that there is no Seventh Amendment right to a jury trial on a veil-piercing claim, and that judges, not juries, are the proper decision-makers to resolve such claims.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 13 FALL 2016 NUMBER 1

STRATEGIC LEGAL BULLYING

DAVID OROZCO*

Our competitive, market-based economy and adversarial legal system encourage strategic behavior among private parties. This system often yields positive economic results. The same system, however, can yield serious negative unintended consequences when unethical actors exploit the system's high costs to harm innovators, entrepreneurs, small businesses, non-profits, and society. In particular, strategic legal bullying exploits the high costs of the legal system to advance a baseless legal position that yields a favorable result at the expense of a much weaker party. This Article defines and analyzes this harmful practice in relation to frivolous or "sham" litigation. As defined in this article, strategic legal bullying goes far beyond sham litigation and encompasses a broad range of harmful strategic business activity. These various practices are assessed in relation to economic terms and classified as a form of rent-seeking behavior. The Article analyzes and categorizes various cases of strategic legal bullying and the defensive methods through which it can be contained. As discussed in the article, business norms, ethics, and corporate social responsibility play a vital role in ongoing efforts to combat the significant harmful effects that arise when companies abuse the legal system for strategic business gain.

INTRODUCTION 138
I. A BASIC ECONOMIC ANALYSIS OF STRATEGIC LEGAL BULLYING 145
A. *Strategic Attorneys* 145
B. *Rent-Seeking* 152

---

* Copyright © 2016 by David Orozco. David Orozco is an Associate Professor of Legal Studies and Dean's Emerging Scholar at Florida State University College of Business. This research benefited greatly from the comments received by Charlotte Alexander, Robert Bird, Nadelle Grossman, Jennifer Pacella, Dan Ostas, and the feedback received by the participants of the 2015 Symposium on the Preventive and Positive Roles of Law organized by George Siedel and the Business Law Department at the University of Michigan's Ross School of Business.

C. *The Legal Entitlement Frontier* 157
II. CASES OF STRATEGIC LEGAL BULLYING 161
A. *Employment* 161
B. *Intellectual Property* 164
C. *Commercial Speech* 168
D. *Business Regulation* 169
E. *Anticompetitive Behavior* 171
III. DEFENSIVE TECHNIQUES 173
A. *Public Ordering Defensive Measures* 174
1. *Judicial Doctrines and Equitable Powers* 174
2. *Legislative Solutions* 176
B. *Private Ordering Defensive Measures* 178
1. *Techniques to Reduce Litigation Costs* 178
a. Class Action Lawsuits 178
b. Contingency Fee Arrangements 180
c. Pro Bono Representation 181
2. *Professional Misconduct Sanctions* 181
3. *Social Media, Public Relations, and Legal Crowdsourcing* 182
IV. BUSINESS NORMS, ETHICS, AND CORPORATE SOCIAL RESPONSIBILITY 183
CONCLUSION 191

INTRODUCTION

> What is the right thing to serve our shareholders and our customers and our fundamental mission, which is about empowering people around the world? It starts with the law and then moves quickly to other things. If one tries to keep these things too separate, I think one can end up doing a disservice—not just to people who own the company as shareholders, but to the people who use our products and the world at large.
> Brad Smith, Microsoft Chief Legal Officer.[1]

In a perfect world, law, business, and ethics would coexist in harmony, as exemplified by the above quote. In today's hypercompetitive and cutthroat business environment, how-

1. David Hechler, *Microsoft's Brad Smith Talks About Getting Kicked Upstairs*, CORP. COUNS. (Sept. 17, 2015), http://www.corpcounsel.com/id=1202737479938/Brad-Smith-Talks-About-Getting-Kicked-Upstairs?mcode=1202615622021&curindex=10&slreturn=20151017163921.

ever, companies increasingly wield the law aggressively as a blunt instrument for strategic business purposes.[2] In their zealous pursuit to use the law for strategic purposes, some companies commit a disservice to others. For example, companies exploit the law when they engage in sham litigation to deter market entry to start-up innovators or when they avoid payment of employee overtime wages and aggressively draft arbitration clauses in consumer contracts.[3]

When companies use the law strategically, they risk overextending themselves and their legal arguments to the point of harassment and bullying. When this occurs, companies behave like bad citizens, or bad neighbors to employ the metaphor adopted in socio–legal research.[4] In socio–legal research, good neighborly norms play a primary role among parties to a dispute.[5] This research demonstrates that good neighborly

2. A strategy is a plan for action intended to accomplish some goal. Lynn M. LoPucki & Walter O. Weyrauch, *A Theory of Legal Strategy*, 49 DUKE L.J. 1405, 1428 (2000). A legal strategy involves a decision or set of decisions taken in response to or anticipation of a legal claim. Daniel T. Ostas, *Corporate Counsel, Legal Loopholes, and the Ethics of Interpretation*, 18 TEX. WESLEYAN L. REV. 703, 706–07 (2012). In the business literature, one of the principal writers on strategy states that "[c]ompetitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value." Michael E. Porter, *What is Strategy?*, HARV. BUS. REV., Nov.–Dec. 1996, at 61, 64; *see also* Robert C. Bird & David Orozco, *Finding the Right Corporate Legal Strategy*, 56 MIT SLOAN MGMT. REV. 81, 81–82 (2014) (discussing how law, in general, can be used to achieve private strategic benefits rather than just compliance or risk management-related goals). The corporate legal strategy perspective falls under the general umbrella of proactive law. *See* PROACTIVE LAW IN A BUSINESS ENVIRONMENT 59–106, (Gerlinde Berger-Walliser & Kim Ostergaard eds., 2012); GEORGE SIEDEL & HELENA HAAPIO, PROACTIVE LAW FOR MANAGERS: A HIDDEN SOURCE OF COMPETITIVE ADVANTAGE (2011); *see also* Constance E. Bagley, *What's Law Got to Do With It?: Integrating Law and Strategy*, 47 AM. BUS. L.J. 587 (2010); Jordan M. Barry & Elizabeth Pollman, *Regulatory Entrepreneurship*, 90 S. CAL. L. REV. (forthcoming 2017) (describing how regulatory entrepreneurs initiate legal change to sustain their business models); Robert C. Bird, *Law, Strategy and Competitive Advantage,* 44 CONN. L. REV. 61 (2011); Nadelle Grossman, *The Duty to Think Strategically*, 73 LA. L. REV. 449 (2013).

3. *See* CHRISTOPHER C. KLEIN, FEDERAL TRADE COMMISSION REPORT, THE ECONOMICS OF SHAM LITIGATION, 1 (1989) (defining sham litigation as "predatory or fraudulent litigation with anticompetitive effect, that is, the improper use of the courts and other government adjudicative processes against rivals to achieve anticompetitive ends").

4. *See* ROBERT C. ELLICKSON, ORDER WITHOUT LAW (1994).

5. *Id.*

norms of fairness, reciprocity, and reputation far outweigh formal legal rules even though legal rights and doctrines are central aspects of private disputes.[6] As bad neighbors, companies that aggressively employ legal strategies to bully weak parties violate important business norms that underlie good corporate citizenship.[7]

This Article will examine a broad array of strategic corporate legal bullying practices that violate fundamental business norms such as fairness, reciprocity, reputation, and community responsiveness.[8] It is worth mentioning that a good deal of corporate legal strategy and business behavior abides by ethical norms and the spirit of fair play in the marketplace. Likewise, it is important to recognize that our culture and legal system encourage parties to strategize, innovate, and submit disputes to governmental bodies, which resolve these cases to benefit individuals and society.[9] Parties that operate within this inherently competitive, dynamic, and adversarial legal system strategically "bargain in the shadow of the law" to achieve efficient private outcomes.[10] Under our legal system, parties are

---

6. *Id.*

7. Good corporate citizenship relies on the heavily debated conceptions of what it means to be "good" and a "corporate citizen" in today's marketplace. Much of this article will focus on bad corporate behavior referred to as strategic legal bullying and good behavior in light of business norms and corporate social responsibility. Corporate citizenship is a debated term, however; according to some scholars it arises when companies act as quasi-state actors and administer rights for other citizens. *See* Dirk Matten & Andrew Crane, *Corporate Citizenship: Toward an Extended Theoretical Conceptualization*, 30 ACAD. MGMT. REV. 166, 171–72 (2005) (stating that "[w]e thus contend that 'corporations' and 'citizenship' come together in modern society at the point where the state ceases to be the only guarantor of citizenship—and that a term such as *corporate citizenship* is a legitimate way of characterizing this situation").

8. *See* Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 58–60 (1963) (discussing the role of some of these norms in the contracting process).

9. *See, e.g.*, *In re* Appraisal of Transkaryotic Therapies, Inc., Civ. Action No. 1554-CC, 2007 WL 1378345 (Del. Ch. May 2, 2007) (upholding the strategic legal practice known as appraisal arbitrage, where an investor buys stock in target companies after the record date for stockholder votes on a merger and then challenges the merger valuation to extract a higher price).

10. *See* Melvin A. Eisenberg, *Private Ordering Through Negotiation: Dispute-Settlement and Rulemaking*, 89 HARV. L. REV. 637 (1976) (discussing the important role of legal norms as enablers of private agreements); Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of*

allowed to advocate their preferences in a way that disadvantages competitors. As the U.S. Supreme Court stated in *Eastern Railroad Presidents Conference v. Noerr Motor Freight*:

> The right of the people to inform their representatives in government of their desires with respect to the passage or enforcement of laws cannot properly be made to depend on their intent in doing so. It is neither unusual nor illegal for people to seek action on laws in the hope that they may bring about an advantage to themselves and a disadvantage to their competitors . . . . Indeed, it is quite probably people with just such a hope of personal advantage who provide much of the information upon which governments must act.[11]

Prior scholars have analyzed the strategic use of the legal system to achieve private gains.[12] The legal realists were the first to recognize the strategic opportunities offered by the common law's flexible, dynamic, and indeterminate nature.[13]

Divorce, 88 YALE L.J. 950, 966 (1979) (discussing how parties achieve private ordering solutions when they take into account bargaining endowments created by legal rules and several other factors).

11. Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127, 139 (1961) (holding that it was not a violation of the Sherman Antitrust Act when railroad companies lobbied in favor of laws that threatened to disadvantage the competing trucking industry).

12. *See infra* notes 13–71 and accompanying text.

13. *See* JEROME FRANK, LAW AND THE MODERN MIND 42–47 (1930) (discussing how a company was advised by a strategic lawyer to reincorporate in a different state before bringing a contracts suit which would trigger the federal rule on diversity and thereby increase the chances that the court would invoke a favorable, out-of-state contracts doctrine that would uphold the parties' exclusivity agreement). Legal realism emphasizes empirically verifiable behaviors as key drivers of legal outcomes. *See* William B. Chandler, III, Chancellor, Del. Ch., *The Institutional Investor's Goals for Corporate Law in the Twenty-First Century, in* 25 DEL. J. CORP. L. 35, 65 (2000) ("[A]s others have described, the United States has a common law system that develops legal principles in an evolutionary way—interstitially, slowly, gradually, leaving great areas of uncertainty, unpredictability."); Karl N. Llewellyn, *A Realistic Jurisprudence—The Next Step*, 30 COLUM. L. REV. 431, 443–45 (1930). Strategic parties often take advantage of legal ambiguity to detriment their opponents. *See* Elizabeth Smith, *Eliminating Predatory Litigation in the Context of Baseless Trade Secret Claims: The Need for a More Aggressive Counterattack*, 23 SANTA CLARA L. REV. 1095, 1098 (1983) ("[T]he inherent difficulty in detecting baseless trade secret claims stems from the amorphous nature of the required elements.").

For example, in *Law and the Modern Mind,* Jerome Frank offered insights into the strategic nature of lawyering to achieve business gains.[14] In their important work on legal strategy, Lynn LoPucki and Walter Weyrauch state that "[l]awyers conceive and execute their strategies in an environment in which the rules for interaction are unclear and constantly in flux."[15] Law and economics scholars have demonstrated that uncertainties and costs innate to our legal system motivate parties to strategically bargain to obtain efficient private ordering solutions.[16] A central tension arises, however, since strategic legal behavior creates the opportunity and temptation for companies to overreach, violate important business norms, and unduly profit at the expense of those who are in a weaker position.[17] Those who find themselves in a weaker position include employees, consumers, individual entrepreneurs, small businesses, non-profits, and start-up companies.

To date, scholars have yet to examine the broad array of strategic legal techniques available to companies and their relation to the broader normative framework of business ethics. This Article aims to fill this research void by introducing and examining a form of strategic behavior labeled strategic legal bullying. One of the main contributions provided by this Article is the labeling, definition, and categorization of strategic legal bullying practices. This descriptive analysis then yields a framework for assessing the normative limits of what amounts

14. FRANK, *supra* note 13. The research of prominent economists suggests that the common law's flexibility and responsiveness offers economic advantages vis-à-vis civil law systems. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (2007); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997) (comparing investment environments in civil and common law countries).

15. LoPucki & Weyrauch, *supra* note 2, at 1427.

16. Mnookin & Kornhauser, *supra* note 10, at 956. Law and economics scholars also advise courts against finding liability for a wide range of strategic behavior which might be construed as anticompetitive or predatory. *See* Frank H. Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263, 272 (1981) (explaining that firms will not generally engage in predatory pricing unless barriers to entry are high).

17. Private ordering, in contrast to public ordering, refers to the processes by which parties create their own legally enforceable commitments. Mnookin & Kornhauser, *supra* note 10, at 950. This Article will deal with examples of strategic behavior in both private and public realms.

to appropriate legal and business behavior from an ethical and economic perspective.

Prior literature has examined anticompetitive sham litigation.[18] However, strategic legal bullying encompasses a greater range of anticompetitive behavior than this limited activity. For example, sham litigation involves asserting a baseless claim during administrative or judicial proceedings.[19] In contrast, strategic legal bullying asserts or frivolously *defends* a baseless legal position to derive advantage by exploiting the high cost of the legal system as a barrier to seeking a remedy.[20]

For example, as discussed below, the practice of efficient patent infringement occurs when a company exploits the weak deterrent effects of the patent laws to appropriate technology, weaken competitors, and increase profits.[21] Companies with ample financial resources can thus exploit the financially weak position of start-up companies and independent inventors by knowingly appropriating their patented technologies. This activity does not amount to sham litigation, yet it falls within the broader umbrella of strategic legal bullying since the party that commits the efficient infringement denies the existence of their opponent's patent and exploits the high costs of litigation to get away with their unauthorized use of the smaller party's technology.[22] Various other legal tactics that fall

---

18. *See* Gary Myers, *Litigation as a Predatory Practice*, 80 KY. L.J. 565, 608 (1992); Smith, *supra* note 13; KLEIN, *supra* note 3; Thomas A. Balmer, *Sham Litigation and the Antitrust Laws*, 29 BUFF. L. REV. 39, 39–71 (1980).

19. Myers, *surpa* note 18.

20. *See* Richard L. Abel, *How the Plaintiffs' Bar Bars Plaintiffs*, N.Y.L. SCH. L. REV. 345, 348 (2006) (discussing how the real crisis in tort litigation is "defendants who assert frivolous defenses, abuse procedure, file hopeless appeals . . . all to discourage legitimate claims and delay payment"). In the United States each party pays their own litigation costs and attorney's fees under what is referred to as the "American rule." Issachar Rosen-Zvi, *Just Fee Shifting*, 37 FLA. ST. U. L. REV. 717, 731 (2010) ("Under the American Rule, the prevailing party is ordinarily not entitled to collect attorney's fee from the loser.").

21. *See* Eric C. Wrzesinski, *Breaking the Law to Break into the Black: Patent Infringement as a Business Strategy*, 11 INTELL. PROP. L. REV. 193, 194–95 (2007) ("[P]atent infringement may remain an effective business strategy for technology-producing firms, even when not employed willfully, due to the inadequate deterrence function of current U.S. patent laws.").

22. Other examples of strategic legal bullying that go beyond sham or frivolous litigation are discussed below; for example, anticompetitive con-

outside of sham litigation will be discussed below as examples of strategic legal bullying.[23]

Evidence suggests that strategic legal bullying is commonplace and has serious harmful consequences.[24] Take the case of large multinational corporation Unilever, owner of the Hellman's brand of mayonnaise, and how they targeted a small company called Simply Mayo for its use of the word "mayo" to describe its vegan mayonnaise substitute. Unilever filed a Lanham Act claim against the much smaller competitor and alleged unfair competition, arguing that the use of the word "mayo" is deceptive since mayonnaise must, as they claim, contain eggs.[25] Eventually, after a wave of negative publicity, Unilever agreed to withdraw their suit.[26] Unilever's initial goal was to seek an injunction that would have forced the smaller company to engage in a costly rebranding process.[27]

The remainder of this Article will proceed as follows: Part I examines the antecedents of law and strategy and assesses law and strategy from an economics perspective to contrast legitimate and illegitimate examples of legal strategy. Within this context, strategic legal bullying is identified as an illegitimate business activity assessed in relation to the economic concepts of rent-seeking, public–private ordering, transaction costs, and

---

tracting, employment wage theft, and employment misclassification. *Infra* notes 113–94 and accompanying text.

23. *See infra* notes 113–94.

24. *See* Myers, *supra* note 18 (stating that the amount of sham litigation cases is high and is likely to be increasing over time). These cases take a financial and emotional toll on the small parties who are often the targets. *See* Mackensey Lunsford, *E. & J. Gallo Forces Asheville Company to Change Name*, CITIZEN-TIMES (June 27, 2014), http://www.citizen-times.com/story/news/local/2014/06/27/e-j-gallo-forces-asheville-company-change-name/11453713/ (discussing the financial and emotional costs imposed on small business owners dealing with litigation and rebranding efforts). In this case, large wine company E.J. Gallo threatened litigation against Tom Gallo, a small Asheville entrepreneur for his use of GalloLea Pizza Kits. *Id.*

25. *See* David Orozco, *Using Social Media in Business Disputes*, 57 MIT SLOAN MGMT. REV. 33, 33–35 (2016).

26. *Id.* at 34. The defensive techniques used to pressure Unilever amounted to a private ordering solution that counteracted the negative effect of their strategic legal bullying. Simply Mayo's victory appeared to be short-lived since the Department of Agriculture's Egg Board was reviewing whether to limit the use of the word mayo for food products that only included eggs as an ingredient, however, this review was eventually withdrawn.

27. *Id.*

unfair competition. Part II categorizes various strategic legal bullying practices employed in the marketplace as types of rent-seeking behavior. Part III discusses some of the public and private ordering responsive techniques that are available to small companies and individuals and highlights several areas ripe for legal reform. Part IV frames the analysis of strategic legal bullying in relation to ethics, business norms, and corporate social responsibility. Following this, the Article concludes.

I.
A Basic Economic Analysis of Strategic Legal Bullying

A. *Strategic Attorneys*

As a general matter, strategic legal behavior relies on the expert engagement of private and public ordering legal institutions such as contracts,[28] litigation,[29] regulation,[30] adminis-

28. *See* Ronald J. Gilson, Charles Sabel & Robert Scott., *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 Colum. L. Rev. 431, 463–67 (2009) (discussing a case involving interlocking contracts to achieve numerous strategic goals); David Orozco, *Legal Knowledge as an Intellectual Property Management Resource*, 47 Am. Bus. L.J. 687, 719–20 (2010) (discussing Ticketmaster's exclusivity contracts as a source of competitive advantage).

29. Frank, *supra* note 13; Tom Hinthorne, *Predatory Capitalism, Pragmatism, and Legal Positivism in the Airlines Industry*, 17 Strat. Mgmt. J. 251, 261 (1996) ("A corporate leader can use the adversary system to destroy or weaken an opposing stakeholder . . . ."); Charles T. Graves & Brian D. Range, *Identification of Trade Secret Claims in Litigation: Solutions for a Ubiquitous Dispute*, 5 Nw. J. Tech. & Intell. Prop. 68, 68 (2006) (discussing how plaintiffs strategically engage in vague pleading during trade secret litigation); Orozco, *supra* note 28, at 716 (discussing how Google claims that competitor Microsoft initiates litigation to access the inner workings of Google's technology and strategy).

30. *See* Victor Fleischer, *Regulatory Arbitrage*, 89 Tex. L. Rev. 227, 230 (2010) (discussing how companies strategically structure complex deals to reduce regulatory costs while raising Coasean transaction costs if the regulatory savings outweigh transaction costs and how "[l]arge companies that can afford elite law firms employ more aggressive deal structures that push the regulatory frontier"); Orozco, *supra* note 25, at 34 (discussing how Uber strategically uses social media and its installed user base and apps to crowdsource favorable regulations); Matt Stempeck, *Are Uber and Facebook Turning Users into Lobbyists*?, Harv. Bus. Rev. (Aug. 11, 2015), https://hbr.org/2015/08/are-uber-and-facebook-turning-users-into-lobbyists.

trative processes,[31] and legislation[32] to advance business objectives. A growing body of academic research examines this practice and the role attorneys play as the agents of business strategy and managerial -making.[33] Some of this research examines the role of entrepreneurial attorneys[34] and managers' capacity to develop non-market strategies[35] and the related, knowledge-oriented capability of legal astuteness.[36]

31. *See* John R. Allison & Starling D. Hunter, *On the Feasibility of Improving Patent Quality One Technology at a Time: The Case of Business Methods*, 21 BERKELEY TECH. L.J. 729, 786–87 (2006) (providing a detailed empirical account of how patent applicants strategically game the technology classification system during the patent application process through creative patent drafting to avoid a more rigorous examination required by the business method technology classification); *see also* Semke v. Enid Automobile Dealers Ass'n, 456 F.2d 1361 (10th Cir. 1972) (defendant car dealers successfully persuaded a regulatory agency to file suit to enjoin a new competitor); Federal Prescription Serv., Inc. v. American Pharmaceutical Ass'n, 663 F.2d 253 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 928 (1982) (start-up company's innovative mail order pharmaceutical delivery business was thwarted when a pharmaceutical trade association used litigation and administrative proceedings in a predatory manner).

32. *See* Orozco, *supra* note 25, at 34 (discussing how Tesla strategically crowdsources favorable legislation); *see also* Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961) (defendant railroad companies sponsored legislation that would disadvantage the competing trucking industry).

33. *See* Kevin J. Delaney, *Power, Intercorporate Networks, and "Strategic Bankruptcy"*, 23 LAW & SOC'Y REV. 643 (1989); Michael J. Powell, *Professional Innovation: Corporate Lawyers and Private Lawmaking*, 18 LAW & SOC. INQUIRY 423 (1993); Mark C. Suchman & Mia L. Cahill, *The Hired Gun as Facilitator: Lawyers and the Suppression of Business Disputes in Silicon Valley*, 21 LAW & SOC. INQUIRY 679, 699–700 (1996). For research that examines the role of corporate legal strategists, see Bird & Orozco, *supra* note 2 and Orozco, *supra* note 28.

34. *See* Robert L. Nelson & Laura B. Nielsen, *Cops, Counsel, and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations*, 34 LAW & SOC'Y REV. 457 (2000).

35. *See* David P. Baron, *The Nonmarket Strategy System*, 37 MIT SLOAN MGMT. REV. 73, 73 (1995) (stating that "[t]he nonmarket environment consists of the social, political, and legal arrangements that structure interactions among companies and their public. For many companies, nonmarket forces have a major impact on performance; hence these forces warrant the same high level of attention in business strategy as do market forces.").

36. *See* Constance E. Bagley, *Winning Legally: The Value of Legal Astuteness*, 33 ACAD. MGMT. REV. 378, 379 (discussing how a legal astuteness managerial capability has four components: (1) a set of value-laden attitudes, (2) a proactive approach, (3) the ability to exercise informed judgment, and (4)

LoPucki and Weyrauch's work is an important departure point to examine the central role of strategic attorneys. According to these scholars, strategy presumes a field of play that includes people, data, and things that can be arranged.[37] Attorneys who excel at legal strategy play a paramount role and can greatly impact legal decisions through their expert interaction with decision-makers, facts, legal cultures, and the law.[38] The law itself, in their theory, is just one additional factor that is highly indeterminate and subject to strategic manipulation.[39]

Other research examines the legal environment as an enabler of strategy and proactive legal decision-making with specific business goals in mind.[40] Scholars recognize that the law can be endogenously impacted and shaped by strategic decision-makers.[41] This approach has a strong behavioral compo-

---

context specific knowledge of the relevant law and the appropriate application of legal tools).

37. LoPucki & Weyrauch, *supra* note 2, at 1428.

38. *Id.*

39. *Id.* at 1411. According to LoPucki & Weyrauch, legal strategies can be broken down into three main categories that include: strategies that enlist judges, those that pressure or limit judges and those that deprive judges of any say in the case outcome. *Id.* at 1443.

40. *See* Constance E. Bagley et al., *Who Let the Lawyers Out? Reconstructing the Role of the Chief Legal Officer and the Corporate Client in a Globalizing World*, 18 U. PA. J. BUS. L. 419 (2016); James E. Holloway, *The Practical Entry and Utility of a Legal-Managerial Framework Without Economic Analysis of Law*, 24 CAMPBELL L. REV. 131, 147 (2002) (distinguishing between compliance decision-making that complies with law and public policy and strategic decision-making that ascertains whether business decision-making creates too great a risk of liability under law or public policy); James E. Holloway, *A Primer on the Theory, Practice, and Pedagogy Underpinning and School of Thought on Law and Business*, 38 U. MICH. J.L. REFORM 587, 607 (2005) ("[A] legal-managerial school recognizes that business decisions must be rationally related to the furtherance of organizational objectives."); *see also* SIEDEL & HAAPIO, *supra* note 2.

41. *See* Constance E. Bagley, *The Value of a Legally Astute Top Management Team: A Dynamic Capabilities Approach*, 2 *in* OXFORD HANDBOOK OF DYNAMIC CAPABILITIES (David Teece ed.), http://www.valuewalk.com/wp-content/uploads/2016/07/SSRN-id2811424.pdf; Constance E. Bagley & Mark Roellig, *The Transformation of General Counsel: Setting the Strategic Legal Agenda*, *in* LEGAL RISK MANAGEMENT, GOVERNANCE AND COMPLIANCE 45–66 (Stuart Weinstein & Charles Wild eds., 2013); Nicholas Argyres & Kyle J. Mayer, *Contract Design as a Firm Capability: An Integration of Learning and Transaction Cost Perspectives*, 32 ACAD. MGMT. REV. 1060, 1061 (2007) (developing a framework to assess the contracting knowledge that resides in various employees); Gary Pisano, *Profiting from Innovation and the Intellectual Property Revolution*, 35

nent where legal and business decision-making is viewed as the product of both economic[42] and psychological factors.[43] In this same vein, legal studies in business scholarship have started to examine the range of strategic legal pathways that are available to firms that employ managers and attorneys.[44]

The assessment of entrepreneurial attorneys promoted by this author calls for the revaluation of the predominant scholarly view that transactional attorneys act as transaction cost engineers.[45] Under this prominent view in the legal academy, transactional attorneys are regarded as efficient facilitators of value-creating transactions, although the opposite is certainly

RES. POL'Y 1122, 1127–29 (2006) (discussing various case studies of endogenous appropriability regimes related to intellectual property).

42. Applying the logic of rational choice, a business assessing a decision purely on economic grounds will compare the costs and benefits of legal compliance. If the benefits outweigh the costs, these economic actors will engage in strategic non-compliance. *See* Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1262 (1995).

43. *See* Robert Prentice, *Whither Securities Regulation? Some Behavioral Observations Regarding Proposals for Its Future*, 51 DUKE L.J. 1397, 1413–14 (2002) (discussing that economics assumes rational behavior when that is not always the case and how a behavioral approach that takes biases and irrational behavior into account is a better alternative to assess regulation in the financial services industry).

44. *See* Robert C. Bird, *Pathways of Legal Strategy*, 14 STAN. J.L. BUS. & FIN. 1, 11 (2008); Bird & Orozco, *supra* note 2; Larry A. DiMatteo, *Strategic Contracting: Contract Law as a Source of Competitive Advantage*, 47 AM. BUS. L.J. 727, 735 (2010) ("[C]ontract is the most flexible, strategic tool that the law offers to the business community.").

45. *See* Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 255 (1984). This perspective draws from the view among many economists that transaction costs are central to the study of economics. The research that follows this general perspective is labeled transaction-cost economics. *See* OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975); R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960); *cf.* Fleischer, *supra* note 30 (calling into question the depiction of attorneys as transaction-cost engineers due to regulatory arbitrage); Steven L. Schwarcz, *Explaining the Value of Transactional Lawyering*, 12 STAN. J.L. BUS. & FIN. 486, 498 (conducting an empirical study on the role of attorneys and finding weak support for the hypothesis that transactional attorneys add value by reducing transaction costs); John Wroldsen, *Creative Destructive Legal Conflict: Lawyers as Disruption Framers in Entrepreneurship*, 18 U. PA. J. BUS. L. 733, 752–54 (2016) (arguing that the classical economic theory underlying transaction-cost economics minimizes the importance of entrepreneurial activity, making it a poor fit to model law and entrepreneurship activities).

true in cases where attorneys acting in an adversarial setting have been known to strategically raise litigation costs.[46] Certain strategic transactional practices, however, are designed to raise a type of transaction cost known as switching costs to achieve lock-in among key stakeholders.[47] A well-known method to gain competitive advantage is to raise long-term switching costs that strategically lock-in customers, employees, and suppliers.[48] For example, a buyer may lock-in a key supplier by inducing the supplier to contractually agree to make costly and irreversible investments in production processes and equipment that are highly specialized and tailored to the buyer's specific needs.[49] This raises the supplier's switching costs relative to other buyers and achieves supplier lock-in. Alternatively, a manufacturer may extend the value of their patent by lowering the product price to create brand loyalty, thus raising the buyer's switching costs after the patent expires.[50] In addition to raising switching costs and creating lock-in among key parties, these strategic business and legal tactics raise competition costs and impose network externalities by creating barriers to entry.[51]

---

46. LoPucki & Weyrauch, *supra* note 2, at 1457–61 (discussing delay strategies in litigation); Mnookin & Kornhauser, *supra* note 10, at 986; Myers, *supra* note 18, at 589–96 (stating that a reason parties engage in predatory litigation is to raise competitors' litigation costs and other market costs such as delayed or deterred market entry).

47. CARL SHAPIRO & HAL R. VARIAN, INFORMATION RULES: A STRATEGIC GUIDE TO THE NETWORK ECONOMY 11–13 (1998) (discussing the role of switching costs in information goods that make it difficult for a technology user to switch to a competing technology or product).

48. *See* Eastman Kodak Co. v. Image Technical Servs., 504 U.S. 451, 458, 485 (1992). In that case, Kodak implemented a policy of selling patented Kodak parts only to customers that obtained after-market servicing and repairs from Kodak, rather than independent service operators. This practice effectively locked-in customers for Kodak's servicing business but was found to be a violation of antitrust laws.

49. *See* Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 2, 233, 240 (1979) (recognizing that lock-in and switching costs can increase due to human capital investments such as specialized training).

50. Gideon Parchomovsky & Peter Siegelman, *Towards an Integrated Theory of Intellectual Property*, 88 VA. L. REV. 1455, 1460–61 (2002).

51. For example, Ticketmaster, Inc. uses exclusivity contracts with major venues to create lock-in and switching costs that raise significant barriers to entry for any potential new entrant in the ticket servicing business. *See* Orozco, *supra* note 28, at 720.

The prevailing scholarly view of attorneys as transaction cost engineers is accurate insofar as it describes how attorneys lower transaction costs to facilitate short-term transactions. Corporate legal strategists, on the other hand, are a subset of attorneys who excel at using legal means to strategically *raise* long-term switching costs among key stakeholders.[52] These strategic attorneys can also raise transaction costs during contracting, litigation, legislative processes, or administrative proceedings when it furthers business objectives.[53]

The rise of in-house legal counsel plays a role in the increased use and sophistication of corporate legal strategy.[54] Chief legal counsel within corporations increasingly seek to reduce the amount of legal expense devoted to external legal counsel.[55] They also increasingly look for ways to use the law to create value and gain prominence within the company's executive suite.[56] In this capacity, in-house legal counsel become regarded by other executives as a source of strategic business advice in addition to legal counsel.[57]

The strategic business dimensions of lawyering, however, have not been well-appreciated in legal education or scholarship due to the prevailing view of attorneys as transaction cost

---

52. *Id.* at 713; DiMatteo, *supra* note 44, at n.165.

53. FRANK, *supra* note 13; Fleischer, *supra* note 30, at 236.

54. *See* Larry E. Ribstein, *The Death of Big Law*, 2010 WIS. L. REV. 749, 760, 778 (discussing how the rise of in-house lawyers leads to greater specialization and less reliance on the reputational capital of big law firms); Leslie Brokaw, *Is it Time to Hire a Chief Legal Strategist?*, MIT SLOAN MGMT. REV. (Dec. 30, 2014), http://sloanreview.mit.edu/article/is-it-time-to-hire-a-chief-legal-strategist/.

55. *See* MARC GALANTER & THOMAS PALAY, TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM, 50 (1991) ("[I]n their relationship with outside law firms, today's enlarged corporate legal departments imposed budgetary restraints, exert more control over cases, demand periodic reports, and engage in comparison shopping among firms."); John P. Heinz et al., *The Scales of Justice: Observations on the Transformation of Urban Law Practice*, 27 ANN. REV. SOC. 337, 347–48 (2001) (discussing how the increased complexity of the in-house attorney's role within a corporation reduced the status and role of external legal counsel).

56. *See* Nelson & Nielsen, *supra* note 34, at 465, 482; Marcos A. Mendoza, *Which One Are You: Cop, Counsel or Entrepreneur?* CORP. COUNS., http://www.corpcounsel.com/id=1202738587150/Which-One-Are-You-Cop-Counsel-or-Entrepreneur?mcode=1202615625483&curindex=0.

57. Nelson & Neilsen, *supra* note 34, at 481–83.

engineers.[58] That viewpoint correctly emphasizes attorney's ability to reduce transaction costs to achieve short-term transactional efficiency and increase social welfare.[59] This Article proposes an expanded view of entrepreneurial transactional attorneys who facilitate corporate legal strategy.[60] Attorneys who excel at implementing corporate legal strategy may certainly behave like transaction cost engineers. What differentiates them, however, from the majority of attorneys is their ability to use legal means to raise switching costs and other transaction costs that further their client's long-term strategic business objectives.[61]

Attorneys who raise transaction costs and align themselves too closely with their clients' business interests may be perceived as unscrupulous "hired guns."[62] A vigorous debate has taken place among those who consider hired-gun attorneys as injurious to the legal profession and the professionally independent, lawyer–statesman ideal.[63] One can certainly be a legal strategist, however, without acting like a hired gun. This would involve respecting professional norms and ethical rules of attorney conduct.[64] It would also involve drawing a line with respect to behavior that lowers social welfare and that violates important business norms, as occurs in cases of strategic legal bullying.[65] On the other hand, those attorneys who disregard professional ethics to advance their clients' narrow business interests behave like hired guns and are likely to be the type of attorneys who enable strategic legal bullying.[66]

---

58. *See* Gilson, *supra* note 45.
59. *Id.*
60. *See* Wroldsen, *supra* note 45, at 761–62.
61. *See* Bagley, *supra* note 36; Bagley & Roelling, *supra* note 41 (arguing legal capabilities can be a source of strategic advantage).
62. ANTHONY T. KRONMAN, THE LOST LAWYER: FAILING IDEALS OF THE LEGAL PROFESSION (1993) (discussing the decline of the lawyer–statesman ideal and how this ideal is challenged by those who are primarily motivated by self-interest rather than citizenship).
63. *Id.*
64. *See* Christopher J. Whelan & Neta Ziv, *Law Firm Ethics in the Shadow of Corporate Social Responsibility*, 26 GEO. J. LEGAL ETHICS 153 (2013).
65. *Id.*
66. *See* Kath Hall & Vivien Holmes, *The Power of Rationalisation to Influence Lawyers' Decisions to Act Unethically* 11 LEGAL ETHICS 137 (2008); Kimberly Kirkland, *Ethics in Large Firms: The Principle of Pragmatism*, 35 U. MEM. L. REV. 631, 634 (2005).

The strategic use of the law to raise switching costs should be permissible, to an extent. For example, the strategic use of contract exclusivity terms may enable parties to commit to one another, build trust, and facilitate productive investments that otherwise would not be made.[67] Such strategic contracting should be permissible as a social welfare-enhancing activity.[68] Raising a buyer's switching costs, for example, can be a social welfare-enhancing activity.[69] In other cases, raising transaction costs in both private and public ordering contexts is socially wasteful since it subverts the notion of efficient market transactions.[70] In its most pernicious form, corporate legal strategy lowers social welfare and crosses into the domain of rent-seeking.[71]

B. *Rent-Seeking*

Rent-seeking activities employ scarce resources to transfer wealth from others instead of using those resources to create new wealth.[72] Rent-seeking may involve wealth transfers solely

---

67. DiMatteo, *supra* note 44, at 736 (discussing the case of a contractor and a subcontractor crafting a number of agreements as "an example of strategically bundling contracts" and as a means to "gradually build a strategic alliance through the sequencing of a number of discrete contracts followed by an agreement for continuing collaboration"); R. Preston McAfee & Marius Schwartz, *Opportunism in Multilateral Vertical Contracting: Nondiscrimination, Exclusivity, and Uniformity*, AM. ECON. REV., Mar. 1994, at 210, 225 (discussing exclusivity terms as a contractual means to reduce opportunism among contracting parties); Steven R. Salbu & Richard A. Brahm, *Strategic Considerations in Designing Joint Venture Contracts*, 1992 COLUM. BUS. L. REV. 253, 296–302 (strategic contract terms such as incentive clauses help minimize opportunism in joint ventures).

68. Salbu & Richard, *supra* note 67, at 296–302.

69. Parchomovsky & Siegelman, *supra* note 50, at 1474–81 (combining utility patents with trademarks to create brand loyalty does not generate any social deadweight losses).

70. WILLIAMSON, *supra* note 45; Coase, *supra* note 45.

71. KLEIN, *supra* note 3, at 20 ("[F]raudulent or strategic litigation among competitors may be motivated by rent-seeking . . . .").

72. James M. Buchanan, *Rent-Seeking and Pro?t-Seeking, in* TOWARD A THEORY OF THE RENT-SEEKING SOCIETY 3, 7–8 (J.M. Buchanan, R.D. Tollison & G. Tullock eds., 1980). I greatly appreciate David Haddock's recommendation to consult this source. *See also* Johann G. Lambsdorff, *Corruption and Rent-Seeking, in* 113 PUBLIC CHOICE 97, 100 (2002); Robert D. Tollison, *Rent Seeking, in* PERSPECTIVES ON PUBLIC CHOICE 506, 506 (Dennis C. Mueller ed., 1997) (defining rent-seeking as the "socially costly pursuit of wealth transfers").

among private parties, for example in cases that involve theft or charity.[73] The state often plays a key role since it defines laws and property rights that mandate or enable rent-seeking.[74] Rent-seeking activities are often socially wasteful due to the presence of transfer costs.[75] A transfer cost attaches to rent-seeking behavior when the state or a party has to expend resources to obtain, maintain, or prevent others from obtaining a rent.[76] For example, a company that seeks to enact or maintain a regulation that transfers wealth has to hire lobbyists and make political contributions.[77] In a purely private context, purchasing locks to protect property is a socially wasteful transfer cost that is necessary to prevent the rent-seeking behavior called theft.[78] Strategic legal bullying is a form of rent-seeking since it relies on a baseless legal position and exploits the inherently high costs of the legal system to transfer and extract wealth from the legal bullying target.[79] The transfer costs related to strategic legal bullying involve attorney's fees, court fees, the time managers must devote to legal matters, and the societal expense of maintaining a judicial and enforcement apparatus to resolve this costly behavior.

From an economic standpoint, legal bullying frequently occurs because it is effective and rational to engage in this

---

73. Lambsdorff, *supra* note 72, at 100.

74. E.g. taxes, subsidies, quotas, license monopolies, regulation. *Id.* at 101.

75. *Id.* at 100 ("Expenses for enacting regulation in industry are another example for transfer costs, including salaries to lawyers and lobbyists.").

76. The seminal work on transfer costs in relation to rent-seeking was developed by Gordon Tullock. *See* Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 W. ECON. J. 224, (1967).

77. *See* Richard L. Hasen, *Lobbying, Rent-Seeking and the Constitution*, 64 STAN. L. REV. 191, 228–31 (2012) (discussing how lobbying is a form of rent-seeking since it is purely redistributive and diverts economic resources away from value-creating activities.); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 13 (1971) (discussing how the content of lobbyist-derived regulation and legislation are likely to be inefficient).

78. Lambsdorff, *supra* note 72.

79. *See* Balmer, *supra* note 18, at 63 ("While the additional costs of doing business imposed on a smaller firm by a dominant firm's predatory pricing or territorial allocation policy may reduce profits and eventually squeeze the small firm out of the market, the added costs bear at least some relation to the firm's sales or share of the market. . . . Predatory litigation, on the other hand, imposes high fixed costs, which are independent of a firm's market position.").

practice, albeit highly unethical.[80] Take the case of trademark bullying, which occurs when a large company asserts a weak trademark claim against a smaller party.[81] A simple economic model explains why some large companies become trademark bullies and the following case offers insight into the matter. The large fast food service operator Chik-fil-A created the valuable phrase "Eat Mor Chikin" and protected it with a slogan trademark.[82] A much smaller company, which is not even a direct competitor, applied to register their "Eat More Kale" mark.[83] Even though the probability of success is very low for Chik-fil-A to win a dubious trademark infringement claim, it is still rational and beneficial for them to oppose the small company's trademark registration after taking litigation costs into account.[84] As long as the expected value from litigation (value of the Eat Mor Chikin brand multiplied by the probability of success) is higher than the litigation costs, it is rational to oppose the new Eat More Kale mark, which is what transpired in this case.[85] It is, therefore, economically rational for large companies with high-value assets to engage in strategic trademark bullying since the expected value often exceeds litigation costs.[86]

---

80. *C.f.* Jessica M. Kiser, *To Bully or Not to Bully: Understanding the Role of Uncertainty in Trademark Enforcement Decisions*, 37 COLUM. J.L. & ARTS 211 (2014) (discussing legal bullying as a form of irrational behavior due to several biases such as the endowment effect).

81. Irina D. Manta, *Bearing Down on Trademark Bullies*, 22 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 853, 854 (2012); DEP'T OF COMMERCE, TRADEMARK LITIGATION TACTICS AND FEDERAL GOVERNMENT SERVICES TO PROTECT TRADEMARKS AND PREVENT COUNTERFEITING, at 15 (2011), http://www.uspto.gov/ip/TMLitig ationReport_final_2011April27.pdf.

82. EAT MOR CHIKIN, Registration No. 2,010,233. This factual scenario is drawn from an actual trademark dispute.

83. EAT MORE KALE, Registration No. 4,795,440.

84. The claim is dubious since the likelihood of confusion factors point to a weak case and the mark is not diluted since it is not famous. *See In re* E. I. du Pont de Nemours & Co., 476 F.2d 1357, (C.C.P.A. 1973) (listing thirteen likelihood of confusion factors). Chik-fil-A actually opposed the Eat More Kale mark. *See* Orozco, *supra* note 25.

85. Issues that involve higher stakes have a much higher chance of being litigated. POSNER, *supra* note 14, at 600.

86. *See* Myers, *supra* note 18, at 602–07 (developing a formal economic model of predatory litigation that takes into account litigation costs and probability of victory and how the model asymmetrically benefits large companies versus small companies).

Although scholars view trademark bullying as a socially wasteful practice, this crude economic model suggests that might not always be the case. As long as the parties have resources to submit their legal claims, tenuous as they may be, for a decision on the merits, this behavior allows the parties to price the risk of losing or reaching a settlement by assessing their respective properties, valuations, and risk preferences.[87] What makes this model quickly begin to lose credibility in practice is the high cost of litigation.[88] This becomes an important factor in the strategic decision-making process since the bullying target is unable to finance its day in court. Knowing this, the larger company can discount the cost of litigation since a quick and favorable settlement is likely to occur.

In practice, the resource-rich party can use the high cost of litigation advantageously as a strategic factor to decide whether to pursue a claim.[89] The model breaks down since the litigation cost cannot be borne by the smaller party. In these cases, the odds of winning increase to one hundred percent regardless of the legal merits of the case. When one party exploits this scenario by advancing or defending a baseless legal position it is appropriate to label the behavior as strategic legal bullying and rent-seeking.[90] Otherwise, rational actors who appear to be legal bullies are not as long as both parties have adequate information and can finance litigation.

Strategic legal bullies exploit the legal system's high transaction and transfer costs, most notably court filing and attor-

87. *See* Mnookin & Kornahuser, *supra* note 10, at 968–74.

88. Proceeding to a jury verdict is notoriously expensive. For example, according to the American Intellectual Property Law Association (AIPLA), the average cost of a jury trial for a patent infringement lawsuit ranges between $970 thousand and $5.9 million, depending on the amount of damages at stake. AIPLA, 2013 REPORT OF THE ECONOMIC SURVEY (2013).

89. KLEIN, *supra* note 3, at 16–17.

90. Strategic legal bullying is broader than sham or predatory litigation since in many cases the strategic legal bully does not initiate a lawsuit, and in some cases is the defendant. They still, however, abuse the high costs of the legal or regulatory system to their advantage. In cases that involve sham or predatory litigation the predator is almost always the plaintiff and the target is normally the defendant. *See* Myers, *supra* note 18, at 597. The literature on sham litigation likewise recognizes that strategic litigation that is predatory seeks to achieve a goal collateral to wining a judgment on the merits. *See* KLEIN, *supra* note 3, at 10.

ney's fees.[91] They also exploit the knowledge and learning costs associated with litigation. Strategic legal bullies are habitual users of the litigation process and have deep levels of knowledge and expertise with respect to the legal system and its complex, arcane procedures.[92] The costs of learning the complex technical procedures used by legal bullies can be inordinate to the small inexperienced parties that are the customary targets of legal bullying.[93] Strategic legal bullies knowingly exploit this information asymmetry.

Strategic legal bullies often raise financial and information transfer costs against those who are ill-equipped to bear them.[94] For example, a strategic legal bully would file their case in a remote jurisdiction, file multiple claims and counterclaims, and file numerous motions and requests for hearings on diverse matters such as changes in venue, jurisdiction, appeals, and claims for attorney's fees.[95] They may also strategically delay the case to weaken the opponent's evidentiary standing.[96] In the context of legal bullying, these rent-seeking activities impose transfer costs, greatly weaken the small party's

---

91. Myers, *supra* note 18, at 597 n.150.

92. *See id.* 599 (discussing how predatory litigators may achieve economies of scale through their repeated use of the legal system to great disadvantage of smaller inexperienced parties). In the case of Chik-fil-A, the company had sent thirty cease-and-desist letters to other small companies before it had sent its letter to Eat More Kale.com. *See* Cease-and-Desist Letter from Auma N. Reggy, Attorney, Arnall, Golden, Gregory, L.L.P., to Daniel P. Richardson, Attorney, Tarrant, Gillies, Merriman & Richardson (Oct. 4, 2011) (on file with author).

93. *See* Balmer, *supra* note 18, at 63–64 (discussing how the costs of sham litigation inordinately fall on smaller inexperienced players such as small businesses).

94. For example, the larger party may file a motion to remove the case to their home jurisdiction.

95. *See, e.g.*, Vermont v. MPHJ Tech. Invs., LLC, 803 F.3d 635, 638 (Fed. Cir. 2015) (defendant patent troll removed the case from state court twice to the U.S. district court and filed multiple appeals on adverse rulings of law related to the pleadings).

96. *See* LoPucki & Weyrauch, *supra* note 2, at 1460 ("The fact that delay affects case outcomes is widely recognized. What is not widely recognized is the capacity of legal strategy to manipulate the extent of delay."); Daniel T. Ostas, *Legal Loopholes and Underenforced Laws: Examining the Ethical Dimensions of Corporate Legal Strategy*, 46 AM. BUS. L.J., 487, 505–06 (2009) (discussing how delay can affect the chances of winning a claim and how various tactical delays exist, such as pretrial motions, challenges to jurisdiction, and delayed discovery).

negotiating power, and greatly increase the likelihood of a settlement advantageous to the legal bully.[97] Strategic legal bullying imposes additional social costs since it increases the chance that a baseless legal claim will be successfully asserted against multiple targets and used to stifle the innovation and efficiency that results from competition. The practice casts a long detrimental shadow on the law since others will be dissuaded from engaging in productive economic activity as a result of faulty or sham precedent.[98]

C. *The Legal Entitlement Frontier*

Private parties bargain in the shadow of the law.[99] The law, however, is hardly ever precise and in most cases the legal issue is uncertain with many possible outcomes or interpretations.[100] Strategic legal bullying compounds this problem by overreaching on the basis of weak or non-existent claims and illegitimately extends the shadow of the law into impermissible territory. The practice extends the law near or beyond the point where legal entitlements are valid, i.e., a "legal entitlement frontier," and has a chilling effect on future legitimate business practices.[101]

For example, the Eat Mor Chikin mark would be asserted as a valid property entitlement and have a high chance of being successfully asserted on the merits against a direct competitor's use of the correctly spelled Eat More Chicken mark. When Eat Mor Chikin was litigated against Eat More Kale,

---

97. *See* Mnookin & Kornhauser, *supra* note 10, at 972 ("The party better able to bear the transaction costs, whether financial or emotional, will have an advantage in divorce bargaining."); Myers, *supra* note 18, at 591 ("[A]nother way in which predatory litigation can raise rivals' costs is through onerous or burdensome settlement terms. A rival may agree to settle a case, paying lump sum damages or a stream of payments, rather than bear the burden and expense of defending the strike suit.").

98. For example, Chik-fil-A was successful in using the same trademark bullying strategy against thirty small companies prior to the Eat More Kale case. Cease-and-Desist Letter from Auma N. Reggy, *supra* note 92. As far as the author can tell, "sham precedent" is a novel term. As it is used here it refers to the deceitful practice of asserting a baseless legal position that increases its persuasive powers the more often it is successfully asserted against weak parties who lack the means to challenge it in court.

99. *See* Mnookin & Kornhauser, *supra* note 10, at 997.

100. *See id.* at 969; LoPucki & Weyrauch, *supra* note 2, at 1413.

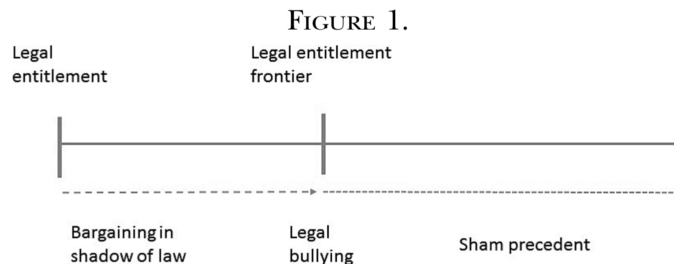
101. *See* Cease-and-Desist Letter from Auma N. Reggy*, supra* note 92.

however, this occurred near Chik-fil-A's legal entitlement frontier since the probability of winning was fairly low, although not zero percent.[102] If Eat Mor Chikin was asserted against the totally unrelated financial services mark—"What's in your wallet?"—it is fair to say that at that point Chik-fil-A crossed its legal entitlement frontier and had a near zero chance of winning under the likelihood of confusion test in trademark law.[103]

When strategic legal bullies assert claims near or beyond the legal entitlement frontier, their target is placed in a weak position since it has to exit the market or bargain within the shadow of rights that have been wrongfully extended.[104] Since each case is unique, good judgment is necessary to decide whether the bully's position is baseless and amounts to legal bullying. In some cases, a baseless legal position is extended multiple times in future cases. At this point, the bully creates the illusion of a valid claim through what is labeled here as "sham precedent." The illusion of sham precedent can have a snowball effect since it becomes stronger each time a target capitulates.[105] As an egregious form of rent-seeking and legal abuse, the use of sham precedent has severe negative economic consequences since it deters what would be otherwise productive economic activity and competition.

Figure 1 below illustrates these relationships.

FIGURE 1.



102. The U.S. Patent and Trademark Office denied Muller-Moore's Eat More Kale application on likelihood of confusion grounds; however, it had twice reached the opposite conclusion during the trademark prosecution process.

103. *See In re* E. I. du Pont de Nemours & Co., 476 F.2d 1357 (C.C.P.A. 1973) (listing thirteen likelihood of confusion factors).

104. Mnookin & Kornhauser, *supra* note 10, at 968–69.

105. *See* Cease-and-Desist Letter from Auma N. Reggy, *supra* note 92.

As an unethical and illegitimate practice, strategic legal bullying also damages the public's perception of the law as an enabler of justice. In our market-based economy, justice in the business context is closely related to the notion of fair competition as operationalized by the adherents of the Chicago School of law and economics ("Chicago School"). Reduced to a maxim, the Chicago School promotes judicial rules and doctrines that advance economic efficiency, or maximum social welfare.[106] The Chicago School is skeptical of the government's ability to promote these aims with respect to private market behavior when transaction costs do not impede private bargaining.[107]

For example, the Federal Trade Commission (FTC) recently issued guidelines related to how it would enforce unfair competition claims. The FTC defined unfair competition as "an act or practice that (1) harms or is likely to harm competition significantly and (2) lacks cognizable efficiencies."[108] As part of its guidelines in prosecuting unfair competition, the FTC adopted a Chicago School approach since it declared that it "will not consider non-economic factors, such as whether the practice harms small business or whether it violates public

106. *See* POSNER, *supra* note 14. The Chicago School's influence on the law has been significant and pervasive. Herbert Hovenkamp, *Positivism in Law and Economics*, 78 CALIF. L. REV. 815, 821 (1990) ("The stated methodology of Chicago School law and economics is at once legal positivism and economic positivism. Positive economic analysis of law seeks to identify a legal rule and then make one or more descriptive statements about the economic effects of that rule.").

107. U.S. competition law from the Chicago School perspective was summarized by Judge Frank Easterbrook as "a profoundly skeptical program" that is comprised of "little other than prosecuting plain vanilla cartels and mergers to monopoly." Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696, 1701 (1986). Also, Chicago School scholars "typically propose the attainment of economic efficiency to be the exclusive basis for the design and application of antitrust rules." William E. Kovacic, *The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix*, 2007 COLUM. BUS. L. REV. 1, 22.

108. Statement of Joshua D. Wright, Commissioner of the Fed. Trade Commission (June 19, 2013), https://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-joshua-d.wright/130619umcpolicystatement.pdf.

morals, in deciding whether to prosecute unfair methods of competition."[109]

The analysis of unfair or anticompetitive behavior from the Chicago School perspective assesses behavior in relation to its effects as opposed to any intrinsic notions of fairness, morals, or justice.[110] Many of the strategic legal bullying practices outlined in this article should be deemed impermissible per se from an intrinsic fairness or ethical perspective; however, these practices are also detrimental from the Chicago School's perspective because they exploit transfer costs and reduce social welfare as a type of rent-seeking behavior. In practice, however, strategic legal bullying is seldom regulated since that would require a judicial assessment of the legal bullying practice. The vast majority of legal bullying cases never reach a decision on judicial merits because the targets lack financial means to obtain judicial redress.

A potential remedy offered by economic analysis is to develop judicial rules and doctrines that lower transaction costs. The U.S. litigation system has been continually vexed, however, by high transaction costs, delay, and uncertainty.[111] These intractable aspects of the legal system pose a major barrier for many to access the legal system and obtain justice.[112]

---

109. *Id.* As a form of rent-seeking, strategic legal bullying would be classified as a form of unfair competition within the FTC's definition. The U.S. Supreme Court also espouses the Chicago School perspective of efficiency in important antitrust decisions, adopting the Chicago School viewpoint on predatory pricing in antitrust. *See, e.g.*, Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 589 (1986) ("[T]here is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful."). In contrast, judges that operationalize unfair competition cases outside of a law and economics approach base their reasoning and doctrines on the "rules of fair play," the "morals of the marketplace," and the "principles of honesty and fair dealing." *See* Smith, *supra* note 13, at 1123.

110. For example, economists often take issue with judicial application of the unconscionability doctrine in contract law. *See* Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293–315 (1975) (arguing in favor of an unconscionability doctrine with much more limited scope to facilitate efficient contract terms).

111. *See* Renee Newman Knake, *Democratizing the Delivery of Legal Services*, 73 OHIO ST. L.J. 1, 2 (2012) ("[O]ne of the most significant problems faced by the legal profession in the twenty-first century is the ineffective delivery of legal services. . . . Lawyers are out of reach for most individuals unless they enjoy extreme affluence or subsist at poverty levels.").

112. *Id.*

The following Part will examine various cases where strategic legal bullies exhibit rent-seeking behavior.

II.
Cases of Strategic Legal Bullying

This Part will discuss strategic legal bullying practices as defined earlier in the areas of employment, intellectual property, commercial speech, business regulation, and anticompetitive behavior. Prior discussions of abusive legal behavior have focused on sham litigation.[113] As this Part demonstrates, strategic legal bullying encompasses a much broader set of activities than what has been previously recognized.

A. *Employment*

Some employers use their legal expertise, resources, and bargaining power to write employment contracts with oppressive, unenforceable terms. These terms amount to legal bullying since they are not enforceable, yet they are successfully asserted against employees who are typically unsophisticated and who face the threat of expensive and protracted litigation. An example of an employer engaging in this practice is fast food operator Jimmy John, whose employment contracts with its sandwich makers and delivery drivers include non-compete terms as a standard employment provision.[114] Most scholars agree that these non-compete terms are not enforceable since they fail to protect a legitimate business interest and are unreasonable in their scope.[115] These contracts are unreasonable since they broadly define a competitor as any establishment that earns at least ten percent of its revenues from sandwiches and is within two miles of an existing Jimmy John's location.[116]

---

113. *See* Myers, *supra* note 18.

114. *See* Mitch Lipka, *This Jimmy John's Labor Practice is Drawing Fire*, CBS News (Dec. 23, 2014, 4:42 PM), http://www.cbsnews.com/news/jimmy-johns-employee-non-compete-clause-reportedly-target-by-ny-attorney-general/ (reporting that the New York Attorney General is investigating the covenants and believes that they raise "serious concerns regarding the legality" of the agreement).

115. *See* Norman D. Bishara & David Orozco, *Using the Resource-Based Theory to Determine Covenant Not to Compete Legitimacy*, 87 Ind. L.J. 979 (2012) (discussing the legitimate business interests in enforceable non-compete clauses as they relate primarily to knowledge-based rights).

116. *See* Lipka, *supra* note 114.

The harm in this case is incurred by employees, competitors, and consumers.

Another example of legal bullying in the employment area involves wage theft. Wage theft occurs when an employer fails to pay the required state or federal minimum wage and fails to meet overtime pay requirements.[117] This practice is fairly common and harms low-wage workers significantly.[118] Some firms raise the cost of reporting wage theft complaints by exploiting the legal knowledge asymmetry between the company and its low-wage workers.[119] Companies also engage in legal bullying when they threaten retaliation if a worker takes action or complains about wage theft.[120] In these cases, companies create a hostile environment for anyone who might submit a claim and indirectly signal that an employee who files a claim will suffer negative repercussions.[121]

Legal bullying in the workplace also occurs when employees are intentionally misclassified as independent contractors.[122] Misclassification occurs when an employer classifies a worker as an independent contractor when the law would categorize them as employees.[123] This practice deprives an employee of legally mandated benefits, wages, and protections afforded under various safety and anti-discrimination statutes.[124]

---

117. *See, e.g.*, *Wage and Hour Division's Complaint Intake and Investigative Processes Leave Low Wage Workers Vulnerable to Wage Theft: Testimony Before the Comm. on Educ. & Labor,* 111th Cong. 1 (2009) (joint statement of Gregory D. Kutz, Managing Director & Jonathan T. Meyer, Assistant Director, Forensic Audits & Special Investigations).

118. *Id.* at 23; Charlotte S. Alexander & Arthi Prasad, *Bottom-Up Workplace Law Enforcement: An Empirical Analysis*, 89 IND. L.J. 1069, 1085 (2014) ("[T]hirty percent of tipped workers had not been paid lawfully, and 70% of workers who had worked beyond their scheduled shift were not paid for this extra working time.").

119. *See* Charlotte S. Alexander, *Anticipatory Retaliation, Threats, and the Silencing of the Brown Collar Workforce*, 50 AM. BUS. L.J. 779 (2013).

120. *Id.*

121. Alexander & Prasad, *supra* note 118, at 1089.

122. CHARLOTTE ALEXANDER & ANNA HALEY-LOCK, NOT ENOUGH HOURS IN THE DAY: WORK HOUR INSECURITY AND A NEW APPROACH TO WAGE AND HOUR REGULATION 2–3 (2013).

123. Charlotte S. Alexander, *Misclassification and Antidiscrimination: An Empirical Analysis*, 101 MINN. L. REV. (forthcoming 2017).

124. *Id.* at 2.

According to studies, misclassification is prevalent and mainly harms female workers and workers of color.[125]

For example, several cases have settled where professional football clubs have been sued by cheerleaders who claimed that they were misclassified and denied minimum wage and overtime pay.[126] In one of these cases, the cheerleaders had signed contracts that classified them as independent contractors even though they were subject to significant control by their employers, underwent humiliating treatment, and were subjected to long work hours at very low pay.[127] In another egregious case, a subcontractor required construction workers to become members of a limited liability company to avoid employee classification.[128]

Another type of legal bullying intends to silence whistleblowers with overly-broad confidentiality agreements.[129] Recently, the Securities and Exchange Commission (SEC) settled a case with a company that made employees sign confidentiality agreements that required them to notify the company of any external communications related to whistleblowing prior to communicating with the external party.[130] According to the SEC, this practice violates section 21F of the Dodd–Frank Act[131] and would stifle whistleblowers' reports of

125. *Id.* at 5–18; *Wage and Hour Division's Complaint*, *supra* note 117.

126. *See* Charlotte S. Alexander & Nathaniel Grow, *Gaming the System: The Exemption of Professional Sports Teams from the Fair Labor Standards Act*, 49 U.C. DAVIS L. REV. 123, 125–26 (2015) (discussing several cases where cheerleaders sued professional sports teams for wage misclassification).

127. *See* Complaint at 12–13, Jaclyn S. v. Buffalo Bills, Inc., No. 804088/2014 (N.Y. Sup. Ct. Apr. 22, 2014).

128. Press Release, U.S. Dep't of Labor, Paul Johnson Drywall Inc. Agrees to Pay $600,000 in Back Wages, Damages & Penalties Following U.S. Labor Department Investigation (May 19, 2014), http://www.dol.gov/opa/media/press/whd/WHD20140827.htm (discussing the unlawful classification of LLC members as employees).

129. *See* Terry Morehead Dworkin & Elletta Sangrey Callahan, *Buying Silence*, 36 AM. BUS. L.J. 151, 169–73 (1998).

130. Scott Higham, *SEC Says Confidentiality Agreements May Have 'Muzzled' Whistleblowers at Top Government Contractor*, WASH. POST (Apr. 1, 2015), https://www.washingtonpost.com/news/federal-eye/wp/2015/04/01/sec-says-major-federal-contractor-tried-to-intimidate-and-muzzle-whistleblowers/?postshare=8211447356425220&tid=SS_tw.

131. The Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 21(f) (2010).

illegal conduct to regulators.[132] These abusive confidentiality agreements can have a chilling effect on whistleblowers since they state that the failure to comply with the terms could lead to disciplinary action or termination.[133] These clauses also stifle the legislative intent behind many of the whistleblowing statutes, which offer rewards or bounties as a means to encourage whistleblowing.[134]

B. *Intellectual Property*

The field of intellectual property is prone to various cases of strategic legal bullying as well. In the trademark arena, large companies have been known to bully small innovative competitors by aggressively asserting weak trademark claims.[135] The Simply Mayo and Eat More Kale cases discussed earlier are just a few instances of this behavior. The outcome of these cases typically results in the smaller entity agreeing to the larger company's demands, which involve some kind of costly cease-

132. To implement section 21F of the Dodd–Frank Act, the SEC implemented Rule 21F-17, which states: "No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications." 17 C.F.R. § 240.21F-17 (2011).

133. The language in the confidentiality agreement in this case stated:

> I understand that in order to protect the integrity of this review, I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the Law Department. I understand that the unauthorized disclosure of information may be grounds for disciplinary action up to and including termination of employment.

KBR, Inc., Order Instituting Cease-and-Desist Proceedings Pursuant to section 21C of the Securities and Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (Securities & Exchange Commission Apr. 1, 2015), https://www.sec.gov/litigation/admin/ 2015/34-74619.pdf.

134. *See* Jennifer M. Pacella, *Advocate or Adversary? When Attorneys Act as Whistleblowers*, 28 GEO. J. LEGAL ETHICS 1027, 1033–45 (2015) (discussing the federal securities laws and their use of bounties to promote whistleblowing).

135. Manta, *supra* note 81; DEP'T OF COMMERCE, TRADEMARK LITIGATION TACTICS AND FEDERAL GOVERNMENT SERVICES TO PROTECT TRADEMARKS AND PREVENT COUNTERFEITING (2011), http://uspto.gov/ip/TMLitigationReport_final_2011April27.pdf.

and-desist activity such as rebranding or withdrawing from the market.[136]

In the patent arena, non-practicing entities, or "patent trolls," can at times behave like legal bullies.[137] This is true when they target small entities such as start-up companies, small businesses, or non-profits.[138] According to one scholar, start-up companies are often the targets of patent troll suits, and many small company targets settle these weak claims because they cannot afford to fight them.[139] These large companies target smaller companies and employ legal harassment tactics as a method to gain strategic advantage.[140]

A recent case in Vermont highlights the abusive tactics that patent bullies employ.[141] As alleged in that case, a patent troll operated through various shell companies and repeatedly sent letters to small businesses and non-profit entities to solicit payment for the alleged infringement of very broad software patent claims.[142] These claims were based on patents that had been voluntarily dismissed from litigation by the patent holder in previous cases.[143] The letters threatened litigation nonetheless and attached draft complaints even though the company had never filed a patent infringement lawsuit in Vermont and had settled a nominal amount of cases for an average amount of less than $900.[144]

---

136. *See* Kiser, *supra* note 80, at 219–20 (discussing the costs imposed on trademark bullying targets that include destroying inventory and packaging, changing advertisement materials, reincorporating with a different name, and the loss of goodwill); Lunsford, *supra* note 24.

137. *See* David Orozco, *Administrative Patent Levers*, 117 PENN. ST. L. REV. 1, 9 (2012).

138. Colleen V. Chien, *Startups and Patent Trolls*, 17 STAN. TECH. L. REV. 461, 477–78 (2014).

139. *Id.*

140. *See* Smith, *supra* note 13, at 1099–1102 (discussing several examples of large companies targeting small companies with baseless patent and trade secret claims to achieve anticompetitive results).

141. Consumer Protection Complaint, State of Vermont v. MPHJ Tech. Invs., LLC, No. 282-5-13Wncv, 2014 WL 5795264 (Super. Ct. Vt. May 8, 2013), http://www.atg.state.vt.us/assets/files/Vermont%20v%20MP]HJ%20 Technologies%20Complaint.pdf.

142. *Id.*

143. *Id.*

144. *Id.*

Other firms adopt an overly aggressive assertion model with weak copyright claims and are labeled copyright trolls.[145] These entities accumulate large copyright portfolios and aggressively seek out infringers.[146] Sometimes they price their settlement offers opportunistically low to induce a quick settlement.[147] Many of the targets include small- and medium-sized businesses and non-profits.[148] These copyright trolls engage in strategic legal bullying since their claims are baseless.[149] Their weak or baseless claims are then aggressively enforced with a legal threat.[150]

Another legal bullying practice in the intellectual property area occurs when a large company willfully breaches a smaller entity's intellectual property and engages in what

---

145. *See* Brad A. Greenberg, *Copyright Trolls and Presumptively Fair Uses*, 85 U. COLO. L. REV. 53, 53–55 (2014) (discussing the emergence of new firms that threaten copyright litigation and the pursuit of statutory damages to extract quick lowball settlements from small unsophisticated parties and non-profits regardless of whether the use was legally protected); Pamela Samuelson, *Is Copyright Reform Possible?*, 126 HARV. L. REV. 740, 759 (2013) (suggesting reforms may be appropriate to address copyright trolls).

146. Greenberg, *supra* note 145, at 53. Getty Images exhibited copyright troll-like behavior when it sent a cease-and-desist letter to an attorney. The attorney litigated against Getty on the basis that he had never used Getty's images. *See* Joel Rothman, *Why We Sued Getty Images*, SCHNEIDER ROTHMAN (Aug. 20, 2014), http://www.sriplaw.com/sued-getty-images/.

147. Greenberg, *supra* note 145.

148. *Id.*

149. *Id.* at 59 (providing several examples of parties who assert weak copyright claims and defining a copyright troll as "a copyright owner who: (1) acquires a copyright—either through purchase or act of authorship—for the primary purpose of pursuing past, present, or future infringement actions; (2) compensates authors or creates works with an eye to the litigation value of a work, not the commercial value; (3) lacks a good faith licensing program; and (4) uses the prospect of statutory damages and litigation expenses to extract quick settlements of often weak claims").

150. For example, New York University law professor and copyright scholar Chris Sprigman agreed to represent an artist who was targeted by Katy Perry and accused of copyright infringement related to her Left Shark costume, which was popularized during a Super Bowl performance. Professor Sprigman's response to Katy Perry's attorneys' cease-and-desist letter is a well-researched and reasoned analysis for why the copyright claim to the Left Shark costume is unfounded. *See, e.g.*, Mike Masnick, *Left Shark Bites Back: 3D Printer Sculptor Hires Lawyer to Respond to Katy Perry's Bogus Takedown*, TECHDIRT (Feb. 9, 2015), https://www.techdirt.com/articles/20150209/11373729960/left-shark-bites-back-3d-printer-sculptor-hires-lawyer-to-respond-to-katy-perrys-bogus-takedown.shtml.

amounts to efficient intellectual property infringement.[151] When this occurs, a large company infringes knowing that the smaller party lacks the resources to challenge the action in court. For example, a U.S.-based entrepreneur in the handheld tool business claims this occurred when Sears broke off its business relationship and outsourced manufacturing of a similar "knock-off" product to China.[152] According to the small tool manufacturer, its patented, made-in-the-U.S.A. product was willfully infringed when Sears commercialized the low-cost and competing product.[153]

A large company can bully a smaller company by acquiring a portfolio of rights that it asserts against a small entity to receive an equity stake, cross-license, or strategic alliance. Something similar occurred when Facebook neared its initial public offering and Yahoo! asserted patent rights against it.[154] The threat of litigation was made to induce a settlement shortly before Facebook's initial public offering, amounting to something akin to extortion.[155] Facebook countered this bullying tactic by purchasing a portfolio of patent rights from its strategic partner Microsoft in order to countersue Yahoo![156] However, a smaller company without Facebook's considerable resources would likely have been forced to settle.

---

151. David Kappos et al., *From Efficient Licensing to Efficient Infringement*, N.Y. L.J. (Apr. 4, 2016), http://www.newyorklawjournal.com/id=1202753754690/From-Efficient-Licensing-to-Efficient-Infringement?slret urn=20160313093242; Wrzesinski, *supra* note 21; *see also* Christopher Coble, *Did Target Steal this IP?*, FINDLAW (May 26, 2015), http://blogs.findlaw.com/free_enterprise/2015/05/did-target-steal-this-ip.html (discussing how retailer Target was accused of stealing an independent designer's t-shirt design).

152. *See* Cheryl Beise, *Sears Cannot Slip Wrench Maker's Trade Dress Claims*, INTELL. PROP. L. DAILY (Jan. 23, 2015), http://www.dailyreportingsuite.com/ip/news/sears_cannot_slip_wrench_maker_s_trade_dress_claims.

153. Complaint at 10–12, Loggerhead Tools, L.L.C. v. Sears Holdings Corp., No. 12-cv-9033 2013 WL 5951832 (N.D. Ill. Nov. 6, 2013).

154. Nicholas Carlson, *Just So We're Clear: Facebook Totally Demolished Yahoo in the Patent Fight that Just Ended*, BUS. INSIDER (Jul. 13, 2012), http://www.businessinsider.com/just-so-were-clear-facebook-totally-demolished-yahoo-in-the-patent-fight-that-just-ended-2012-7.

155. Other similar cases involve trade secrets and confidentiality agreements. *See, e.g.*, CVD, Inc. v. Raytheon Co., 769 F.2d 842 (1st Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986) (describing a case where a large company sued former employees who had started a competing business alleging baseless trade secret claims and demanding a large royalty as a settlement).

156. *Id.*

C. *Commercial Speech*

To silence negative critiques made against them, companies sometimes assert tenuous disparagement claims against individuals or small businesses who make negative statements. These entities abuse the legal system by threatening legal action to silence any negative criticism. Faced with the prospect of expensive litigation, individuals capitulate and are effectively silenced. This litigious activity has been referred to as a strategic lawsuit against public participation, or a "SLAPP" suit.[157] In some cases, companies attempt to restrict consumers from posting truthful reviews online by adding non-disparagement clauses into contracts with customers.[158]

In one case, a blogger criticized a company called Magic Jack and its terms of service.[159] This negative online critique discussed how the end-user license agreement allowed Magic Jack to target ads based on its users' calls.[160] In response, Magic Jack filed a lawsuit against the blogger alleging that these statements were false and misleading and irreparably harmed Magic Jack's reputation.[161] The lawsuit demanded removal of the comments and unspecified damages.[162] The judge in the case declared the suit to be a SLAPP suit, granted the blogger's motion to dismiss the case, and awarded attorney's fees.[163]

In another case, the Dole Food Company filed a defamation suit against the filmmakers behind the documentary *Bananas!* because the film portrayed the company's activities in a

157. *See* Dwight H. Merriam & Jeffrey A. Benson, *Identifying and Beating a Strategic Lawsuit Against Public Participation*, 3 DUKE ENVTL. L. & POL'Y F. 17 (1993).

158. *See* Drew Fitzgerald, *Yelp, TripAdvisor Gain Legal Cover for Negative Reviews*, WALL ST. J. (Sept. 13, 2016) (discussing how small businesses attempted to silence truthful negative reviews through gag clauses in contracts), http://www.wsj.com/articles/yelp-tripadvisor-gain-legal-cover-for-negative-reviews-1473800424.

159. Complaint, MagicJack L.P. v. Happy Mutants L.L.C., No. CIV 091108 (Marin County Sup. Ct. 2009).

160. *Id.*

161. *Id.*

162. *Id.*

163. MagicJack L.P. v. Happy Mutants L.L.C., No. CIV 091108 (Marin County Sup. Ct. Jan. 5, 2010).

negative light.[164] This lawsuit was likewise declared to be a SLAPP suit and subsequently dismissed.[165] These two examples are outliers, however, since the targets of these SLAPP suits prevailed. In the majority of cases, the targets capitulate due to the high costs of litigation. The consequences of SLAPP suits extend beyond the cases at hand since these suits deter future speech and civic engagement.[166]

The attempt to suppress speech can cross into the intellectual property domain when parties abuse the Digital Millennium Copyright Act (DMCA) takedown notice process. In these cases, parties claim copyright or trademark ownership and make bulk claims of unlicensed use of their content, often in error.[167] Online service providers often take down material that property owners claim violates their rights even though a substantial portion of these takedown requests do not comply with basic legal requirements.[168]

D. *Business Regulation*

Sophisticated parties can also abuse the regulatory system to derive competitive advantage. In these cases, the legal bully exploits the high costs that arise from the complex institutional characteristics and procedures of our modern administrative state.[169] This type of bullying frequently occurs in industries that are traditionally regulated but also extends to those that are not.[170] For example, large alcohol manufactur-

---

164. David S. Olson, *Dole Ordered to Pay Attorneys' Fees for Filing Defamation Lawsuit without Merit*, FOAM CAGE (Dec. 3, 2010), http://foamcage.com/dole-ordered-to-pay-attorneys-fees-for-filing-defamation-lawsuit-lacking-in-merit.

165. *Id.*

166. GEORGE W. PRING & PENELOPE CANAN, SLAPPS: GETTING SUED FOR SPEAKING OUT 219 (1996).

167. Jeffrey Cobia, *The Digital Millennium Copyright Act Takedown Notice Procedure: Misuses, Abuses, and Shortcomings of the Process*, 10 MINN. J.L. SCI. & TECH. 387, 398 (2009).

168. *Id.* at 398–99.

169. *See* Mathew D. McCubbins et al., *Administrative Procedures as Instruments of Political Control*, 3 J.L. ECON. & ORG. 243, 244 (1987) ("[A] major puzzle . . . is why administrative law is as complex as it is . . . .").

170. *See* Myers, *supra* note 18, at 592–96 (discussing multiple cases where large incumbent firms abused the regulatory process to deter entry from start-up companies and competitors). These industries included traditionally regulated ones such as transportation, utilities and telecommunications but

ers, distributors, and retailers in Florida filed a regulatory challenge to injure the state's thriving microbrewery industry.[171] These large incumbent competitors filed an administrative challenge against the Florida Department of Business and Professional Regulation (DBPR).[172] The challenge sought to eliminate the DBPR's authority to license microbreweries' tasting rooms on the grounds that the DBPR lacked statutory authority to grant those permits. The claim was weak since there was statutory language indicating otherwise and the DBPR had been granting those licenses for several years.[173] The challenge was withdrawn after the microbrewery industry launched a legal-crowdfunding campaign that garnered significant financial backing and public support through social media and the mainstream press.[174]

As discussed earlier, Chik-fil-A strategically targeted the U.S. Patent and Trademark Office (PTO) to prevent Bo Muller-Moore, a Vermont entrepreneur and t-shirt maker, from registering the Eat More Kale mark.[175] Chik-fil-A filed a protest against this registration at the PTO and was successful in delaying the application and increasing Muller-Moore's registration costs. On December 18, 2011, Muller-Moore received an office action from the PTO indicating that they had

---

also included industries that are not traditionally regulated, such as real estate. *Id.*

171. Andrew Thurlow, *Challenge to Craft Beer Taprooms is Withdrawn*, JACKSONVILLE BUS. J. (Jan. 28, 2015), http://www.bizjournals.com/jacksonville/news/2015/01/28/challenge-to-craft-beer-taprooms-is-withdrawn.html.

172. *Id.*

173. *Id.* The Florida statute under which the DBPR derived authority to grant microbreweries' the license to operate tasting rooms states:

> (2)(a) Notwithstanding s. 561.22, s. 561.42, or any other provision of the Beverage Law, the division is authorized to issue vendor's licenses to a manufacturer of malt beverages, even if such manufacturer is also licensed as a distributor, for the sale of alcoholic beverages on property consisting of a single complex, which property shall include a brewery. However, such property may be divided by no more than one public street or highway.

FLA. STAT. §561.221 (2012).

174. *See* David Orozco, *The Use of Legal Crowdsourcing ("Lawsourcing") to Achieve Legal, Regulatory and Policy Objectives*, 53 AM. BUS. L.J. 169 (2016).

175. *Id.* at 174.

not found any similar or pending marks.[176] Shortly after, on December 22, the PTO sent Muller-Moore notice that a letter of protest had been submitted claiming that Chik-fil-A's marks would be infringed and requesting that the Eat More Kale application be denied.[177] On March 27, 2012, the PTO reversed their earlier position and denied Muller-Moore's application on the basis of likelihood of confusion with the Eat Mor Chikin mark.[178] It was only after Muller-Moore secured pro bono legal representation with the University of New Hampshire Law School Intellectual Property Clinic and several lengthy office action rebuttals that he finally received a notice of allowance to register his trademark on December 9, 2014. This was nearly three years after he had received the initial favorable response from the PTO prior to Chik-fil-A's opposition.

E. *Anticompetitive Behavior*

Market incumbents sometimes resort to sham litigation as a rent-seeking behavior when they feel threatened by a new entrant that is taking away market share or disrupting their industry.[179] This rent-seeking behavior exploits litigation to shut out competitors in public and private ordering contexts and raises antitrust scrutiny. In reference to the abuse of public ordering means, former Judge Robert H. Bork once stated that "[p]redation by abuse of governmental procedures, including administrative and judicial processes, presents an increasingly dangerous threat to competition."[180]

In *California Motor Transport Co. v. Trucking Unlimited*, the U.S. Supreme Court held that the abuse of administrative and

176. Office action from Caryn Glasser, U.S. Trademark Examiner to Daniel P. Richardson, attorney at Tarrant, Gillies, Merriman & Richardson (Dec. 18, 2011) (on file with author).

177. Letter of Protest Memorandum from Charles G. Joyner, Office of the Deputy Comm'r for Trademark Examination Policy to Andrew D. Lawrence (Dec. 22, 2011) (on file with author).

178. Office action from Caryn Glasser, U.S. Trademark Examiner to Daniel P. Richardson, attorney at Tarrant, Gillies, Merriman & Richardson (Mar. 27, 2012) (on file with author).

179. Orozco, *supra* note 25, at 34 (discussing the Florida microbreweries and Tesla cases as examples where incumbents use regulation to suppress new competitors who are disrupting the market).

180. ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 347 (1978).

judicial processes through sham litigation could trigger antitrust liability under the Sherman Act.[181] This liability is an exception to the immunity generally provided by the Noerr–Penington doctrine.[182] The Noerr–Pennington doctrine stands for the proposition that lobbying or petitioning the government to achieve anticompetitive goals does not generally impose antitrust liability since the Sherman Act was meant to regulate business activity, not political activity.[183] As a result, only when sham litigation seeks to achieve plainly anticompetitive results would it lose its First Amendment protection and potentially result in antitrust liability.[184] The courts recognize that sham litigation intended to harass a competitor can have an immediate and severe impact on competitors.[185]

In other instances, legal bullies use private contracting as a means to stifle competition in a way that triggers antitrust scrutiny. For example, in 1983 Ben and Jerry's ice cream was a relatively new but growing company trying to expand into the Boston area.[186] Their much larger competitor, Haagen Dazs, owned by Pillsbury, attempted to thwart that process by forcing its distributors and grocery store customers to sign exclusive distribution agreements in the premium ice cream market category.[187] In the end, Ben and Jerry's prevailed due to a clever public relations campaign—"What's the doughboy afraid of?"—that publicly shamed Pillsbury into withdrawing their ex-

181. California Motor Transp. Co. v. Trucking Unlimited, 404 U.S. 508 (1972).

182. *See* Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127, 136 (1961). Also, the Court held that the First Amendment protects the right to petition the government. *Id.* at 137–38; Balmer, *supra* note 18, at 56–60.

183. *Noerr Motor Freight, Inc.*, 365 U.S. at 136.

184. *See* Balmer, *supra* note 18, at 56; California Motor Transp. Co. v. Trucking Unlimited, 404 U.S. 508 at 512–16 (1972) (holding that filing baseless suits that have an anticompetitive effect are not protected under the Noerr–Pennington doctrine and may trigger antitrust liability).

185. Balmer, *supra* note 18, at 63 ("[I]ndeed, by striking directly as a competitor through the judicial process, it is likely that one firm can cause more harm to another than it could through predatory pricing, exclusive dealing, or other frequently discussed anticompetitive activities. This is particularly true when lawsuits are brought against small companies.").

186. Ben Cohen, *When the Market Rules, the Big Guy Wins*, CNN (Dec. 18, 2011), http://www.cnn.com/2011/12/16/opinion/cohen-benjerry-business-regulations/.

187. *Id.*

clusivity demands.[188] Ben and Jerry's also filed a lawsuit on antitrust grounds. However, they later acknowledged that they would have been financially hampered had the public relations campaign not induced a favorable and quick out-of-court settlement.[189]

Another legal bullying practice that triggers antitrust liability is the use of contracts to control the supply of key inputs. An example of this practice occurred in the case of *Eastman Kodak Co. v. Image Technical Services*.[190] In that case, Kodak implemented a policy of selling copier parts exclusively to customers that obtained after-market maintenance and repair services from Kodak. Independent service operators were ineligible to buy these parts and many of them were forced out of business even though later the courts held Kodak's practice to be in violation of the antitrust laws.[191]

Filing a meritless lawsuit with the goal of shutting out a competitor has clear anticompetitive aims. Sometimes it is combined with other abusive tactics. For example, in some cases, large companies file meritless suits against smaller entrants to the market.[192] This burdens the smaller entrant with the high costs of litigation and the large company may take further steps to engage in a public relations campaign to discredit the new entrant by informing their investors, suppliers, and customers about the pending litigation.[193] This unfair activity takes a negative toll on the smaller company's business.[194]

III.
Defensive Techniques

The rent-seeking legal bullying strategies discussed in the prior section yield significant gains for companies. However, they distort the competitive landscape, create social welfare

---

188. *See* Orozco, *supra* note 25; J.P. Kahn, *The Inc. 100 Portfolio*, Inc. Mag. (May 1, 1986), http://www.inc.com/magazine/19860501/194.html.

189. Cohen, *supra* note 186.

190. Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451, 458 (1992).

191. *Id.*

192. Smith, *supra* note 13, at 1099.

193. *Id.* at 1100–01.

194. *Id.* at 1101–02 (discussing cases where products were boycotted and investors pulled financing as a result of meritless litigation).

losses, and injure the public perception of the law as a means to achieve justice and fairness in the marketplace. When successful, these practices yield competitive advantage due to lower labor costs, expanded market power, and preferential access to resources achieved by thwarting competition and silencing negative commentary. Much more can be done to prevent these abusive practices, however. The legal system has developed several protective defensive measures. Victimized parties have also started to employ innovative extra-legal defensive techniques. Both types of public and private ordering defensive measures are examined in this section.

A. *Public Ordering Defensive Measures*

1. *Judicial Doctrines and Equitable Powers*

As the gatekeepers of legal claims during the early pleadings stage of litigation, judges can significantly reduce litigation costs and limit the harmful effects of legal bullying. For example, in some cases the courts tailor doctrines that immediately blunt the force of legal bullying. One recent example involved social media and personal jurisdiction. In *Burdick v. Superior Court*, the California appellate court granted defendant's motion to dismiss a defamation case due to lack of personal jurisdiction.[195] That court stated:

> We hold that posting defamatory statements about a person on a Facebook page, while knowing that person resides in the forum state, is insufficient in itself to create the minimum contacts necessary to support specific personal jurisdiction in a lawsuit arising out of that posting. Instead, it is necessary that the nonresident defendant not only intentionally post the statements on the Facebook page, but that the defendant expressly aim or specifically direct his or her intentional conduct at the forum, rather than at a plaintiff who lives there.[196]

The California court's standard for personal jurisdiction in online defamation cases can limit SLAPP suits filed by legal bullies domiciled there. The doctrine set forth in *Burdick* raises litigation costs for legal bullies who reside in California and

195. Burdick v. Superior Court, 233 Cal. App. 4th 8 (2015).
196. *Id.* at 13.

lowers the costs for the bullying target who resides outside the state.

Another important tool used by courts to limit legal bullying during the pleading stage is the authority to grant a motion to dismiss.[197] The motion to dismiss is based on the failure to state a claim for which relief can be granted.[198] In these cases, the legal bullying target can make a strong case that the bully's complaint is near the legal entitlement frontier and asserts a position that is contrary to established precedent, fails to address controlling law, or cannot cite case law to support its theory.[199] The motion could spell the end of a legal bullying campaign in the early stages of litigation.[200]

Specifically, judges should be looking for certain clear indicators of strategic legal bullying that will help them decide whether to grant a motion to dismiss. In addition to a baseless claim, these indicators include: (1) the legal bully is a dominant firm or part of a conspiracy; (2) the legal bullying target is a recent or potential entrant or competitor; and (3) the effect of the legal bully's action is to deter or delay entry or expansion by the target or to cause its exit from the market.[201]

Courts can also deter legal bullying by imposing sanctions and awarding attorney's fees under the rules of civil procedure and professional conduct. One standard for imposing sanctions and awarding attorney's fees is governed by Rule 11 of the Federal Rules of Civil Procedure[202] and state law equivalents.[203] Rule 11 imposes a duty on attorneys to certify that they have conducted a reasonable inquiry and have determined that any papers filed with the court are well-grounded

197. FED. R. CIV. P. 12(b)(6). Under Rule 12(b)(6), a motion to dismiss can be awarded for failure to state a claim, claiming that even if all the plaintiff's allegations are true, they would not be legally sufficient to state a claim on which relief might be granted.

198. *Id.*

199. *See* Monte L. Mann & John Haarlow, Jr., *Recovering Attorney Fees for Defending Frivolous Claims*, 100 ILL. B.J. 474, 475 (2012).

200. *See, e.g.*, Brooks Bros. Grp., Inc. v. Bubbles by Brooks, LLC, No. 91205596 (T.T.A.B 2013) (case in which Brooks Brothers' trademark opposition against a small business owner was withdrawn after a motion to dismiss was filed that argued the marks were vastly dissimilar).

201. KLEIN, *supra* note 3, at 25.

202. FED. R. CIV. P. 11.

203. *See, e.g.*, WIS. STAT. § 802.05 (2015) (the Wisconsin equivalent of Federal Rule 11).

in fact, legally tenable, and not meant to harass, cause delay, or raise litigation costs.[204] The courts employ a standard of "objective reasonableness," and if a violation is found, sanctions are awarded in the court's discretion.[205]

Furthermore, Rule 11 specifically provides that "[o]n its own, the court may order an attorney, law firm, or party to show cause why conduct specifically described in the order has not violated Rule 11(b)."[206] Whenever there is evidence of legal bullying, judges should signal their intent to apply Rule 11. If a violation has occurred, judges can grant motions for punitive damages,[207] sanctions,[208] and/or attorney's fees. These remedies should be awarded in cases that involve legal bullying to deter future instances of this harmful behavior.[209] Yet another option is for targets to file a claim of vexatious litigation, which may result in trebled damages.[210] These claims, however, are tort-like in nature and require a jury assessment. They are, therefore, lengthy and expensive proceedings that many legal bullying targets are unable to finance.[211]

2. *Legislative Solutions*

Legislative efforts to curtail legal bullying practices involve a patchwork of statutes that cut across numerous state and federal legal subject areas. For example, a growing number of state statutes protect employees from wage theft.[212] Various recently-enacted state statutes protect individuals from patent

---

204. FED. R. CIV. P. 11.

205. *See* Merriam & Benson, *supra* note 157, at 30.

206. FED. R. CIV. P. 11(c)(3).

207. Punitive damages are often awarded in cases involving bad faith, fraud or willful conduct. *See* William S. Dodge, *The Case for Punitive Damages in Contracts*, 48 DUKE L.J. 629, 644–51 (1999) (discussing the role of punitive damages in state contract law).

208. *See* 28 U.S.C. § 1927 (sanctions awarded for unreasonable and vexatious conduct); Lanham Act § 35, 15 U.S.C. § 1117 (2006) (allowing for the awarding of attorney's fees in exceptional cases).

209. These sanctions can only be awarded within the context of litigation and in many instances of legal bullying litigation is never pursued since the target lacks the finances to access the courts. *See* Manta, *supra* note 81, at 860.

210. *See, e.g.*, CONN.]GEN. ST. § 52-568 (1992); GA. CODE ANN. § 51-7-81 (1992); MICH. COMP. LAWS § 600.2907 (1986).

211. Mann & Haarlow, *supra* note 199.

212. *See, e.g.*, S.B. 914, 2015 Leg. Sess. (Conn. 2015) (allowing victims of wage theft to collect double the amount due them and shifting the burden of proof from the employee to the employer).

bullying behavior.[213] Some state laws have been enacted to prevent SLAPP suits.[214] Federal and state consumer protection laws also prohibit anticompetitive behaviors and have been used to combat legal bullying behavior.[215] This patchwork of statutes offer some relief, however. They are not uniformly distributed across all the states and they are subject to legislative processes that might be tempered by lobbying from large corporations, the parties most likely to engage in strategic legal bullying.[216]

The general rule governing attorney's fees in the United States is that each party pays their own legal fees regardless of who wins or loses.[217] Legal bullies greatly exploit this fundamental feature of the U.S. litigation system.[218] Some statutes, however, contain fee-shifting provisions that allow judges to award attorney's fees to the winning party. Fee-shifting provisions can be found in some statutes that involve strategic legal bullying. For example, section 285 of the Patent Act and section 1117(a) of the Lanham Act authorize a district court to award attorney's fees in patent and trademark litigation. Both statutes state that "[t]he court in exceptional cases may award reasonable attorney fees to the prevailing party."[219] Courts also

---

213. *See, e.g.*, VT. STAT. ANN. tit. 9, § 4196-99 (West 2013) (regulating bad faith assertions of patent infringement); FLA. STAT. ANN. § 501.991-997 (West 2015) ("Patent Troll Prevention Act").

214. *See, e.g.*, ARIZ. REV. STAT. ANN. §§ 12-751 to -752 (2006); IND. CODE § 34-7-7-1 (1998).

215. *See* Roger Allan Ford, The Uneasy Case for Patent Federalism 9 (2015) (working paper) (on file with author) ("State attorneys general have occasionally targeted patent owners under state 'mini FTC' laws, but otherwise, states have mostly stayed out of patent disputes."); *see also* Vermont v. MPHJ Tech. Invs., LLC, No. 2:14-cv-192, 2015 U.S. Dist. LEXIS 3309 (D. Vt. Jan. 9, 2015) ("[T]he State filed its original Complaint in this case under the VCPA, Vt. Stat. Ann. tit. 9 §§ 2451 et seq.").

216. *See* Dave Jamieson, *U.S. Chamber Lobbies to Kill Measure That Would Punish Wage Theft*, HUFFINGTON POST (Jul. 10, 2014), http://www.huffington post.com/2014/07/10/us-chamber-lobbies-wage-theft_n_5575095.html (discussing how the U.S. Chamber of Commerce attempted to thwart a federal bill that would punish federal contractors who had committed wage theft).

217. Rosen-Zvi, *supra* note 20, at 731 ("[U]nder the American Rule, the prevailing party is ordinarily not entitled to collect attorney's fee from the loser.").

218. Most foreign jurisdictions follow the opposite rule whereby the losing party pays the winning side's fees.

219. 35 U.S.C. § 285; 15 U.S.C. § 1117(a). The U.S. Supreme Court recently held that an exceptional case "is simply one that stands out from

maintain an inherent power to order fee-shifting when the losing party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons.[220]

Statutory fee-shifting provisions, however, have several important drawbacks. First, they exist within the patchwork of individual statutes that disparately deal with legal bullying and, therefore, will not apply to all instances of legal bullying.[221] Fee-shifting provisions that deal with purely state law issues, therefore, may not exist in all fifty states. Second, fee-shifting provisions are within the judge's discretion and are not automatically granted.[222] Since fees are awarded after litigation they also suffer the fundamental drawback of not entirely removing the financial burdens of litigation, which is the strategic advantage legal bullies exploit to extract favorable out-of-court settlements. Lastly, fee-shifting statutes often do not provide reimbursement for expert witness expenses.[223]

B. *Private Ordering Defensive Measures*

1. *Techniques to Reduce Litigation Costs*

a. Class Action Lawsuits

Individuals and small businesses are prime legal bullying targets because they often lack legal knowledge and the means to finance litigation. Class action litigation offers an opportunity for parties who have been aggrieved under similar circum-

---

others with respect to the substantive strength of a party's litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated." Octane Fitness, LLC. v. ICON Health & Fitness, Inc., 134 S. Ct. 1749, 1751 (2014).

220. *Octane Fitness, LLC.*, 134 S. Ct. at 1749 (quoting Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 258–59 (1975)).

221. *Supra* notes 113–94 and accompanying text.

222. Rosen-Zvi, *supra* note 20, at 731; *see also* Malibu Media, LLC v. Leo Pelizzo, No. 14-11795 (11th Cir. Mar. 26, 2015) (motion for attorney's fees was denied despite defendant winning a case against copyright troll Malibu Media).

223. *See* Order Granting in Part and Denying in Part Defendant's Motion for Attorney's Fees, Advanced Ground Information System, Inc. v. Life360, Inc., No. 14-CV-8065, 2015 WL 4522718, at *2–3 (S.D. Fla. Mar. 3, 2015). In this "exceptionally weak case" that involved patent claims, the judge awarded attorney's fees to the defendant but denied their request for expert witness fees. *Id.*

stances by the same party to collectively file a suit.[224] This spreads litigation costs among various plaintiffs who might be harmed by legal bullying. For example, employees victimized by wage theft or oppressive contract terms have successfully joined together in class action suits.[225] Likewise, class actions can be an effective technique in cases that involve weak intellectual property claims. For example, a class action lawsuit effectively challenged the copyright troll that claimed ownership of, and litigated, the lyrics to the Happy Birthday song.[226]

Recently, however, the courts have limited plaintiffs' ability to join class action suits. In *Wal-Mart v. Dukes*, the U.S. Supreme Court developed a standard that makes it more difficult for plaintiffs to be certified as a class per the commonality requirement.[227] The courts have also upheld arbitration clauses in contracts that prevent contracting parties from joining a class action suit or arbitration.[228] When applicable, these judicial doctrines raise the cost of litigation by preventing an indi-

224. *See* Ford v. Murphy Oil U.S.A., Inc., 703 So.2d 542, 544 (La. 1997) (discussing how class action certification is a non-traditional litigation procedure that allows a representative with typical claims to stand in judgment for a class of similarly situated persons). Recently, however, the U.S. Supreme Court has tightened restrictions for certifying a group of plaintiffs as a class. *See* Georgene Vairo, *Is the Class Action Really Dead? Is that Good or Bad for Class Members?*, 64 EMORY L.J. 477, 483 (2014) ("Rule 23 does not set forth a mere pleading standard. . . . A party seeking class certification must affirmatively demonstrate his compliance with the Rule—that is, he must be prepared to prove that there are in fact sufficiently numerous parties, common questions of law or fact, etc.") (citing Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2551 (2011)).

225. *See* Brown v. Abercrombie & Fitch Co., No. CV141242JGBVBKX, 2015 WL 9690357 (C.D. Cal. July 16, 2015).

226. *See* Trial Motion, Memorandum & Affidavit at 1–2, Good Morning to You Prods. Corp. v. Warner/Chappell Music, Inc., No. 2:13-cv-04460-GHK (MRWX), 2016 WL 616583 (C.D. Cal. Feb. 8, 2016).

227. *Dukes*, 131 S. Ct. at 2551 (requiring plaintiffs to demonstrate significant proof that a unifying element exists to demonstrate that a general, corporate-wide policy of discrimination caused the injury to the class members). Class certification is based on four threshold requirements, i.e., whether there is a sufficiently large number of individuals to justify a class, commonality exists among all members, the plaintiff represents a typical member of the class, and the representative adequately protects the interests of the class without substantively jeopardizing their own interests. FED. R. CIV. P. 23(a).

228. *See* AT&T Mobility, LLC. v. Concepcion, 563 U.S. 333, 352 (2011) (holding that the Federal Arbitration Act preempts state laws that forbid class arbitration waivers).

vidual from joining a class and spreading the high cost of litigation among various parties.[229] Indirectly, these doctrines enable strategic legal bullies in cases where class action suits would deter their abusive behavior.

b. Contingency Fee Arrangements

If a party is the sole target of legal bullying, a class action lawsuit will not be available and the inordinate costs of litigation will fall solely upon that individual.[230] In these cases, the attorney–client contingency fee arrangement plays an important role in providing necessary up-front financing to the plaintiff, to be recouped by the attorney once a settlement is reached or judgment entered. For example, a small company whose patent is being willfully infringed by a large company may use this technique to finance a patent lawsuit.[231] A boutique legal industry has taken hold that litigates patent suits that allege infringement by a large "deep pocket" company.[232] This option is unfortunately not available in many cases since contingency fee attorneys selectively choose to litigate cases with favorable prospects of substantial financial recovery. In some legal bullying cases, the prospect of significant financial recovery is not available and will prevent parties from securing contingency fee-based representation.[233] This is likely to occur in cases that involve trademarks, patents, copyrights, or business regulation.

Victims of trademark bullying can rarely obtain monetary damages since they often must defend a baseless suit that has been brought against them. Even if the issue involves efficient trademark infringement and the victim is the plaintiff, usually all the plaintiff can hope to obtain is the equitable remedy of

---

229. *See* Myriam Gilles & Gary Friedman, *After Class: Aggregate Litigation in the Wake of* AT&T Mobility v. Concepcion, 79 U. CHI. L. REV. 623, 634 (2012) (discussing cases that challenged the use of these waivers as a mechanism that raises costs for plaintiffs).

230. *See id.*

231. *See* AIPLA, *supra* note 88.

232. *See* David L. Schwartz, *The Rise of Contingent Fee Representation in Patent Litigation*, 64 ALA. L. REV. 335, 351–54 (2012).

233. Rosen-Zvi, *supra* note 20, at 729 ("[T]he risk contingency fee lawyers bear in taking on cases on this basis creates a strong incentive for them to screen cases and turn down the riskier ones that are unlikely to generate any profit.") Also, contingency fee-based representation will not occur in cases that do not involve monetary damages. *Id.* at 730.

an injunction.[234] The same can be said of copyright and patent trolling, where the bullying victim must respond defensively and absorb the high costs of litigation without prospect for monetary damages. Monetary damages are also seldom awarded in business regulation disputes since the nature of these disputes often involves challenges to property rights rather than their enforcement.

c. Pro Bono Representation

In some cases, individuals or small businesses may seek pro bono legal assistance. This occurred in the Eat More Kale case. In that case, the University of New Hampshire Law School Intellectual Property Clinic agreed to represent Muller-Moore in his case against Chik-fil-A on a pro bono basis. Small and medium-sized business may take advantage of similar pro bono intellectual program clinics that participate in the U.S. Patent and Trademark Office's Law School Clinic Certification Program.[235] Alternatively, they may seek pro bono representation from law firms or local small business development councils and aid groups such as the Volunteer Lawyers for the Arts. However, the need and demand for pro bono legal representation among small business owners and entrepreneurs are very high.[236] Only a few entrepreneurship law clinics will represent parties who have been targeted by legal bullying.[237]

2. *Professional Misconduct Sanctions*

State rules based on the American Bar Association's *Model Rules of Professional Conduct* may apply in egregious cases that involve legal bullying.[238] For example, Model Rule 3.1 addresses the issue of good faith in advocacy. Rule 3.1 states: "A

234. *See* Ryan McLeod, Note, *Injunction Junction: Remembering the Proper Function and Form of Equitable Relief In Trademark Law*, 13 DUKE L. & TECH. REV. 1 (2006).

235. *Law School Clinic Certification Program*, USPTO (2016), http://www.uspto.gov/learning-and-resources/ip-policy/public-information-about-practitioners/law-school-clinic-1.

236. *See Entrepreneurship Legal Clinic*, UNIV. PA. L. SCH., https://www.law.upenn.edu/clinic/entrepreneurship/clinic-client.php (last visited Jan. 19, 2016).

237. For example, the University of New Hampshire Intellectual Property Clinic represented Mr. Muller-Moore in his case against Chik-fil-A.

238. *See generally* MODEL RULES OF PROF'L CONDUCT (AM. BAR ASS'N 2016).

lawyer shall not bring or defend a proceeding, or assert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal."[239] This rule encourages zealous legal advocacy and allows for strained interpretations of the law. However, in egregious cases of legal bullying where an argument is made near or at the legal entitlement frontier, professional misconduct sanctions should be pursued.[240]

Judges, however, rarely award sanctions even when they are requested, in part to promote the standard of zealous advocacy that is expected under the rules of professional conduct.[241] The standards for awarding sanctions also rely on subjective good faith requirements that are difficult to prove.[242] In one egregious case, the court denied sanctions even when attorneys cited authority in a brief without mentioning that their citations and arguments would result in the extension of existing law.[243] Also, the standards for awarding sanctions are far from uniform and vary considerably from judge to judge and state to state.[244] As a result, attorney conduct must reach fairly egregious levels for judges to award sanctions to the opposing party.[245]

3. *Social Media, Public Relations, and Legal Crowdsourcing*

Entrepreneurs and small businesses have started to employ creative extra-legal methods to combat strategic legal bullying. An emergent practice uses social media to influence public opinion and exert public relations pressure on legal bullies.[246] This occurred in the Simply Mayo, Eat More Kale, and Florida microbrewery cases mentioned earlier. In these

---

239. *Id.* at R. 3.1.

240. *See* Ostas, *supra* note 2, at 713 ("Zealousness on one side balances zealousness on the other, and the synthesis, provided by the impartial judge, renders a reasonably fair, and potentially best, result. If the system is working effectively, the advocate should assert the interpretation, even if strained, that advances the interests of the client.").

241. David P. Atkins, *SLAPP Suit Remedies: Attorney Sanctions*, 12 U. BRIDGEPORT L. REV. 993, 998 (1992).

242. *Id.*

243. *Id.*

244. *Id.* at 994.

245. *Id.* at 998.

246. Orozco, *supra* note 174.

cases, aggrieved individuals and advocacy groups leverage social media to build awareness and initiate advocacy campaigns based on discrete legal issues.[247] These public relations, social media, and legal crowdsourcing campaigns highlight the legal bullying tactics and often depict a David-versus-Goliath scenario that builds awareness and support through vigorous public debate. The negative attention often causes the legal bully to capitulate and drop their legal claim.[248]

IV.
BUSINESS NORMS, ETHICS, AND CORPORATE SOCIAL RESPONSIBILITY

The best approach to combat strategic legal bullying is to allow parties to devise private ordering solutions that limit this practice as much as possible. Business norms, ethics, and corporate social responsibility play an instrumental role to achieve an efficient and positive level of self-enforcement and regulation.[249] Business norms provide an important backdrop to any legal decision. As stated by LoPucki and Weyrauch in their important work on legal strategy: "The view that written law drives legal outcomes is plausible only because written law (to the extent it has any meaning at all) is usually in accord with social norms."[250]

As Robert Ellickson's *Order Without Law* demonstrates, parties who bargain in the shadow of the law sidestep the formal legal system when they prioritize social norms above formal legalistic solutions, even when transaction costs are low and not an impediment to bargaining.[251] In those circumstances, being a good neighbor means resolving conflicts with-

247. *Id.*
248. Orozco, *supra* note 25.
249. *See* David Hess et al., *The Next Wave of Corporate Community Involvement: Corporate Social Initiatives*, 44 CAL. MGMT. REV. 110, 114 (2002) ("A firm's performance depends on its capacity to anticipate and adjust not only to competition and rapid technological transformation, but also to changes in the attitudes of consumers, employees, governments, investors and other stakeholders.").
250. LoPucki & Weyrauch, *supra* note 2, at 1435.
251. When the cost of resorting to public ordering institutions such as the courts is high, private parties often negotiate their own private ordering solution. *See* ELLICKSON, *supra* note 4, at 52.

out resorting to legal threats.[252] In the context of corporate conduct, however, legal bullying epitomizes bad neighborly behavior since it disregards business norms in favor of hyper-litigious behavior.

Business norms play a fundamental role in any well-functioning marketplace. According to research, fundamental business norms include maintaining a strong reputation, good faith, honoring agreements, and standing behind a high-quality offering.[253] The fact that a great quantity of businesses refuse to engage in strategic legal bullying even though it would be economically rational attests to the power of business norms and ethics in day-to-day marketplace behavior.[254] The important role that business norms play in business was examined by the pioneering work of sociological and relational contract scholars. These scholars were among the first to study the priority that business people ascribe to norms rather than legalistic formalities and processes.[255]

Legal bullies violate important relational contracting norms when they exploit the high costs of the legal system and stand behind baseless legal claims. Often times, a private ordering solution to a dispute can be achieved through contracts and relationship building that seeks to avoid litigation. Legal bullies, however, do not proceed in this manner. Instead, they resort to the threat of litigation to support their rent-seeking strategy to chill what would be otherwise productive and lawful

---

252. *Id.*

253. Macauley, *supra* note 8.

254. *See* Daniel T. Ostas, *Cooperate, Comply or Evade? A Corporate Executive's Social Responsibilities with Regard to Law*, 41 AM. BUS. L.J. 559 (2004) (distinguishing between businesses that comply vs. cooperate with existing laws and regulations). According to Ostas, ethical behavior sometimes calls for cooperation with the law to resist the temptation to exploit legal loopholes, interpret legal ambiguities with reference to the public good, and uphold the spirit of the law even when it is not effectively enforced.

255. *See* IAN R. MACNEIL, CONTRACTS: EXCHANGE TRANSACTIONS AND RELATIONS 12–13 (2d ed. 1978). The hallmarks of a relational contract include longer duration and greater personal interaction and cooperation between the contracting parties. *Id.*; *see also* Ian R. Macneil, *Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus"*, 75 NW. U. L. REV. 1018, 1025 (1981) (discussing how discrete contractual transactions differ from relational contracts in such characteristics as: commencement, duration, termination, measurement and specificity, planning, sharing vs. dividing benefits and burdens, interdependence, future cooperation, solidarity, personal relations among participants and power).

behavior. This aggressive and abusive tactic, often accomplished through impersonal letters sent by hired-gun attorneys, violates the important business norms of trust, fairness, reciprocity, and honorable conduct that can be gained through a good faith effort to develop relational business contracts.[256]

The bad litigious neighbors described in *Order Without Law* failed to maintain a good neighborly reputation that is gained by acting in an amicable, helpful, and respectful way towards others. Like bad neighbors, corporate legal bullies downplay the role of reputation, mainly because they assume that they will not suffer any negative reputational harm. Unlike the ranchers in tight-knit rural California, legal bullies exploit the fact that they are largely unknown to their target and its surrounding community. Legal bullies are often large corporations domiciled in a distant place or shell companies that communicate primarily through their hired-gun attorney's letterhead.[257]

The legal bully's presumption of anonymity is increasingly misplaced given the widespread use of social media to shame legal bullies.[258] Like some of the cattle ranchers in *Order Without Law,* legal bullying victims resort to self-help when they encounter unethical behavior.[259] Their analogue to gossip as a self-help remedy among cattle ranchers is their use of social and traditional media to generate public commentary and to tarnish the legal bully's reputation.[260] Increasingly, companies view their reputation and standing in the community as a vital business asset.[261] This negative public commentary focuses on the unfair, harassing nature of the legal bully's claim and exposes the bully to severe criticism, as demonstrated in the Just

256. MACNEIL*, supra* note 255, at 12–13.
257. *See* Vermont v. MPHJ Tech. Invs., LLC, 803 F.3d 635 (Fed. Cir. 2015).
258. Orozco, *supra* note 25.
259. ELLICKSON, *supra* note 4, at 56–57.
260. Orozco, *supra* note 25.
261. *See* Neil Gunningham et al., *Social License and Environmental Protection: Why Businesses Go Beyond Compliance*, 29 LAW & SOC. INQUIRY 307, 320–21 (2004) (discussing how businessmen surveyed in their study mentioned that the sanctions they feared the most were not legal, but instead the informal sanctions imposed by the media and the public and how they went to great lengths to avoid "anything that could give you a bad name").

Mayo, Eat More Kale, Florida microbreweries, and Ben and Jerry's examples discussed earlier.[262]

When a case of legal bullying is removed from the private litigation sphere to the arena of public discourse, the conversation shifts from one that primarily involves legal language to one that primarily involves ethics.[263] The bully's hyper-litigious behavior is recast in relation to their unreasonable demands and oppressive conduct though the lens of public ethical commentary. The risk of this occurrence increases as the bully's baseless claim approaches the legal entitlement frontier. At some point near this frontier the legal bully enters a public "shaming zone."

This process can be depicted theoretically and visually in Figure 2.

FIGURE 2.

Legal Entitlement; 100% likelihood of winning case

Legal entitlement Frontier; 0% likelihood of winning case

Shaming zone

Bargaining in shadow of law

Legal bullying

Sham precedent

Ethical claim

Weak

Strong

As illustrated in Figure 2, the legal entitlement frontier is the point where the legal claim is no longer viable if it were to be decided on the legal merits in court. As the bully's claim nears the legal entitlement frontier the claim gets weaker. The legal bully strategically asserts a baseless claim near or beyond the frontier and exploits the high legal transaction and transfer costs to extract rents from their target. Once a claim enters the shaming zone, however, the public takes interest in the issue and public discourse rapidly adopts ethical overtones.

262. Orozco, *supra* note 25.
263. *Id.*

Corporate legal bullies fail to recognize that the ethical impact of their claims increase as they enter the shaming zone, the area near the entitlement frontier where they are at risk of being publicly vilified through legal crowdsourcing methods.[264] Once they are in the shaming zone, the legal bully is at great risk of breaching the implied social contract between businesses and society.[265] Also, at this point they risk a viable challenge to their social license to operate since the community is likely to support the target.[266] A reason why the targets of legal bullying have been able to successfully use legal crowdsourcing methods to obtain support far beyond their immediate communities and existing customer base may be because the bullying act violates a hyper-norm.[267] When a company violates a hyper-norm, the reaction extends beyond the immediate locality since the behavior is universally condemned.[268] In this case, the hyper-norm that is violated is the misuse of the legal system to achieve illegitimate business objectives.[269] As

264. Orozco, *supra* note 174.

265. *See* Thomas Donaldson & Thomas W. Dunfee, *Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory*, 19 ACAD. MGMT. REV. 252, 262 (1994) (discussing how communities may define social microcontracts).

266. *See* Gunningham et al., *supra* note 261, at 308 (defining the social license to operate as "the demands on and expectations for a business enterprise that emerge from neighborhoods, environmental groups, community members, and other elements of the surrounding civil society. In some instances the conditions demanded by 'social licensors' may be tougher than those imposed by regulation, resulting in 'beyond compliance' corporate environmental measures even in circumstances where these are unlikely to be profitable.").

267. *See* Donaldson & Dunfee, *supra* note 265, at 265 (defining a hypernorm as "principles so fundamental to human existence that they serve as a guide in evaluating lower level moral norms"); Orozco, *supra* note 174 (discussing how legal crowdsourcing methods generate support beyond the existing customer base and might actually lead to new customers and supporters).

268. *See* Andrew Spicer et al., *Does National Context Matter in Ethical Decision Making? An Empirical Test of Integrative Social Contracts Theory*, 47 ACAD. MGMT. J. 610, 617–18 (2004) (finding that hyper-norms were universally respected across national boundaries).

269. *See* Donaldson & Dunfee, *supra* note 265, at 265 (proposing to "use the existence of the convergence of religious, cultural, and philosophical beliefs around certain core principles merely as a clue to the identification of hypernorms").

seen in prior cases, violating this hyper-norm results in swift and universal condemnation.

When a company enters the shaming zone, various parties such as customers, the media, activists, regulators, business partners, and investors respond with non-market strategies that pressure the legal bully to stop its rent-seeking behavior.[270] Non-market activists are becoming increasingly sophisticated and successful in coordinating their public shaming and advocacy campaigns.[271]

From a social welfare perspective, the best antidote to strategic legal bullying is for companies to realize that this practice is illegal, unethical, and against their own interests. To operationalize this private ordering self-policing solution, companies should integrate in-house and external legal counsel with their existing compliance and corporate social responsibility (CSR) programs.[272] CSR has become an important business ethics issue and it promotes behavior that goes beyond legal compliance. One of the dominant paradigms of CSR includes stakeholder theory, which asserts that firms have relationships with several important constituent groups and that these stakeholders both affect and are affected by the firm's behavior.[273]

From a compliance perspective, firms can integrate a policy against legal bullying with their existing code of ethics, compliance program, employee training modules, and statements made by top executives that reflect the "tone at the top."[274] All of these integrity-based compliance practices can help to establish a corporate culture that prevents legal bullying from taking root.[275] Compliance personnel and in-house

---

270. *See* Baron, *supra* note 35, at 80; David P. Baron & Daniel Diermeier, *Strategic Activism and Nonmarket Strategy*, 16 J. ECON. MGMT. & STRAT. 599, 602–03 (2007) (discussing how activists employ targeted campaigns against companies they view are acting unethically and the target of the campaigns are the company's existing customers).

271. Baron & Diermeier, *supra* note 270; Orozco, *supra* note 174.

272. *See* Whelan & Ziv, *supra* note 64.

273. *See* Abagail McWilliams & Donald Siegel, *Corporate Social Responsibility: A Theory of the Firm Perspective*, 26 ACAD. MGMT. REV. 117, 118 (2001).

274. *See* Robert C. Bird & Stephen Kim Park, *Turning Corporate Compliance into Competitive Advantage*, 19 U. PA. J. BUS. L. (forthcoming 2017) (manuscript at 45–47) ("A 'tone at the top' established by senior management and the board of directors is critical to ensuring corporate integrity and deterring fraud.").

275. *Id.*

corporate legal departments should take a strong leadership position to ensure that the principal corporation does not condone or engage in any strategic legal bullying practices.

Firms that integrate a legal bullying prohibition within a CSR framework have a better chance of implementing self-policing behaviors that result in restraint, good judgment, and the ability to seek a fair resolution that upholds business norms such as relational contract.[276] As the principals in the attorney–client relationship, companies should guide attorneys towards the ethical values reflected in these policies instead of the knee-jerk aggressive legal tactics that hired-gun attorneys facilitate. The in-house attorneys should play a gatekeeping role to ensure that internal and external attorneys do not engage in the hired-gun practices that enable legal bullying. In this role, corporate attorneys work as advisors rather than advocates in a way that ensures compliance through shared governance with internal and external stakeholders.[277] The spirit of ethical advising is also reflected in the American Bar Association's Model Rule 2.1. That rule states: "In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation."[278]

As a form of private regulation, CSR plays a significant role in shaping good corporate citizenship.[279] Companies that follow CSR models increasingly require their partners and suppliers to abide by CSR principles that respect labor, diversity, environmental, and human rights interests.[280] External law firms are increasingly viewed as suppliers and firms require

---

276. *See* Ostas, *supra* note 254 (calling for legal cooperation rather than mere compliance).

277. *See* Susan D. Carle, *Progressive Lawyering in Politically Depressing Times: Can New Models for Institutional Self-Reform Achieve More Effective Structural Change?*, 30 HARV. J.L. & GENDER 323, 341 (2007) (noting that one aspect of the lawyer's role in new governance involves "freeing lawyers from their traditional, cautious, litigation-wary stance so that they can become more creative problems solvers."); Jennifer M. Pacella, *Conflicted Counselors: Retaliation Protections for Attorney-Whistleblowers in an Inconsistent Regulatory Regime*, 33 YALE J. ON REG. (forthcoming 2016) (discussing the emerging roles of in-house attorneys as advisors and whistleblowers through a new governance model of self-regulation and self-policing).

278. MODEL RULES OF PROF'L CONDUCT r. 2.1 (AM. BAR ASS'N 2016).

279. *See* Whelan & Ziv, *supra* note 64.

280. *Id.*

them to follow CSR guidelines and best practices. It is now common for large in-house departments to issue guidelines to external counsel that requires them to adopt the firm's internal CSR policies.[281] These guidelines are closely monitored and enforced by in-house counsel. The threat to terminate a lucrative business relationship due to non-compliance is a significant deterrent.[282]

The CSR guidelines that in-house legal departments issue to external counsel often refer to ethics and the fair engagement of the legal system. Bank of America's attorney guidelines, for example, direct outside lawyers not to use "[c]oercive, dilatory or obstructive tactics" and discourage protracted motion practice.[283] Guidelines also encourage external counsel to pursue alternative dispute resolution practices to solve disputes in a speedy and fair manner.[284] Wal-Mart also amended its outside counsel guidelines to warn external counsel not to abuse the legal system during the discovery stages in litigation, a maneuver that imposes significant costs and delays, particularly on smaller parties.[285]

In-house counsel should, therefore, adopt specific language in their existing attorney guidelines that forbids strategic legal bullying practices. Periodic audits should be done to ensure compliance and any evidence of actions that violate the prohibition against legal bullying should be promptly addressed. This all assumes that strategic legal bullying is initiated by an overzealous hired-gun attorney, but that is not always the case. Often, the corporate client is the impetus for legal bullying behavior. In these instances, external counsel should rely on the company's CSR guidelines to thwart the bullying attempt and counsel the client that engaging in this behavior would be legally untenable, and against their own

281. *Id.*
282. *Id.*
283. *Id.*
284. For example, parties to a trademark dispute might avoid costly and protracted litigation by signing a coexistence agreement. *See* Marianna Moss, *Trademark "Coexistence Agreements:" Legitimate Contracts or Tools of Consumer Deception?*, 18 LOY. CONSUMER L. REV. 197, 197 (2005) ("[C]oexistence agreements allow potentially confusing trademarks to coexist in the market without trademark infringement lawsuits.").
285. *See* Whelan & Ziv, *supra* note 64, at 156–57.

CSR policies and long-term interests in light of the potentially negative public reaction.[286]

Conclusion

A competitive, market-based economy and adversarial legal system encourage strategic behavior. This system often yields positive economic results. The system can yield serious negative unintended consequences, however, since unethical actors exploit the high costs of the legal system to harm innovators, entrepreneurs, small businesses, non-profits, and society. In particular, strategic legal bullying exploits the high costs of the legal system to advance a baseless legal position that yields a favorable result at the expense of a much weaker party. This Article defines and analyzes this harmful practice in economic terms and classifies it as a form of rent-seeking behavior. The Article also analyzes the various manifestations of strategic legal bullying practices and the defensive methods through which it can be contained. As discussed in the article, business norms, ethics, and corporate social responsibility play a vital role in ongoing efforts to combat the significant harmful effects that arise when companies abuse the legal system for strategic business gain.

286. Larry E. Ribstein, *Delawyering the Corporation*, 2015 Wis. L. Rev. 305, 316 ("Avoiding improper conduct which could hurt the [corporation's] reputation and trigger significant legal fees is an important business function.").

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 13 FALL 2016 NUMBER 1

MORTAL DEMOCRACY: WHEN CORPORATIONS BRIBE

ROBERT E. WAGNER*

The crime of bribery has been around for almost as long as the possibility of obtaining special benefits from governments has existed. Meanwhile, corporate crime has been a concern only in recent centuries, but its importance continues to grow. Ever since bribery first appeared, questions have arisen as to who should be considered a criminal, who a victim, what behavior qualifies as bribery, and how society should punish this offense. Similarly, with corporate crime there have been persistent questions about the possibility/impossibility of corporations committing crimes, the optimal ways to treat innocent participants in a corporation if only one segment of it has committed a crime, and the proper type and level of punishment for corporations in these settings. This Article investigates in detail for the first time what should happen to corporations that bribe public officials. After describing the historical arguments for and against corporate criminal liability and those related to liability for bribery generally, the Article examines the dangers and harms of corporate bribery. This Article then presents a proposal that involves vigorous pursuit by law enforcement of corporate bribery and uses of multiple types of punishments. Specifically, the Article endorses implementing a targeted type of community service for guilty members of a corporation, a mandatory official acknowledgment and publicity regarding the bribery, and a default rule requiring any corporation that commits bribery to terminate its CEO automatically.

INTRODUCTION 194
I. CORPORATE CRIMINAL LIABILITY 197
A. *The Framework of Corporate Criminal Liability* . . 197

* Copyright © 2016 by Robert E. Wagner. Assistant Professor, Baruch College Zicklin School of Business Department of Law; M.B.A., University of Chicago Booth School of Business; J.D., Cornell Law School. I would like to thank Irina Manta. I am grateful to the Baruch College Zicklin School of Business Department of Law and its staff for support during my research.

1. *Historical Progression of Corporate Criminal Liability* 198
2. *Deterrence*............................... 202
3. *Retribution* 205
B. *The Purpose and Means of Corporate Criminal Liability*.................................... 206
C. *The Implementation of Corporate Criminal Liability* 211
II. BRIBERY... 215
A. *The History of Bribery*......................... 220
B. *The Harms Associated with Bribery*............. 222
III. CORPORATE BRIBERY............................ 224
A. *Applying the Bribery Concept to Corporations* 224
B. *Making Punishments Fit the Corporate Bribery Crime* 227
CONCLUSION 233

INTRODUCTION

Bribery of public officials has grown to epic proportions. In recent years, the Mexico Walmart bribery scandal involved the company giving over $24 million to public officials, which allowed Walmart to grow in that country at an unprecedented pace.[1] Just last year, a number of International Federation Association Football (FIFA) officials were accused of taking $150 million in bribes related to the issuing of media and marketing rights for soccer games in the Americas.[2] In the United States itself, the scope of incidents in the last five to ten years related to bribery of elected officials alone is alarming. For example, former Boston city councilor Chuck Turner was sentenced to three years in prison for accepting a $1000 bribe,[3] State Sena-

1. David Barstow, *Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle,* N.Y. TIMES (Apr. 21, 2012), http://www.nytimes.com/2012/04/22/business/at-wal-mart-in-mexico-a-bribe-inquiry-silenced.html?pagewanted=all.
2. Michael E. Miller & Fred Barbash, *U.S. Indicts World Soccer Officials in Alleged $150 Million FIFA Bribery Scandal*, WASH. POST (May 27, 2015), http://www.washingtonpost.com/news/morning-mix/wp/2015/05/27/top-fifa-officials-arrested-in-international-soccer-corruption-investigation-according-to-reports/.
3. Andrew Ryan, *Turner Sentenced to 3 Years in Prison*, BOS. GLOBE (Jan. 26, 2011), http://www.boston.com/news/politics/articles/2011/01/26/judge_rebukes_turner_sentencing_him_to_3_years_in_prison/.

tor Ronald Caldero has been indicted for receiving $88 thousand in bribes,[4] State Senator Dianne Wilkerson was sentenced to three and a half years in prison for taking $23,500 in bribes,[5] New York Assemblyman Eric A. Stevenson was convicted of bribery and sentenced to three years in prison,[6] Representative Randy Cunningham was sentenced to eight years and four months in prison for taking $2.4 million in bribes,[7] Congressman William J. Jefferson was sentenced to thirteen years in prison for accepting hundreds of thousands of dollars in bribes,[8] City Councilman Marcelo Co was sentenced to sixty months in federal prison for accepting a $2.36 million cash bribe,[9] and New York State Senator Carl Kruger was sentenced to seven years in prison for involving himself in bribery.[10] The judge in Senator Kruger's trial, Judge Rakoff, accurately described the dangers of bribery when he characterized Mr. Kruger's actions as "extensive, long-lasting, substantial bribery schemes that frankly were like daggers in the heart of honest government."[11] As Judge Rakoff emphasized, it is "difficult to overstate the evils that are wrought when government officials succumb to bribery."[12] "We have only to look at other countries," he said, "to see that once corruption takes hold, democ-

---

4. Patrick McGreevy, *Calendar Sheds Light on Indicted Ex-Sen. Ronald Calderon's Actions*, L.A. TIMES (June 23, 2015), http://www.latimes.com/local/political/la-me-pc-calendar-sheds-light-on-indicted-ex-sen-calderon-s-actions-20150623-story.html.

5. Jonathan Saltzman, *Wilkerson Receives 3½ years in Prison*, BOS. GLOBE (Jan. 7, 2011), http://www.boston.com/news/local/massachusetts/articles/2011/01/07/wilkerson_receives_3_years_in_prison/.

6. Benjamin Weiser, *Former Bronx Assemblyman Sentenced for Corruption*, N.Y. TIMES (May 24, 2014), http://www.nytimes.com/2014/05/22/nyregion/former-bronx-assemblyman-sentenced-for-corruption.html.

7. Randal C. Archibold, *Ex-Congressman Gets 8-Year Term in Bribery Case*, N.Y. TIMES (Mar. 4, 2006), http://www.nytimes.com/2006/03/04/politics/04cunningham.html.

8. Jerry Markon, *Ex-Rep. Jefferson (D-La.) Gets 13 Years in Freezer Cash Case*, WASH. POST (Nov. 14, 2009), http://www.washingtonpost.com/wp-dyn/content/article/2009/11/13/AR2009111301266.html.

9. Paloma Esquivel, *Former Moreno Valley City Councilman Sentenced in Bribery Case*, L.A. TIMES (June 1, 2015), http://www.latimes.com/local/lanow/la-me-ln-former-moreno-valley-councilman-sentenced-20150601-story.html.

10. Benjamin Weiser, *Former State Senator Is Sentenced to 7 Years in Vast Bribery Case*, N.Y. TIMES (Apr. 26, 2012), http://www.nytimes.com/2012/04/27/nyregion/carl-kruger-sentenced-to-seven-years-in-corruption-case.html?_r=0.

11. *Id.*

12. *Id.*

racy itself becomes a charade, justice becomes a mere slogan camouflaging a cesspool of self-interest."[13]

At the same time that bribery has continued to grow, corporations have become the second most powerful institution in the world, outpaced only by nations.[14] The consequence is that we have one of the most powerful types of institutions in the world possibly corrupting another. This Article looks at the dangers of this situation, explores some of the limitations on criminalizing corporate behavior, and concludes with a recommendation for increasing and modifying how corporations are punished for this criminal violation.

This Article discusses the issue of criminal penalties for bribing a public official and how they should be applied to corporations that pay such bribes. The analysis begins in Part I with an overview of corporate criminal liability generally, including an exposition of its history and current application. The Article then discusses in Part II the crime of corruption, and specifically the bribery of public officials. Part III describes the traditional way in which bribery is treated in terms of criminal sentences and of how punishments apply to the corporate context. Part III discusses the disparity between bribe giver and taker in terms of the consequences that they each suffer and argues that the corporate bribe giver is in some ways more harmful to society and yet seems to be let off the hook more readily. Part III also develops a proposal advocating not only for continued prosecutions for bribery, but also for the abolition of the current trend of deferring prosecutions or engaging in other forms of avoiding a full criminal process. This Part also shows why and how to implement enhanced penalties like mandatory termination for CEOs when their corporations pay bribes, community service for the responsible individuals, and compulsory acknowledgment and publicity regarding the crime.

---

13. *Id.*

14. *See* Darrell A.H. Miller, *Guns, Inc.:* Citizens United, McDonald*, and the Future of Corporate Constitutional Rights*, 86 N.Y.U. L. REV. 887, 949–50 (2011).

I.
CORPORATE CRIMINAL LIABILITY

A. *The Framework of Corporate Criminal Liability*

Corporate criminal liability is the frequent subject of criticism by scholars, who refer to it as "pointless," "unprincipled," "illogical," and lacking in "empirical justification."[15] Punishing shareholders for the crimes of the corporation has even been compared with the collective punishments often used by fascist regimes.[16] Some scholars have contended that there is also no theoretical justification for corporate criminal liability.[17] For decades, many scholars have thus argued against corporate criminal liability, both for being ineffective and for running against the principles of criminal law.[18]

A number of the critiques in this context refer to the idea that the corporation has no will or is not self-conscious.[19] Due to this, many opponents of corporate criminal liability have claimed that it violates the primary purposes of criminal law, namely retribution, deterrence, and rehabilitation, and that rather than punishing the individuals responsible, it punishes shareholders and stakeholders.[20] One of the first legal objections to corporate liability was that to "punish the corporation is in reality to punish the innocent stockholders, and to deprive them of their property without opportunity to be heard, consequently without the due process of law."[21]

15. Preet Bharara, *Corporations Cry Uncle and Their Employees Cry Foul: Rethinking Prosecutorial Pressure on Corporate Defendants,* 44 AM. CRIM. L. REV. 53, 58 (2007).

16. John Hasnas, *A Context for Evaluating Department of Justice Policy on the Prosecution of Business Organizations: Is the Department of Justice Playing in the Right Ballpark?,* 51 AM. CRIM. L. REV. 7, 11 (2014).

17. John Hasnas, *The Centenary of a Mistake: One Hundred Years of Corporate Criminal Liability,* 46 AM. CRIM. L. REV. 1329, 1329 (2009).

18. Assaf Hamdani & Alon Klement, *Corporate Crime and Deterrence*, 61 STAN. L. REV. 271, 272–73 (2008).

19. Carlos Gomez-Jara Diez, *Corporate Criminal Liability in the Twenty-First Century: Are All Corporations Equally Capable of Wrongdoing?*, 41 STETSON L. REV. 41, 50 (2011).

20. Erin Sheley, *Perceptual Harms and the Corporate Criminal,* 81 U. CIN. L. REV. 225, 230 (2012).

21. BRANDON L. GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS 34 (2014).

1. *Historical Progression of Corporate Criminal Liability*

The debate about both the appropriate level and the sheer existence of corporate criminal liability began over a hundred years ago.[22] Originally, criminal law was not applied to corporations. William Blackstone thought that the inapplicability of criminal law to corporations was "so obvious that it needed no elaboration."[23] The early American courts that considered the issue held that only individuals could be charged criminally.[24] This changed in the early 1900s when the United States Supreme Court established corporate criminal liability in *New York Central & Hudson River Railroad Co. v. United States*[25] and used the respondeat superior principle to determine guilt. With the exception of crimes requiring a natural person,[26] such as rape,[27] a corporation can now be held criminally liable. Nonetheless, this was not the end of the controversy surrounding corporate criminal liability. The opponents of corporate criminal liability perceive the practice "as the senseless and puerile reaction of an ignorant public, or as an inefficient relic best replaced by a civil scheme."[28]

Some commentators have noted that the sanctions in civil and criminal proceedings are often essentially the same, raising the question of why we should use criminal law at all.[29] A number of scholars have claimed that instead of criminal liability, we should just use civil liability, and possibly some form

22. Amy J. Sepinwall, *Guilty by Proxy: Expanding the Boundaries of Responsibility in the Face of Corporate Crime,* 63 HASTINGS L.J. 411, 415 (2012); *see also* V. S. Khanna, *Corporate Criminal Liability: What Purpose Does It Serve?,* 109 HARV. L. REV. 1477, 1478 n.2 (1996).

23. Albert W. Alschuler, *Two Ways to Think About the Punishment of Corporations*, 46 AM. CRIM. L. REV. 1359, 1363 (2009) (citing 1 WILLIAM BLACKSTONE, COMMENTARIES 476) ("A corporation cannot commit treason, or felony, or other crime.").

24. Kathleen F. Brickey, *Perspectives on Corporate Criminal Liability, in* ENCYCLOPEDIA OF CRIMINOLOGY & CRIMINAL JUSTICE (2012).

25. New York Cent. & H.R.R. Co. v. United States, 212 U.S. 481, 493–95 (1909). For a discussion of the case, see Sheley, *supra* note 20, at 230–32.

26. A natural person has been defined as "[a] human being, as distinguished from an artificial person created by law." Utica Mut. Ins. Co. v. Precedent Cos., 782 N.E.2d 470, 476 (Ind. Ct. App. 2003).

27. Khanna, *supra* note 22, at 1488.

28. Gregory M. Gilchrist, *The Expressive Cost of Corporate Immunity,* 64 HASTINGS L.J. 1, 5 (2012).

29. Khanna, *supra* note 22, at 1488.

of insurance.[30] There are, however, several differences between corporate criminal and civil liability, including that criminal liability has stronger procedural protections, more powerful enforcement devices, more severe and unique sanctions (as well as stigma), and stronger expressive ability than civil liability.[31] The government seems to think that more corporate enforcement would be appropriate, as evidenced by the fact that the Department of Justice (DOJ) has increased its focus on corporate crime.[32] Both sides of the debate admit that there has been harm from the actions of corporations in these contexts, but there is disagreement about who is responsible and who should suffer the consequences. It has been argued that criminal sanctions carry with them a moral condemnation that should only be used when the government can point to a "substantive wrong in the corporation's compliance practices, leadership, culture or internal controls."[33]

What does it mean to say, however, that a corporation has committed a wrong? One possibility is that someone with a high level of decision-making authority in the corporation has behaved inappropriately.[34] Shareholders do not usually have much control in the management of their corporation because the actual decision-making authority is with the board and the day-to-day decisions are made by other corporate officers.[35] Hence, we often hear the complaint that it is unfair to hold the entire corporation liable when in reality only a small part (perhaps even just one person) actually participated in wrongdoing.[36] The critics complain that holding everyone liable turns innocent shareholders and employees into "collat-

---

30. GARRETT, *supra* note 21, at 268–69.

31. Khanna, *supra* note 22, at 1492.

32. *See* David M. Uhlmann, *Deferred Prosecution and Non-Prosecution Agreements and the Erosion of Corporate Criminal Liability*, 72 MD. L. REV. 1295, 1309 (2013).

33. Cheryl L. Evans, *The Case for More Rational Corporate Criminal Liability: Where Do We Go From Here?*, 41 STETSON L. REV. 21, 28 (2011).

34. *See, e.g.*, Hunter v. Allis-Chalmers Corp., Engine Div., 797 F.2d 1417, 1422 (7th Cir. 1986).

35. Carol R. Goforth, "*A Corporation Has No Soul"—Modern Corporations, Corporate Governance, and Involvement in the Political Process*, 47 HOUS. L. REV. 617, 629 (2010).

36. Miriam H. Baer, *Organizational Liability and the Tension Between Corporate and Criminal Law*, 19 J.L. & POL'Y 1, 5–6 (2010).

eral" damage.[37] Indeed, the argument that one punishes innocent shareholders when one punishes the corporation was one of the main points raised by the defendants in *New York Central*.[38] The defendants further claimed that it was impossible for the corporation as an entity to commit a crime because those who are ultimately responsible for making decisions, i.e., the board, could not legally authorize criminal acts.[39] In fact, it was a long-held and firmly established belief that a corporation was not capable of possessing the moral blameworthiness necessary to perpetrate an intentional crime.[40] Yet, the Supreme Court held that since a corporation acts through its officers and agents, their purposes, motivations, and intentions are also those of the corporation.[41] The principle of respondeat superior was thus taken from tort law and placed into the context of corporate criminal law.

The use of this tort concept in the criminal law was quickly attacked, leading to many of the objections to corporate criminal liability. Many people believed, and still believe, that the use of such liability was inconsistent with the purpose of criminal law, that is, "punishment of the morally blameworthy—because it relied upon vicarious guilt rather than personal fault."[42] Using respondeat superior in the criminal law has also been criticized because it is "overly broad."[43] For example, under respondeat superior, even if an employee was specifically told not to take some action and even if the corporation itself was a victim, it is still possible for the corporation to be held liable.[44] In fact, some convictions do seem to be based upon the actions of a few individual actors and result in thousands of lost jobs and numerous difficulties for not only the employees, but also their families, others who depend upon their support, and people who counted on the services

---

37. Alschuler, *supra* note 23, at 1359.
38. New York Cent. & H.R.R. Co. v. United States, 212 U.S. 481 (1909).
39. *Id.* at 492.
40. *See* Pamela H. Bucy, *Corporate Criminal Responsibility*, *in* 1 ENCYCLOPEDIA OF CRIME & JUSTICE 259, 259 (Joshua Dressler ed., 2d ed. 2002).
41. *New York Centr.*, 212 U.S. at 492–93.
42. Khanna, *supra* note 22, at 1485.
43. Sheley, *supra* note 20, at 228.
44. *See, e.g.*, United States v. Sun-Diamond Growers of Cal., 138 F.3d 961, 970 (D.C. Cir. 1998); United States v. Automated Med. Labs., Inc., 770 F.2d 399, 407 (4th Cir. 1985).

that the company became unable to provide.[45] In one example, all of this occurred possibly due to a few employees performing actions that resulted in a criminal conviction, which was itself later reversed, but still led to the demise of the Arthur Andersen corporation.[46]

Unfortunately, scholars today cannot agree on the exact ontological status of the corporation. They argue about whether it is real or fictional, whether it is an aggregation or an association, and whether it is a distinct entity or a nexus of contracts.[47] Some jurists conceive of corporations as mere legal fictions that refer to the people and agreements behind the organizations; these jurists believe, therefore, that liability should attach to the individuals involved.[48] Countering this view is a fact on which most scholars do agree, which is that a corporation may continue even when specific individuals are no longer a part of it.[49] Furthermore, corporations have their own cultures that are different from those of the individuals in them.[50] Yet, scholars have argued that since a corporation contains elaborate methods of individual decision making, any decision that was made in conformity with these methods can be appropriately attributed to the corporation.[51] This militates for the rejection of the argument that corporations should not be criminally prosecuted because they are "fictitious entities"; indeed, there is some support for the idea that corporations do act as persons under the law—in that they make a certain set of decisions—and that they should be treated accordingly.[52]

Many other complaints about corporate criminal liability rest on the claim that it violates the aim of criminal law to punish the morally blameworthy by using vicarious guilt rather than personal fault.[53] This vicarious liability often harms indi-

---

45. *See* Hamdani & Klement, *supra* note 18, at 273.
46. Alschuler, *supra* note 23, at 1364–66.
47. Sepinwall, *supra* note 22, at 427.
48. Gilchrist, *supra* note 28, at 15.
49. Sepinwall, *supra* note 22, at 427.
50. Gilchrist, *supra* note 28, at 16.
51. Peter French, *The Corporation as a Moral Person,* 16 AM. PHIL. Q. 207, 211 (1979).
52. Lucian E. Dervan, *Reevaluating Corporate Criminal Liability: The DOJ's Internal Moral-Culpability Standard for Corporate Criminal Liability,* 41 STETSON L. REV. 7, 10 (2011).
53. Khanna, *supra* note 22, at 1484–85.

viduals, giving fuel to another argument often used against corporate criminal liability, which is that it harms employees, suppliers, and other third parties, as most famously happened once the company Arthur Andersen was criminally convicted.[54] Arthur Andersen's conviction cost the United States 28 thousand jobs even though the conviction itself was eventually overturned by the Supreme Court.[55] Corporate convictions can often have terrible consequences against innocent people like employees, shareholders, and the public, but the failure to prosecute in such cases can also result in significant harm.[56] According to the DOJ, "[a]lmost every conviction of a corporation, like almost every conviction of an individual, will have an impact on innocent third parties, and the mere existence of such an effect is not sufficient to preclude prosecution of the corporation."[57] Since the very first Supreme Court case upholding corporate criminal liability, legal minds have indicated that this form of sanction was designed to punish the innocent.[58] Nevertheless, scholars have also argued that while shareholders experience the individual deprivations, much of the harm associated with the actual stigmatization of persons is absent and hence reduces the impact that the innocent shareholders actually suffer.[59] This counterargument has yet to convince many of the critics. In fact, they continue to claim that corporate criminal liability does not fit with the traditional purposes of criminal sanctions.[60]

2. *Deterrence*

Under deterrence principles, "the ultimate purpose of organizational criminal sanctioning is to galvanize the organizations to put in place policies, and to reform organizational cul-

---

54. Hamdani & Klement, *supra* note 18, at 273.
55. Carrie Johnson, *U.S. Ends Prosecution of Arthur Andersen,* WASH. POST (Nov. 23, 2005), http://www.washingtonpost.com/wp-dyn/content/article/2005/11/22/AR2005112201852.html.
56. GARRETT, *supra* note 21, at 42.
57. U.S. DEP'T OF JUSTICE, PRINCIPLES OF FEDERAL PROSECUTION OF BUSINESS ORGANIZATIONS, UNITED STATES ATTORNEY'S' MANUAL §§ 9-28.000 to -28.1300, § 9-28.11000(B) (2008) [hereinafter Filip Memorandum].
58. Hasnas, *supra* note 17, at 1344.
59. Meir Dan-Cohen, *Sanctioning Corporations*, 19 J.L. & POL'Y 15, 41 (2010).
60. Hasnas, *supra* note 16, at 8.

tures, such that future criminal harms will be avoided."[61] Deterrence traditionally has two categories, general and specific deterrence, the former of which focuses on incentivizing people to avoid the consequences that they observe others endure, and the latter of which tries to change the future behavior of the individual wrongdoer by having her suffer consequences herself.[62] Arguably, corporate criminal liability can increase both types of deterrence by internalizing the public cost of wrongdoing by putting corporate assets at risk, which can particularly help with specific deterrence if and when the agent who committed the wrongdoing is judgment-proof.[63]

The United States endorses the deterrence rationale for corporate criminal liability. For instance, the DOJ's stated reasons for indicting corporations include the belief that other members of that corporation's industry will learn from the incident and not commit similar crimes (i.e., general deterrence), and that an indicted corporation may be influenced to change its behavior in the future (i.e., specific deterrence).[64] Furthermore, "[t]he possible unfairness of visiting punishment for the corporation's crimes upon shareholders may be of much less concern where those shareholders have substantially profited, even unknowingly, from widespread or pervasive criminal activity."[65]

Over-deterrence is another issue that scholars have considered in this context because corporate criminal liability leads to corporations spending more money avoiding crime than they should.[66] For example, if a corporation spent $100 thousand to avoid a criminal environmental sanction for an act that would have caused $1000 worth of damage, that would be over-deterrence.

---

61. Julie R. O'Sullivan, *Some Thoughts on Proposed Revisions to the Organizational Guidelines,* 1 OHIO ST. J. CRIM. L. 487, 512 (2004).

62. Marcia Narine, *Whistleblowers and Rogues: An Urgent Call for an Affirmative Defense to Corporate Criminal Liability*, 62 CATH. U. L. REV. 41, 54 (2012).

63. Vikramaditya S. Khanna, *Should the Behavior of Top Management Matter?*, 91 GEO. L.J. 1215, 1224 (2003).

64. Filip Memorandum, *supra* note 57.

65. *Id.*

66. Daniel R. Fischel & Alan O. Sykes, *Corporate Crime,* 25 J. LEGAL STUD. 319, 321–22 (1996).

However, many commentators and judges still treat deterrence as the main goal of both criminal and civil liability,[67] and given the importance of this aspect of criminal prosecution, this Section describes deterrence in the corporate setting before looking at the actual implementation and the guidelines used to prosecute corporations. Deterrence is not necessarily or always achieved with the possibility of harsh corporate penalties.[68] "Using the threat of going out of business as a deterrent may be unwise. Harsh corporate penalties might distort firms' incentives to monitor for misconduct, and undermine deterrence of professional firms' members."[69] Too harsh a sentence may lead to corporate collapse, and a punishment that can only be applied once may not be optimal.[70]

Critics also argue that traditional deterrence does not warrant "the imposition of punishment on those without fault whenever doing so may reduce the overall level of criminal activity," which is what they claim corporate criminal liability may do.[71] Professor Bucy perhaps best laid out some of the arguments for and against corporate liability when she said:

> Why prosecute something that "has no soul to damn" and "no body to kick?" The major argument in favor of prosecuting corporations is as follows: corporations are major actors in today's world; the criminal law is the most effective method of influencing behavior by rational actors; therefore, criminal prosecution is the most effective way to influence corporate actors. The major argument against corporate criminal liability is that it makes no sense. The distinguishing feature of the criminal law, as contrasted to civil law, is its focus on intent, and no matter what fiction we employ, a corporation has no intent.[72]

The claim that corporations have "no intent" stems from the idea that corporations do not act; their agents do,[73] and since the corporations are not themselves agents, they do not

67. Khanna, *supra* note 22, at 1494–95.
68. Hamdani & Klement, *supra* note 18, at 273–74.
69. *Id.* at 308.
70. *Id.* at 276.
71. Hasnas, *supra* note 16, at 9.
72. Pamela H. Bucy, *Why Punish? Trends in Corporate Criminal Prosecutions,* 44 AM. CRIM. L. REV. 1287, 1288 (2007).
73. Khanna, *supra* note 63, at 1223.

have the ability to be morally responsible.[74] Due to the claim that corporations are "mindless legal entities," some law professors have called corporate criminal liability a mistake like the ancient practice of punishing an animal or inanimate object that has killed a person.[75]

3. *Retribution*

Scholars have also defended the imposition of corporate criminal liability on retributivist grounds, stating that it is the means by which we can properly apply blame upon the corporation's officials,[76] and that it functions well in that regard.[77] At the same time, the appropriateness of criminal sanctions is even further complicated by the availability of civil corrective measures. Corporate misconduct might be controllable strictly through civil enforcement, but it is also possible that this would be ineffective because civil fines cannot replicate the reputational harm of criminal sanctions.[78] Professor Hart said "what distinguishes a criminal from a civil sanction . . . is the judgment of community condemnation which accompanies and justifies its imposition."[79] The expressive function of criminal law cannot be replicated in any other way. Furthermore, the condemnatory function of punishment is also very important in shaping how people feel about the law and their likelihood of following it.[80] Corporate criminal liability allows the community to express its moral judgment.[81] The criminal justice system itself may be weakened due to appearances of favoritism and unequal application of the law, which could arise if we did not hold corporations criminally liable when people think we should.[82] The fact that people reportedly experience "*greater* moral indignation toward corporations than toward

---

74. *See, e.g.*, Manuel Velasquez, *Debunking Corporate Moral Responsibility,* 13 BUS. ETHICS Q. 531 (2003).
75. GARRETT, *supra* note 21, at 268.
76. Sepinwall, *supra* note 22, at 417.
77. GARRETT, *supra* note 21, at 168.
78. *See* Samuel W. Buell, *The Blaming Function of Entity Criminal Liability*, 81 IND. L.J. 473, 512–16 (2006).
79. GARRETT, *supra* note 21, at 274.
80. Sheley, *supra* note 20, at 237.
81. Peter J. Henning, *Corporate Criminal Liability and the Potential for Rehabilitation*, 46 AM. CRIM. L. REV. 1417, 1427 (2009).
82. Gilchrist, *supra* note 28, at 51.

natural persons for the same crimes"[83] could enhance this effect. This may be a double-edged sword in that one problem with the expressive function of criminal law is the possibility that finding a fictional entity criminally liable may be viewed as farcical by some of the public and actually decrease public support for criminal law generally.[84]

Given the amount of power that a corporation can accumulate, it is no surprise that corporations have also caused many types of disasters.[85] It is not only their power, but also their size and complexity that can at times allow corporations to commit crimes far beyond what individuals can accomplish.[86] The "collective qualities" of corporations contribute to this increased harm. By "collective qualities," this Article means their "geographic, structural, and temporal complexities" that end up amplifying the potential harm caused.[87] Conversely, another reason for corporate criminal liability is that it can protect innocent corporations. Indeed, corporations that follow the law may be at a competitive disadvantage compared to corporations that disregard the law.[88] These law-abiding corporations might be placed at an even greater disadvantage if we did not have criminal sanctions.

B. *The Purpose and Means of Corporate Criminal Liability*

The debate about the appropriateness of corporate criminal liability will continue for a while, but for now, we do have such liability and it is not likely to go away any time soon. The more immediate question is how it should be used. As pointed out above and as other scholars have commented, "legal entities do not commit crimes; individuals do. Ideally, the legal

83. *Id.* (emphasis added); *see also* Susanna M. Kim, *Characteristics of Soulless Persons: The Applicability of the Character Evidence Rule to Corporations*, 2000 U. ILL. L. REV. 763, 792 ("People often search for group rather than individual-level causes for extremely negative events.").

84. Khanna, *supra* note 22, at 1531.

85. Susanna Kim Ripken, *Corporations Are People Too: A Multi-Dimensional Approach to the Corporate Personhood Puzzle*, 15 FORDHAM J. CORP. & FIN. L. 97, 119 (2009).

86. Sara Sun Beale, *A Response to the Critics of Corporate Criminal Liability*, 46 AM. CRIM. L. REV. 1481, 1484 (2009).

87. Sheley, *supra* note 20, at 228.

88. Mary Kreiner Ramirez, *The Science Fiction of Corporate Criminal Liability: Containing the Machine Through the Corporate Death Penalty*, 47 ARIZ. L. REV. 933, 942–43 (2005).

system would target only culpable individuals within organizations. But a system of pure personal liability would likely fail to produce adequate deterrence."[89] Even though corporations cannot be put in jail, they can be forced to pay both the state and the victims that they harmed.[90] Corporations can be forced to pay huge fines, suffer harm to their reputations, and possibly lose their licenses and hence ability to operate, among other consequences.[91]

Next, this Article will turn to how this is achieved in the criminal law, i.e., what does this form of liability look like in the United States? In other countries, corporate liability is established through the acts of the people in the higher levels of corporate organizations.[92] In situations in which the corporation has repeatedly committed criminal acts, many would argue that it may be that the top management has failed to establish an ethical corporate culture[93] and hence deserves criminal prosecution. Under our system, upper management involvement will not affect whether a corporation is liable (but it can affect to what extent the corporation will be held liable,[94] in that some laws add punitive damages when upper management is involved[95]). In the United States, a corporation is criminally liable as long as any member of it commits a crime while acting within the scope of his employment and intended at least some part of the action to benefit the corporation.[96] It is particularly irritating to opponents of corporate criminal liability that even a menial employee can subject a gigantic corporation to liability,[97] and many commentators are concerned with the possibility that a rogue employee can subject an essentially law-abiding corporation to significant harm.[98]

---

89. Hamdani & Klement, *supra* note 18, at 282.

90. GARRETT, *supra* note 21, at 68.

91. *Id.* at 4.

92. Bruce Carolan, *Criminalizing Corporate Killing: The Irish Approach,* 41 STETSON L. REV. 157, 161 (2011).

93. Ramirez, *supra* note 88, at 940.

94. Khanna, *supra* note 63, at 1220.

95. *Id.* at 1221.

96. Bharara, *supra* note 15, at 57.

97. *Id.* at 63.

98. *See generally* Ellen S. Podgor, *A New Corporate World Mandates a "Good Faith" Affirmative Defense,* 44 AM. CRIM. L. REV. 1537 (2007).

Controlling powerful corporations is as important (and maybe more so) today as it was over a hundred years ago when the Supreme Court initially implemented the corporate liability standard.[99] Following the decision in *New York Central*,[100] courts used respondeat superior to determine liability without any significant additional analysis,[101] and even though judges do not always agree with or even understand respondeat superior, corporate criminal liability clearly can be established through the acts of the corporation's agents committed in the scope of employment.[102] In *New York Central*, the statute explicitly said that a corporation could be held criminally liable.[103] Yet, after that case, many courts began reading other criminal statutes as though they too were meant to be applied to corporations even when there was little to no indication that the legislature had intended to have that happen.[104]

Under the respondeat superior standard, there are three necessary elements for a corporation to be held criminally liable: (1) an agent of the corporation acted with the requisite mental state, (2) the agent acted within the scope of his employment, and (3) the agent intended to benefit the corporation.[105] Many opponents have come up with scenarios, such as that involving a low-level employee who violates company policy while committing a crime, that question the underlying fairness of the modern corporate liability standard.[106] It has been claimed that once there is evidence of any low-level employee engaging in the relevant type of criminal activity, a criminal case against the employing corporation is virtually bulletproof.[107] This is true even though the range of criminal behavior in a corporation is incredibly broad and covers

99. Geraldine Szott Moohr, *Why Punish? Of Bad Apples and Bad Trees: Considering Fault-Based Liability for the Complicit Corporation,* 44 AM. CRIM. L. REV. 1343, 1357 (2007).

100. New York Cent. & H.R.R. Co. v. United States, 212 U.S. 481 (1909).

101. Alschuler, *supra* note 23, at 1364.

102. GARRETT, *supra* note 21, at 167.

103. *New York Central*, 212 U.S. at 491.

104. *See, e.g.*, United States v. Union Supply Co., 215 U.S. 50, 54–55 (1909); London v. Everett H. Dunbar Corp., 179 F. 506, 510 (1st Cir. 1910); People v. Star Co., 120 N.Y.S. 498, 500 (N.Y. App. Div. 1909); State v. Ice & Fuel Co., 81 S.E. 737, 738 (N.C. 1914).

105. Khanna, *supra* note 22, at 1489–90.

106. Evans, *supra* note 33, at 25.

107. Dervan, *supra* note 52, at 8–9.

agents basically working at the behest or with the approval of management as well as rogue agents working without approval or knowledge, for either some internal reward (such as a raise or promotion) or external reward in cases like insider trading.[108] Scholars point out that there is literally nothing a corporation can do to guarantee that it will not commit a crime[109] and have expressed concern over the way that corporations are treated in our criminal system, with criminal liability having significantly increased while available corporate defenses have decreased.[110]

Also upsetting to many opponents of corporate criminal liability is the doctrine of collective knowledge, which enables a corporation to be prosecuted when there is literally no single person that knew everything about the criminal activity and no single person that intended to commit a crime.[111] Under the collective knowledge theory, no one had the required mens rea, but the corporation is still deemed to have had it, which results in corporate liability even though no culpable individual could be identified.[112] An example of collective mens rea would be: "if agent *Y* dumps material into a river without knowledge of its hazardousness, but agent *X* knows of its hazardousness, yet does not engage in dumping, then the corporation is liable under [collective mens rea] for knowingly dumping hazardous material into a river."[113] Given the collective knowledge doctrine, finding a corporate mens rea will be considerably easier in many situations than finding an individual one. Furthermore, many of the elements of criminal corporate liability are fairly easily met for several reasons. For example, the requirement that an agent act within the scope of his employment can be satisfied even though the agent had been clearly and possibly repeatedly told not to commit the wrongful conduct. It is also relatively easy to show that an agent "benefited the corporation." Even if the agent was not solely motivated by and in fact did not end up benefiting the

---

108. Narine, *supra* note 62, at 43–44.
109. Hasnas, *supra* note 17, at 1343.
110. Bharara, *supra* note 15, at 55.
111. *Id.* at 64.
112. Michael B. Metzger & Dan R. Dalton, *Seeing the Elephant: An Organizational Perspective on Corporate Moral Agency*, 33 AM. BUS. L.J. 489, 501 (1996).
113. V.S. Khanna, *Is the Notion of Corporate Fault a Faulty Notion?: The Case of Corporate Mens Rea*, 79 B.U. L. REV. 355, 408 (1999).

corporation at all, the "benefiting the corporation" element can still be satisfied.[114]

In part due to the view that this ease of prosecution is inappropriate, there has been an increasing amount of support for limiting corporate liability to those cases in which the government could establish the corporation's failure to prevent a crime; only then, the argument goes, should courts attribute the conduct of an employee to the corporation.[115] Professor Podgor proposes a good-faith defense for corporations so that when they have an effective compliance program, they are not subject to prosecution even though one or more agents committed a crime in the course of their employment.[116] Meanwhile, some foreign countries explicitly provide a defense to corporations in criminal settings when the corporations can show that they had "adequate procedures" in place to prevent the crime.[117]

Nevertheless, some have argued that even potentially excessive prosecution of corporations, which result in punishment for employees' actions that are clearly against publicized corporate policies, can help to deter wrongdoing and encourage corporations to implement effective measures rather than empty policy declarations.[118] This makes it less likely that a corporation could impose a facially rigorous compliance program that never actually affects the culture or desire to comply with the law.[119] Due to this possibility, courts usually do not acknowledge even extensive compliance programs as a defense to the illegal conduct, including if only one employee committed the crime.[120] Naturally, avoiding criminal behavior is highly desirable, but excessive penalties can cause over-deterrence and lead to an inappropriate increase in the level of corporate resources devoted to enforcement.[121] Further, as

114. Khanna, *supra* note 22, at 1490. Practically speaking, prosecutors do consider whether or not it was a "rogue" employee who committed the crime or if the culture of the corporation contributed to the offense. *See* Baer, *supra* note 36, at 7 (internal quotation marks omitted).

115. Evans, *supra* note 33, at 34–35.

116. Podgor, *supra* note 98, at 1538.

117. Evans, *supra* note 33, at 35.

118. *See* Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 55–56 & n.6 (1986).

119. Ramirez, *supra* note 88, at 965.

120. Brickey, *supra* note 24, at 604.

121. Fischel & Sykes, *supra* note 66, at 325–26.

several scholars have pointed out, it is possible for a corporate criminal indictment to lead to the demise of a corporation, and thus defending against said indictment may effectively result in corporate suicide.[122] Therefore, it is crucial to examine how we implement criminal prosecutions and what guidelines are in place before an indictment is even issued.

C. *The Implementation of Corporate Criminal Liability*

Over the last decade, there has not been an increase in the number of cases initiated against corporations, but there has been an increase in the size and importance of the prosecutions that have been brought.[123] After the most recent financial scandals, many have asked if the government is doing enough to curb corporate crime,[124] and scholars have argued that we do not hold corporations sufficiently accountable, and that, even worse, we do not know how to hold complex corporations accountable.[125] Nonetheless, as mentioned in the previous Section, when considering corporate criminal liability, lawmakers have to take into account the cost to all corporate players and consider the near-certain fact that some innocent participants will be hurt.[126] There are an increasingly large number of issues concerning where the lines of criminal culpability should be drawn.[127] Due to what happened with Arthur Andersen, prosecutors are more careful when they target corporations.[128] The DOJ was criticized for its prosecution of Arthur Andersen, with some calling it the equivalent of a "corporate death penalty."[129] Corporate prosecutions, perhaps more so than other types of prosecutions, are subject to external influences based upon their importance to the economy, their somewhat unique legal status, and their relationship with stakeholders, among other reasons.[130]

---

122. Bharara, *supra* note 15, at 73.
123. GARRETT, *supra* note 21, at 5.
124. *Id.* at 12.
125. *Id.* at 2.
126. Evans, *supra* note 33, at 24–25.
127. Samuel W. Buell, *Culpability and Modern Crime*, 103 GEO. L.J. 547, 548 (2015).
128. Bucy, *supra* note 72, at 1287.
129. Uhlmann, *supra* note 32, at 1310–11.
130. Bharara, *supra* note 15, at 73.

"The prosecution of corporate crime is a high priority for the Department of Justice,"[131] and the DOJ lists several reasons for the importance of corporate prosecutions, a few of which are protecting the integrity of our free economic and capital markets; safeguarding consumers, investors, and business entities that compete only through lawful means; and keeping Americans from environmental damage.[132] The DOJ must weigh the importance of deterrence as seen in those reasons, with the knowledge that maximizing a punishment may not maximize deterrence and the external interests of all those involved with the corporation. How can the government accomplish that? The DOJ attempts to reconcile these interests as indicated by an internal memorandum that explains how to evaluate corporate crime. The memo begins its analysis by stating that the DOJ is supposed to apply the same factors in determining which corporations should be prosecuted as it does to decide which individuals should be.[133] Following this general acknowledgement is a set of factors explaining more specifically how prosecutors should evaluate a corporate criminal case, stating that prosecutors should take into account:

1. The nature and seriousness of the offense, including the risk of harm to the public . . . ;
2. The pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management;
3. The corporation's history of similar misconduct . . . ;
4. The corporation's timely and voluntary disclosure of wrongdoing . . . ;
5. The existence and effectiveness of the corporation's pre-existing compliance program;
6. The corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitu-

131. Filip Memorandum, *supra* note 57, at § 9-28.010.
132. *Id.*
133. *Id.*

tion, and to cooperate with the relevant government agencies;

7. Collateral consequences, including whether there is a disproportionate harm to shareholders, pension holders, employees, and others not proven personally culpable, as well as impact on the public arising from the prosecution;
8. The adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and
9. The adequacy of remedies such as civil or regulatory enforcement actions.[134]

Other factors that the DOJ considers before prosecuting a corporation are the sufficiency of the evidence and the likelihood of success at trial.[135] Of the corporations that are charged with a crime, only eight percent even go to trial because most plead guilty and accept some form of deal.[136]

Given the potential grave consequences of a criminal prosecution, the government has been trying new methods of dealing with corporations beyond just increased numbers of criminal laws and sanctions, such as the use of deferred prosecutions and non-prosecutions.[137] The deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs) of recent years have established a middle ground between declining to prosecute completely and engaging in a full-blown prosecution.[138] The idea of a deferred prosecution is to file a case, and then put it on hold to give the corporation a chance to stay clean and, if it does, ask the judge to dismiss the case.[139] NPAs are not filed with the court, and many agreements are not made publicly available.[140] Recently, NPAs have been used more and more frequently, even when the corporate misconduct has resulted in multiple deaths.[141] NPAs and DPAs are more appropriate when the conditions are designed to pro-

---

134. *Id.* at § 9-28.300.
135. *Id.*
136. GARRETT, *supra* note 21, at 162.
137. Uhlmann, *supra* note 32, at 1307–08.
138. *Id.* at 1315.
139. GARRETT , *supra* note 21, at 13.
140. *Id.* at 63–64.
141. Uhlmann, *supra* note 32, at 1300.

mote compliance with the law and prevent recidivism.[142] Today, prosecutors using DPAs and NPAs try to change the way a corporation is managed by putting systems in place to detect and prevent crime.[143] As part of a DPA, a monitor is often installed, who can at times request the board to terminate specific employees, including the CEO.[144] Yet, typically the job done by the monitor is not divulged to the public.[145]

DPAs have steadily increased in the years since the Arthur Andersen case, from only a few per year to now an average of thirty per year.[146] DPAs are both praised and condemned by various scholars; the criticisms range from a complaint that they give too much power to prosecutors to the claim that they amount to a "slap on the wrist" for corporations.[147] There are also claims that DPAs have completely failed at preventing corporate recidivism.[148] While small corporations are still prosecuted, many large corporations are not, and instead receive these DPAs or NPAs, in part due to the perceived fear of a "corporate death penalty,"[149] as seen with Arthur Andersen. At least one researcher has pointed out, however, that it is possible that Arthur Andersen was an exceptional case and that typical criminal convictions will not result in the "death" of a corporation.[150] When prosecuting corporations, a recurring question is whether any of the penalties actually reach the top executives rather than only lower-level employees.[151] In approximately two thirds of the cases resulting in a DPA or NPA, the corporation is punished, but no employees are prosecuted at all.[152] With this preliminary understanding of how corporate prosecutions occur, this Article will now focus on the specific offense of bribery.

142. Filip Memorandum, *supra* note 57.
143. GARRETT, *supra* note 21, at 7.
144. *Id.* at 15.
145. *Id.*
146. Gabriel Markoff, *Arthur Andersen and the Myth of the Corporate Death Penalty: Corporate Criminal Convictions in the Twenty-First Century,* 15 U. PA. J. BUS. L. 797, 807 (2013).
147. *Id.* at 800–01.
148. *Id.* at 801.
149. *Id.* at 800.
150. *Id.* at 822–23.
151. GARRETT, *supra* note 21, at 3.
152. *Id.* at 13.

II.
Bribery

All politicians say that they are opposed to corruption; in fact, it is almost as clichéd at this point as saying that one likes "mom and apple pie."[153] By one definition, corruption is not just bribes but rather includes all situations in which politicians or public servants serve their own interests at the public's expense.[154] But to what does this opposition to corruption amount? Theodore Roosevelt said that bribery/corruption "strikes at the foundation of all law,"[155] but the question remains what precisely bribery is. As Professor Lowenstein stated several decades ago, bribery is "identifying as immoral or criminal a subset of transactions and relationships within a set that, generally speaking, is fundamentally beneficial to mankind, both functionally and intrinsically."[156] Arguably, bribery has no clear line differentiating it from acceptable activity.[157] It can be a very well-financed endeavor, with some reported incidents of bribery worldwide involving upwards of one billion dollars for one corporation,[158] or it can be a simple-sounding promise. So even if bribery is the quintessential example of corruption,[159] and the worst and clearest form of corruption,[160] as has been claimed, there is still a wide variety of behavior that may qualify.

In fact, the Supreme Court has stated that the law of bribery focuses on the most blatant attempt to influence governmental action by those with money.[161] In addition to the Supreme Court's, many other formulations of definitions of bribery have been offered, such as "paying for better than fair

153. *See* Peter J. Henning, *Public Corruption: A Comparative Analysis of International Corruption Conventions and United States Law*, 18 ARIZ. J. INT'L & COMP. L. 793, 794–95 (2001).
154. ZEPHYR TEACHOUT, CORRUPTION IN AMERICA: FROM BENJAMIN FRANKLIN'S SNUFF BOX TO CITIZENS UNITED 2 (2014).
155. *Id.* at 185.
156. *Id.* at 17.
157. *Id.* at 166.
158. GARRETT, *supra* note 21, at 1.
159. George D. Brown, *Putting Watergate Behind Us—Salinas, Sun-Diamond, and Two Views of the Anticorruption Model,* 74 TUL. L. REV. 747, 752 (2000).
160. Henning, *supra* note 153, at 801.
161. Buckley v. Valeo, 424 U.S. 1, 28 (1976).

treatment"[162] or a "corrupt benefit given or received to influence official action."[163] Another way to phrase it is that bribery is the word we use when a promise turns criminal.[164] There are many different definitions of bribery/corruption, ranging from anything that varies from accepted norms to actual exchanges of money for the purpose of influencing an official to break the law.[165] Bribery is just one manifestation of public corruption,[166] and on the other end of the spectrum, corruption could be "any criminal offense(s) committed by governmental officials related to, or growing out of, their governmental duties."[167] The Supreme Court has said that in some circumstances, the *appearance* of corruption can be as important as corruption itself,[168] and Americans have a longstanding mistrust of "the influence of private power in the public sphere."[169] At the same time, too much use of the criminal law can weaken its moral legitimacy and reduce its power to stigmatize and/or concentrate public blame,[170] and therefore, rather than discussing the entirety of corruption law (which is arguably too broad), this Article will focus on bribery, and specifically corporate bribery of politicians.

Bribery can be a difficult crime to pursue for many reasons, not the least of which is the fact that it can lie on a hazy boundary between criminal conduct and behavior that is valuable or even necessary in a democracy.[171] The behavior of interest for purposes of this Article, however, is not in the gray area, but is rather the more blatant variety in which a "quid

---

162. Ian Ayres, *The Twin Faces of Judicial Corruption: Extortion and Bribery,* 74 DENV. U. L. REV. 1231, 1234 (1997).

163. James Lindgren, *The Theory, History, and Practice of the Bribery-Extortion Distinction,* 141 U. PA. L. REV. 1695, 1696 (1993).

164. James Lindgren, *The Elusive Distinction Between Bribery and Extortion: From the Common Law to the Hobbs Act,* 35 UCLA L. REV. 815, 909 (1988).

165. John Hogarth, *Developments in Criminal Law and Criminal Justice: Bribery of Officials in Pursuit of Corporate Aims*, 6 CRIM. L.F. 557, 558 (1995).

166. Henning, *supra* note 153, at 793.

167. Norman Abrams, *The Distance Imperative: A Different Way of Thinking About Public Official Corruption Investigations/Prosecutions and the Federal Role*, 42 LOY. U. CHI. L.J. 207, 211 (2011).

168. TEACHOUT, *supra* note 154, at 167 (citing Buckley v. Valeo, 424 U.S. 1 (1976)).

169. Brown, *supra* note 159, at 755.

170. *Id.* at 759.

171. Daniel H. Lowenstein, *Political Bribery and the Intermediate Theory of Politics*, 32 UCLA L. REV. 784, 813 (1985).

pro quo" requirement is present, meaning that something specific is given in exchange for an official act.[172] If there is no direct exchange, there may be a lesser offense like gratuity,[173] which is also offensive, criminal, and problematic, but different and ultimately less harmful.

Professor Lowenstein defined political bribery as the bribery of a policy-making official, especially of an elected official as opposed to anything like the bribery of a police officer to get out of a ticket.[174] There are many criminal and administrative laws and regulations that govern the receipt of "gifts" by public officials,[175] and every nation has criminalized bribing government officials.[176] Yet, even limiting the discussion to this context, the types and levels of bribery are diverse, including not only legislatures taking a bribe to pass a law,[177] but also very common forms of local bribery, like a building inspector taking a bribe connected with a building that he is reviewing.[178] Another way to define political bribery is that it is the use of resources from outside the political market to alter a governmental decision,[179] or, put another way, bribery involves "an abuse of public office by officials for private gain."[180] Corruption and bribery can occur in the legislative, executive, or judicial branches in ways that share some features but not others.[181] Accepting a bribe is a breach of a public official's fiduciary duty,[182] but how does one get from the wrongful breach of a fiduciary duty to a criminal act?

Concern about corruption and bribery has led to many laws being passed, including constitutional amendments.[183]

172. Brennan T. Hughes, *The Crucial "Corrupt Intent" Element in Federal Bribery Laws,* 51 CAL. W. L. REV. 25, 40 (2014).
173. *Id.* at 40.
174. Lowenstein, *supra* note 171, at 785 n.2.
175. United States v. Sun-Diamond, 526 U.S. 398, 410 (1999).
176. Henning, *supra* note 153, at 793.
177. Abrams, *supra* note 167, at 223–24.
178. *Id.* at 222.
179. Brown, *supra* note 159, at 752–53.
180. Lydia Segal, *Can We Fight the New Tammany Hall?: Difficulties of Prosecuting Political Patronage and Suggestions for Reform*, 50 RUTGERS L. REV. 507, 534 (1998).
181. *See* Abrams, *supra* note 167, at 212–13.
182. David Mills & Robert Weisberg, *Corrupting the Harm Requirement in White Collar Crime*, 60 STAN. L. REV. 1371, 1374 (2008).
183. TEACHOUT, *supra* note 154, at 4–5.

Early political bribery laws focused on paying for votes to get elected rather than paying an official to get a law passed.[184] One of the first bribery laws that did deal with legislatures was passed in the State of Georgia in 1816, providing a five-year sentence for the attempt to influence an officer of the state.[185] Corruption laws in the United States are scattered across the federal and state codes and represent a "hodgepodge" of numerous laws.[186] Multiple federal statutes have been used to prosecute bribery for decades, including the Hobbs Act, the Travel Act, RICO, the statute criminalizing theft or bribery concerning programs receiving federal funds, and mail and wire fraud statutes.[187] Depending upon which law prosecutors choose to use to pursue a bribery case, the penalty can range from five to twenty years in prison per offense.[188] In addition to the fact that prosecutors have at their disposal a vast number of laws in this setting, many of these laws are easy to violate.[189] This concern is exacerbated by prosecutors' knowledge that they can get public acclaim and crucial political power by prosecuting elected officials for bribery.[190]

A large problem when dealing with political bribery is how to differentiate it from standard and acceptable politics and business.[191] Many have argued that the laws regarding bribery must be interpreted narrowly, lest they impede the way that our democratic system works.[192] Some others argue that America has not found a good way to differentiate between corruption and ordinary politics.[193] This is part of the reason why—while avoiding corruption or even the appearance of corruption is an important consideration according to com-

---

184. *Id.* at 109.
185. *Id.* 114.
186. Henning, *supra* note 153, at 798.
187. Michael W. Carey, Larry R. Ellis & Joseph F. Savage, Jr., *Federal Prosecution of State and Local Public Officials: The Obstacles to Punishing Breaches of the Public Trust and a Proposal for Reform, Part One,* 94 W. VA. L. REV. 301, 324 (1992).
188. Lindgren, *supra* note 164, at 816.
189. Hughes, *supra* note 172, at 26.
190. TEACHOUT, *supra* note 154, at 195.
191. Buell, *supra* note 127, at 566.
192. Segal, *supra* note 180, at 539–40.
193. Buell, *supra* note 127, at 566.

mentators and courts[194]—the Supreme Court has also instructed that corruption statutes be interpreted narrowly to avoid prosecuting benign activity.[195] In addition to this concern, the fact that a bribery conviction carries a heavy stigma, including society's moral condemnation,[196] also argues for the proper level of caution in these settings. In practice, bribery is usually enforced more narrowly than the statutes would permit; for example, many courts impose a quid pro quo requirement on laws that do not specifically contain one.[197] Furthermore, bribery is often held to require an "evil intent to violate the law," and is not considered to have been established when there is mere criminal negligence.[198] As mentioned, there are many different definitions and laws dealing with bribery. For the sake of clarity, this Article will simply refer to the Supreme Court's description of bribery when it was interpreting 18 U.S.C. § 201(b)(1), which deals with the bribery of public officials and witnesses:

> Requiring a showing that something of value was corruptly given, offered, or promised to a public official (as to the giver) or corruptly demanded, sought, received, accepted, or agreed to be received or accepted by a public official (as to the recipient) with intent, inter alia, "to influence any official act" (giver) or in return for "being influenced in the performance of any official act" (recipient).[199]

Breaking bribery down into its elements, it could be defined as consisting of these five:

1. A public official
2. A corrupt intent by the defendant
3. Something of value given to the public official
4. Some connection between the thing of value and an official act

---

194. Dennis F. Thompson, *Two Concepts of Corruption: Making Campaigns Safe For Democracy,* 73 GEO. WASH. L. REV. 1036, 1036 (2005).
195. Hughes, *supra* note 172, at 26–27.
196. Segal, *supra* note 180, at 545–46.
197. *Id.* at 536.
198. Hughes, *supra* note 172, at 36.
199. United States v. Sun-Diamond, 526 U.S. 398, 404 (1999).

5. An intent to influence the official in the carrying out of his/her duties.[200]

Furthermore, the type of bribery on which this Article focuses should involve a "quid pro quo" or a "specific intent to give or receive something of value in exchange for an official act,"[201] and one should keep in mind that both parties involved in bribery, the giver and the receiver, are considered responsible.[202]

A. *The History of Bribery*

Acts of bribery and prosecutions for bribery are not rare and have not been rare for a very long time.[203] Bribery is considered wrong in both democracies and non-democracies.[204] In fact, laws and moral judgments dealing with bribery have been around for centuries, but have gone through significant changes over the years. The initial moral judgments of bribery were very harsh, but focused primarily on the bribe receiver; for example, Plato believed that someone who took a bribe should die.[205] In the early history of bribery, the focus was much more on the person taking the bribe, such as a king-appointed judge who accepted money improperly.[206] Indeed, it was originally only judges and witnesses that could be bribed criminally.[207] Bribing judges was criminalized well before bribing legislatures.[208] Originally, "briber" referred to the person receiving the bribe, and not the giver as it is usually termed

---

200. Lowenstein, *supra* note 171, at 796 (citing 18 U.S.C. § 201 (1986)). Section 201 states:

> (b) Whoever, directly or indirectly, corruptly gives, offers or promises anything of value to any public official . . . with intent
>
> (1) to influence any official act
>
> (2) to influence such public official . . . to commit . . . any fraud . . . on the United States; or
>
> (3) to induce such public official. . . to do or omit to do any act in violation of his lawful duty, . . . shall be fined, imprisoned or both.

201. United States v. Sun-Diamond Growers, 526 U.S. 398, 404–05 (1999).
202. Lindgren, *supra* note 163, at 1699.
203. Lowenstein, *supra* note 171, at 786.
204. Thompson, *supra* note 194, at 1040.
205. TEACHOUT, *supra* note 154, at 21.
206. Lindgren, *supra* note 164, at 838.
207. *Id.* at 860.
208. *See* TEACHOUT, *supra* note 154, at 103.

today.[209] The early concern with bribery appears to have focused on the greedy official as opposed to the bribe payer that was distorting government.[210] While today some statutes punish the bribe payer and receiver, historically a few actually viewed the bribe payer as a victim.[211] This old idea has fortunately faded over the years, and now we recognize that if we did not prosecute the bribe payer, he could continue to cheat the public by bribing other officials.[212]

Bribery was viewed as problematic in the United States well before it was acknowledged as an issue in Europe or the rest of the world.[213] After the ratification of the Constitution, bribery of customs officers and judges was one of the first federal criminal statutes.[214] Bribery was discussed by the Founding Fathers more frequently than issues such as factions, instability, and even violence.[215] Not only did the United States recognize the harms of bribery early, but the evolution of bribery laws continued. For example, early court decisions showed a reluctance to enforce any corruption laws other than the "quid pro quo" variety.[216] Today, there are many laws which do not have this requirement.[217] Enhanced federal law enforcement in this area really began in the early 1970s and has continued ever since.[218] Investigating and prosecuting corruption/bribery has been labeled by the federal government as an "important federal mission."[219] That said, people have argued about who should prosecute bribery.[220] The federal government investigates and prosecutes local bribery/corruption cases fairly frequently, but there does not seem to be much of a pattern as to which cases the federal government chooses to pursue.[221]

---

209. Lindgren, *supra* note 164, at 874.
210. Lindgren, *supra* note 163, at 1705.
211. Carey, Ellis & Savage,, *supra* note 187, at 353.
212. *See* Lindgren, *supra* note 163, at 1700.
213. TEACHOUT, *supra* note 154, at 1.
214. Henning, *supra* note 153, at 829.
215. TEACHOUT, *supra* note 154, at 57.
216. *Id.* at 7.
217. For example, "gratuity" is a form of corruption/bribery that does not have this requirement. *See* 18 U.S.C. § 201(c)(1)(A) (1962).
218. George D. Brown, *Stealth Statute—Corruption, The Spending Power, and the Rise of 18 U.S.C. § 666,* 73 NOTRE DAME L. REV. 247, 253 (1998).
219. Abrams, *supra* note 167, at 246.
220. *See generally* Brown, *supra* note 218.
221. Abrams, *supra* note 167, at 244.

Public corruption is one of the hardest crimes to investigate and prosecute.[222] It is often hard to prosecute bribery crimes in part because neither the bribe payer nor the bribed complains.[223] In addition, bribery often produces difficult questions of individual culpability.[224] Last, it is not like murder or even theft where the injured party is readily and immediately apparent. For these and numerous other reasons, ranging from states' limited resources to the level of political connections that influence states' behavior, bribery cases are often pursued at the federal rather than state or local level.[225] The crime of bribery has been described by scholars and courts as "worse" than other crimes, "akin to treason," and "despicable."[226] While it is true that bribery is objectionable from both a deontological perspective and a consequentialist one,[227] this Article will especially focus on the latter—in short, it will analyze the harms that bribery causes.

B. *The Harms Associated with Bribery*

Theodore Roosevelt said that bribe payers are worse than thieves because "the thief robs the individual, while the corrupt official plunders an entire city or state. He is worse than a murderer because a murderer takes one life while the corrupt official and the man who corrupts the official alike aim at the assassination of the commonwealth itself."[228] As described by President Roosevelt, the harm of bribery is far-reaching and affects many people. Harm from bribery has two aspects, namely harm from the original action itself, and harm from subsequent bad substantive decisions.[229] Scholars have argued that the criminal law should only be used when there is a public harm (i.e., a harm that damages a collective social interest) and not just a purely private harm.[230] Bribery is often viewed as

222. Henning, *supra* note 153, at 804.
223. TEACHOUT, *supra* note 154, at 121.
224. Buell, *supra* note 78, at 518.
225. Carey, Ellis & Savage, *supra* note 187, at 304–05.
226. Lowenstein, *supra* note 171, at 806.
227. Daniel H. Lowenstein, *Campaign Contributions and Corruption: Comments on Strauss and Cain,* 1995 U. CHI. LEGAL F. 163, 181 (1995).
228. TEACHOUT, *supra* note 154, at 185.
229. Lowenstein, *supra* note 171, at 843.
230. Hasnas, *supra* note 17, at 1337.

a crime against public justice rather than against a person.[231] "Those who bribe seek undeserved favors for themselves, and those who are bribed violate the public trust."[232] This violation of trust is the lens through which the abstract harm can be seen. Commentators have pointed out that government corruption at any level threatens public confidence at all levels.[233] Political corruption is a special kind of threat to a government, and said government has the authority and duty to prevent it.[234] Bribery specifically and corruption in general cause the destruction of democratic institutions, and leads to fatalism, moral decay, hopelessness, and inaction.[235] One of the main concerns with bribery is the risk of subversion of the democratic electoral process.[236] "Bribery is undemocratic . . . . A public official who fails to act in the larger public interest because of a bribe payment has disrupted democracy and political participation."[237] Beyond the harms caused by the deterioration of "public confidence" in the government,[238] there are also more tangible harms.

There are many direct and indirect costs of corruption, including an increase in the costs to taxpayers from noncompetitive bidding, nonproductive use of money for bribes, loss of tax income, erosion of the free market, costs associated with investigation and prosecution.[239] The corrupt payment unfairly disrupts the official decision-making process[240] and, for instance, can lead to improper infrastructure that can even result in the destruction of multiple buildings in times of natural disasters.[241] In such dramatic and tragic instances, bribery can result in lower-quality goods that kill dozens, hundreds, or

231. Lindgren, *supra* note 164, at 862.
232. Thompson, *supra* note 194, at 1040.
233. Brown, *supra* note 218, at 259.
234. Abrams, *supra* note 167, at 212.
235. Duane Windsor & Kathleen Getz, *Multilateral Cooperation to Combat Corruption: Normative Regimes Despite Mixed Motives and Diverse Values,* 33 CORNELL INT'L L.J. 731, 757 (2000).
236. Segal, *supra* note 180, at 521.
237. Windsor & Getz, *supra* note 235, at 756–57.
238. Sheley, *supra* note 20, at 247.
239. Hogarth, *supra* note 165, at 559.
240. Lindgren, *supra* note 163, at 1699.
241. Windsor & Getz, *supra* note 235, at 757.

even thousands of individuals.[242] Another harm can be observed when bribed politicians are able to give licenses or contracts to people who have not met the qualification usually required, as has happened with unlicensed medical doctors.[243] Perhaps less dramatically but still very importantly, bribery can result in large costs to the community, such as how in the 1990s, twenty percent of the extraordinary inflation seen in Russia was attributable to bribes.[244] Even the perception or possibility of bribery can cause harm; for example, if a judge takes bribes in some cases, people in other cases may think that he was overly harsh to them to make it appear as if he was a strict judge.[245] It should be pointed out that while some legal economists have pointed out that bribery can have beneficial consequences, such as reducing the uncertainty of investments,[246] it seems clear that the vast amount of harm will outweigh these benefits. The criminal prosecution of bribery is needed to punish those who strike at the "roots of fairness and democracy" when they use their public trust for private advantage or solicit others to do so.[247] As George Mason said, "[I]f we do not provide against corruption, our government will soon be at an end."[248]

III.
Corporate Bribery

A. *Applying the Bribery Concept to Corporations*

Even though others have argued that corporate criminalization is itself over-criminalization,[249] and in non-bribery settings it has been suggested that some corporations should face reduced penalties,[250] the level of harm involved in bribery renders that argument harder to make there. Many early examples of corporate criminal liability resulted from public harms

242. Sheley, *supra* note 20, at 249 (citing Philip M. Nichols, *The Myth of Anti-bribery Laws as Transnational Intrusion,* 33 Cornell Int'l L.J. 627, 627 (2000)).
243. Carey, Ellis & Savage, *supra* note 187, at 311.
244. Hogarth, *supra* note 165, at 566.
245. Ayres, *supra* note 162, at 1247.
246. Mills & Weisberg, *supra* note 182, at 1379.
247. Lowenstein, *supra* note 171, at 806.
248. Teachout, *supra* note 154, at 38.
249. Gomez-Jara Diez, *supra* note 19, at 43–44.
250. *Id.* at 41.

that lawmakers wanted corporations to internalize rather than have society bear the often large cost.[251] There are some companies that engage in wide-scale bribery,[252] but bribery is not the crime committed most frequently by corporations (those would be fraud, environmental offenses, antitrust activity, and food and drug violations).[253] But bribery is more problematic in several ways.

Traditional arguments that tort law, regulatory law, and other civil remedies are superior to corporate criminal liability are much weaker in the context of bribery compared to other corporate crimes. Even though many scholars have argued that criminal sanctions are not needed in the corporate setting and we should just use tort law, regulatory law, and other civil remedies,[254] for the most part, this is just not possible for bribery. There is no bribe tort (with the possible exception of something like fraud in some situations) and there is no "BPA" (Bribery Protection Agency) like there is an agency for environmental violations. In many if not most situations, if a corporation has bribed an official, the only realistic alternative is the criminal law. Furthermore, bribery is particularly problematic for corporations. Scholars have argued that criminal law is not able to deter bribery because of corporate institutional factors that support it.[255] Several of the inherent attributes of a corporation that may support bribery include the separation of owners and controllers (increasing the difficulties surrounding accountability), the central goal of profit maximization, a frequent ethos of moral neutrality, the necessity to continually grow, constant competition, and the lack of both internal and external visibility.[256] Some scholars have also argued that the harms caused by corporations are magnified by the "geographic, structural, and temporal complexities of its operations."[257] There is often a sense that other corporations are engaged in bribery, and if a given corporation does not participate in it as well, it will be at a competitive disadvantage.[258]

---

251. Khanna, *supra* note 22, at 1485–86.
252. Narine, *supra* note 62, at 74.
253. GARRETT, *supra* note 21, at 36.
254. *See id.* at 268–69; Khanna, *supra* note 22, at 1488.
255. Hogarth, *supra* note 165, at 572.
256. *Id.* at 560.
257. Sheley, *supra* note 20, at 228.
258. Hogarth, *supra* note 165, at 562.

Systematic problems within corporations that result in bribery demand systematic solutions. Individuals alone may in fact not be perpetrating or at least orchestrating the criminal behavior, and instead it may be a corporation's standard operating procedure or a part of its business strategy that is creating the criminal behavior.[259] Corporations' cultures and customs can affect an individuals' attitudes and behaviors.[260] "Corporate culture can encourage agents to act unlawfully."[261] If we attribute the criminal behavior of corporations to the individual alone, we may disregard the institutional processes occurring within the organization, which may have at least contributed to, if not in fact caused, the criminal behavior.[262] There are many relevant ways that corporate culture and organizational structure can influence individual decision making.[263] Indeed, the policies of corporations can actually encourage criminal behavior.[264] A well-known example of wrongdoing intimately tied to the character and culture of the corporations involved was the tobacco companies' longstanding pattern of fraudulently misleading regulators and the public about the health risks related to smoking.[265] In these types of situations, the right question to ask is: "What was going on in that organization that made people act that way?"[266] In the bribery setting, part of what is happening is that there is a reduced incentive for the corporation to discover the misconduct[267] combined with a large amount of money involved (in excess of one billion dollars in some high-stakes situations).[268]

---

259. *See* Beale, *supra* note 86, at 1484 (citing the engineering giant Siemens's systemic use of bribes as one example).

260. Ripken, *supra* note 85, at 103.

261. Moohr, *supra* note 99, at 1358.

262. Charles R.P. Pouncy, *Reevaluating Corporate Criminal Responsibility: It's All About Power*, 41 STETSON L. REV. 97, 110 (2011).

263. *See* Goforth, *supra* note 35, at 634 (identifying increased risk taking, the desire to engage in team playing at the expense of good judgment, and the decision to cut corners).

264. *See* MARSHALL B. CLINARD & PETER C. YEAGER, CORPORATE CRIME 58 (2006).

265. *See generally* Peter Pringle, *The Chronicles of Tobacco: An Account of the Forces that Brought the Tobacco Industry to the Negotiating Table*, 25 WM. MITCHELL L. REV. 387 (1999).

266. Goforth, *supra* note 35, at 648.

267. Narine, *supra* note 62, at 44.

268. Sheley, *supra* note 20, at 254.

Given these motivations on the part of corporations, it is not surprising that they are often repeat offenders, and even though recidivism is a generally acknowledged problem and specifically mentioned in the U.S. Federal Sentencing Guidelines, it is not clear that prosecutors take it all that seriously in the corporate criminal context.[269] Corporations exist to make a profit, so if the primary mechanism for dealing with criminal activity is a fine, the corporation will evaluate whether the crime is worth the cost[270] and potentially carry on with business as usual. So what can be done about that?

B. *Making Punishments Fit the Corporate Bribery Crime*

Typically, if convicted of bribery[271] (either giving or receiving) an individual could be sentenced to fifteen years in prison and a $250 thousand fine, and a corporation could receive a $500 thousand fine or triple the value of the bribe.[272] Only a few CEOs or other high-level officers are held accountable in many corporate crimes, in part because it can be difficult to hold an individual responsible in a complex case in which lots of people made decisions.[273] Furthermore, corporate structure makes it very hard to prosecute senior managers and owners for liability; indeed, tracing the chain of responsibility is difficult because the line officers are separated from the upper-level managers, and the owners are separated from the managers.[274] Unfortunately, in at least one survey of corporate ethics, "superiors" were classified as the most important contributing factor to criminal or unethical decision making.[275] In view of this, criminal liability should encourage the optimal level of effort on the parts of owners and managers when they guide their various agents to comply with the law.[276]

---

269. GARRETT, *supra* note 21, at 166.
270. Ramirez, *supra* note 88, at 963.
271. This is one example, since as this Article pointed out earlier, there are many options of laws to use, but the penalties for the most part change in size rather than type.
272. *See* 18 U.S.C §§ 201(b), 3571(b)(3)–(c)(3) (2000).
273. GARRETT, *supra* note 21, at 14.
274. Hogarth, *supra* note 165, at 567.
275. CLINARD & YEAGER, *supra* note 264, at 59.
276. United States v. Hilton Hotels Corp., 467 F.2d 1000, 1005 (9th Cir. 1972).

To analyze when corporate criminal liability should be imposed, we need to "compare the net benefits of imposing corporate criminal liability with the net benefits of imposing alternative liability strategies . . . [like] imposing civil liability on a corporation, imposing civil liability on a manager, and imposing criminal or civil liability on a third party."[277] In conducting this analysis, one should also take into account the possible sanctions used for each offense. Occasionally, the reason for criminal activity in a corporation is that the informal sanctions within the corporation are weak, giving little motivation to the agents of the corporation to follow them, in which case imposing external sanctions can help to correct this error.[278] At the same time, criminal responsibility must always take into account practical considerations to achieve proper application.[279] Scholars have pointed out that some types of liability can either increase or decrease self-policing depending upon the costs and benefits.[280]

Therefore, simply imposing a standard strict liability for all bribery cases may not work. The problem with this approach was demonstrated by Professor Khanna:

> Assume that a corporation wants to reduce the amount of employee wrongdoing by instituting a new internal oversight system that keeps detailed records of what employees do and promises to report suspected instances of wrongdoing to the authorities. Under strict liability, an employee may not believe that the corporation will report employee wrongdoing to the authorities or keep detailed records because doing so would increase the likelihood of bearing a sanction. Strict liability results in the corporation being sanctioned even if it had reported its employees' wrongdoing to authorities. Thus, strict liability makes the firm's threat to "rat out" the employee less credible because the corporation would be increasing the chances of facing a sanction itself. If the measures do not deter employees, then the corporation, anticipating this reaction, probably will not

277. Khanna, *supra* note 22, at 1492.
278. Khanna, *supra* note 63, at 1247–48.
279. Hasnas, *supra* note 17, at 1334.
280. Khanna, *supra* note 63, at 1229.

> implement them or will employ "window dressing" measures—for example, announcing that they will implement the measures and then not actually doing so. Thus, certain enforcement measures will probably unravel under strict liability.[281]

Arguably, the best-case scenario for a corporation in that context is to have a compliance program that appears to comply with the law and encourage agents to comply, but in fact does not actually deter wrongful conduct.[282] Whatever strategy is employed needs to avoid this "cosmetic compliance"[283] whereby a corporation has very ethical-sounding policies, but does not follow them. My proposal may avoid both the "cosmetic compliance" possibility and the chance of reduced policing, because the CEO's job could be at risk. While it may be argued that over-deterrence can result with such a high personal stake for the CEO, this is not a large concern in the case of bribery.

If upper-level managers are involved, typical corporate sanctions may not be effective.[284] Fortunately, there are many different ways to combat corporate crime: the corporation itself can be prosecuted, the officers may be prosecuted in some situations, DPAs and NPAs can force compliance measures upon corporations, and numerous types of regulatory and civil laws can impose many different types of fines upon corporations.[285] The key is to take Professor Lowenstein's observation, that "[s]elf interest should be channeled and tamed, but not condemned,"[286] to heart and figure out how to implement it.

There have been many calls to reform corporate criminal liability, which range from small changes to massive overhauls of the entire system.[287] My proposal is limited to bribery scenarios and attempts to channel self-interest into avenues that also serve the public interest. Corruption and bribery scandals often prompt a typical American reaction of passing laws and toughening enforcement.[288] While the proposal in this Article

281. *Id.* at 1230–31.
282. Narine, *supra* note 62, at 45.
283. GARRETT, *supra* note 21, at 74.
284. Hasnas, *supra* note 16, at 18.
285. Markoff, *supra* note 146, at 799.
286. Lowenstein, *supra* note 227, at 191.
287. Bharara, *supra* note 15, at 58–59.
288. Brown, *supra* note 159, at 752.

does that in some ways, it seeks to improve on the inconsistently successful methods of simply increasing fines and/or jail time. A problem with the existing punishment options that primarily consist of some version of a fine is the fact that the public may view it as a corporation buying its way out of a criminal prosecution.[289] Scholars have pointed out the desirability of not allowing corporations to appear to be doing that.[290] The proposal in this Article increases penalties, but not in a way that creates this impression.

An aspect of showing the appropriateness of corporate criminal liability is establishing that such liability is both needed and efficacious.[291] A number of punishments should be explored in this context. One could involve community service, with specific types of socially beneficial service to be performed and possibly a requirement as to who exactly will provide it.[292] Another option that has been considered in different settings is a so-called adverse publicity order, which requires the corporation to publicly acknowledge the crime that was committed.[293] Both these alternatives have advantages missing from traditional fines. By providing community service, the harm is in some ways redressed more directly, and as long as the corporation must do the work itself, there is no appearance of a corporate buyout. The public acknowledgement could have the increased benefit of not only shaming the corporation, meaning specifically shaming the management, but it would also likely have an impact on the value of the firm (in terms of lost customers and/or stock depreciation). This would result in a less direct fine of sorts, but without the appearance of the corporation buying its way out, and perhaps more importantly, the publicity would decrease the likelihood of repeat offenses. If the general public is aware that a corporation has bribed an official in the past, that corporation will be watched much more carefully than others. In addition, if political officials know that this corporation is being watched, they will not want to engage in any shady dealings with the corporation. As Justice Brandeis famously said, "Publicity is

289. Carolan, *supra* note 92, at 170.
290. Uhlmann, *supra* note 32, at 1301.
291. Dan-Cohen, *supra* note 59, at 27.
292. Carolan, *supra* note 92, at 172–73.
293. *Id.* at 173.

justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[294]

These two suggestions are meant to be less punitive and more rehabilitative, which fits with the DOJ's preference of structural reforms over the more traditional punitive goals associated with the criminal law.[295] Getting the corporation as a whole to avoid bribery is largely accomplished if the upper management fully supports the position. "Corporate compliance is enhanced when management commits to ethical conduct and integrates that commitment into employee performance evaluation."[296]

Some scholars believe that it may in some ways be easier to rehabilitate a corporate offender than an individual, and that this can in part be accomplished by removing the person who is responsible for the situation.[297] That brings this Article to the key part of its proposal, which is to terminate CEOs when their corporation engages in bribery. Specifically, this Article proposes that a default be established as part of any conviction, DPA, or NPA, that the CEO immediately leave her position. In some criminal settings, corporations have already fired the CEO and occasionally all of its top leadership.[298] This would in some ways be an action taken by the corporation, but effectively it would be mandated. The government already imposes requirements on upper-level executives like the CEO and CFO.[299] Clearly, this will be easier to accomplish with DPAs and NPAs. The DOJ has stated that the current deferred prosecutions and non-prosecutions are used in an effort to "avoid collateral consequences."[300] This is so because rather than the shareholders suffering the injury via some kind of fine, the person who is ultimately responsible suffers the consequences. Scholars have argued that corporate managers deserve the blame for a corporation's crimes regardless of their

294. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (1914).
295. Uhlmann, *supra* note 32, at 1323.
296. Ramirez, *supra* note 88, at 958.
297. Carolan, *supra* note 92, at 170.
298. GARRETT, *supra* note 21, at 103, 173.
299. Bucy, *supra* note 72, at 1291.
300. Uhlmann, *supra* note 32, at 1320.

individual participation in the crime.[301] This blame is based on the idea that whether managers committed the crime personally or not, they are responsible for everything that happens under their direction. A number of NPAs and DPAs have already required personnel changes.[302] Some other DPAs have included the requirement of a monitor being installed, and this monitor has on occasion required the board to fire the CEO and other corporate officers.[303]

In settings in which there is no DPA or NPA, the corporation could still be forced to terminate the CEO. In other situations, scholars have recommended that the upper-level managers be forced to leave or that the corporation be forced into dissolution.[304] The mechanisms to force the corporations to undertake certain actions are already in place. The Sentencing Guidelines contain options that if imposed would result in the death of most corporations, and in extreme situations (if the corporation exists for a criminal purpose) the Guidelines explicitly authorize fines large enough to take all the assets of the corporation.[305] Even in situations in which this would not be appropriate, there are other avenues that could be followed that would result in the termination of the corporation. Corporations can be barred from their industry or have their various licenses revoked, states can repeal corporate charters, and several other actions can be taken that would result in the end of the corporation.[306] For example, a healthcare corporation can be barred from any kind of participation in a federal healthcare program, which would effectively cause the demise of a corporation working in that field.[307]

To be clear, this Article is not endorsing the actual termination of a corporation for all instances of bribery, but rather pointing out that we have leverage to force corporations to terminate CEOs whenever bribery occurs. Use of this option would have multiple beneficial effects. First, there would be no sense of a corporation buying its way out of a crime; second, the public would see that upper-level management is not im-

---

301. Sepinwall, *supra* note 22, at 436.
302. Narine, *supra* note 62, at 60.
303. GARRETT, *supra* note 21, at 183.
304. Ramirez, *supra* note 88, at 942.
305. *Id.* at 943–45.
306. *Id.* at 950–51.
307. *Id.* at 949.

mune from consequences when illegalities happen; and most importantly, it would be an effective means of reducing instances of bribery. If the CEO knows that she will lose her job or career if her corporation engages in bribery, there are few if any instances in which she would allow it. Hence, effective and not just cosmetic measures would be in place to virtually guarantee that such conduct does not occur.

CONCLUSION

There is much debate about whether a corporation should be prosecuted for the crimes committed on its behalf, and if so, how. There is little debate that bribery should be a crime, however, at least in the forms presented in this Article. The argument here shows that in the bribery setting, many of the arguments against corporate liability are either eliminated or significantly reduced. Further, this Article demonstrates that the harm involved in bribery can be magnified in the case of corporations. Therefore, unlike many crimes that still have a debatable place in the corporate criminal sanction sphere, corporate bribery must be prosecuted and at least reduced if not eliminated.

Little can be done to reduce human greed, but opportunities for its exploitation can be reduced,[308] and consequences can be increased significantly. When speaking about a crime like bribery that is very hard to catch, has huge possible incentives, and large harmful consequences, more targeted approaches become necessary. Simply increasing fines will not work, as there will always be a setting where the payoff is larger. Subjecting the individuals that actually participate in the bribery to punishment is also no panacea, because the people involved are hard to catch and often will view the potential reward as worth the risk. The solution is to focus the penalties better by requiring corporate personnel to engage in community service, mandating public acknowledgement of inappropriate actions, and, most importantly, forcing CEO termination.

---

308. Hogarth, *supra* note 165, at 567.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 13 FALL 2016 NUMBER 1

NFL TEAM RELOCATIONS IN THE AGE OF MODERN STADIUM FINANCE: MOTIVATIONS FOR A TEAM TO MOVE AND IMPLICATIONS FOR SMALLER MARKETS

ADAM B. HANAU*

INTRODUCTION: FOOTBALL IN LOS ANGELES 236
I. THE EVOLUTION OF STADIUM FINANCE 238
A. *Introduction* 238
B. *History* 238
C. *The Economics of Business Subsidization as Compared to Stadium Subsidization* 242
II. NEW METHODS OF FINANCE 243
A. *The Fall of Municipal Stadium Subsidization and Rise of New NFL Stadium Financing Methods* ... 243
B. *Sports.comms* 245
C. *Personal Seat Licenses (PSLs)* 249

* Copyright © 2016 by Adam B. Hanau. Real Estate Associate at Gibson, Dunn & Crutcher LLP; J.D., 2016, New York University School of Law; B.S., 2013, Columbia University School of Engineering. I would like to thank Gregory Carey, Amy Forbes, Professor Helen Scott, and Professor Gerald Rosenfeld for their assistance with this Note. Without their guidance and direction, this Note would not have been possible. I would also like to acknowledge the NYU Law School Jacobson Leadership Program in Law and Business for providing the opportunity to research and write a Note of this scope. Finally, I would like to thank the entire editorial staff of the NYU Journal of Law & Business for their work in making this Note the finished product that it is. All errors are my own. As this Note is being published, the Oakland Raiders are seriously considering a move to Las Vegas, Nevada. Sheldon Adelson, a local casino magnate, has pledged to contribute funds, and legislation was passed in Nevada that allows for hotel tax increases to contribute to stadium funding.

D. *Stadium Sponsorships* 251
III. THE IMPACT OF SPORTS.COMMS, PSLS, AND STADIUM SPONSORSHIPS ON RELOCATIONS 252
A. *Do These New Financing Methods Facilitate Relocations?* 252
B. *Ramifications of Inquiry* 253
C. *Methodology* 254
D. *The Various Components that Constitute a Team's Value* 254
E. *Pinpointing the Components that Vary from Market to Market* 256
1. *Key Variable #1: Stadium Financing* 257
a. Sports.comm Cash Flows 257
b. Funds from a PSL Offering 258
c. Stadium Sponsorship Revenue 260
d. The Aggregate Effect of These Three Revenue Sources on Stadium Finance 261
2. *Key Variable #2: Television Revenue* 265
CONCLUSION 267

INTRODUCTION: FOOTBALL IN LOS ANGELES

It was only a matter of time before a professional football team returned to Los Angeles. Access to this sort of desirable market, with a population of more than eighteen million people,[1] an entertainment industry that annually generates approximately $120 billion in output,[2] property with an aggregate value of more than $1 trillion,[3] and over forty-five million tourists a year,[4] could not remain untapped for long. In fact, teams used the threat of moving to Los Angeles to extract sub-

1. DISCOVER LOS ANGELES, http://www.discoverlosangeles.com/press-releases/facts-about-los-angeles (last updated Mar. 30, 2016) (this population figure includes the entire Los Angeles Five-County Area).

2. KLEINHENZ ET AL., , THE ENTERTAINMENT INDUSTRY AND THE LOS ANGELES COUNTY ECONOMY (Nov. 2012), http://laedc.org/reports/Entertainmentin LA.pdf.

3. Hannah Miet, *Los Angeles Real Estate More Valuable Than Ever*, L.A. BUS. J. (Aug. 28, 2014), http://www.labusinessjournal.com/news/2014/aug/28/los-angeles-real-estate-more-valuable-ever/ (this aggregate property value is inclusive of property in the entire Los Angeles Five-County Area).

4. DISCOVER LOS ANGELES, *supra* note 1 (this tourism total is inclusive of tourism in the entire Los Angeles Five-County Area).

sidies from their local municipalities for years.[5] By the 2015 National Football League (NFL) season, however, moving to Los Angeles was no longer just a threat. Three different teams, the Oakland Raiders, San Diego Chargers, and St. Louis Rams, all taken by the appeal of Los Angeles, began vying for the opportunity to play in the city.[6] On January 12, 2016, the NFL owners approved the St. Louis Rams' bid to relocate to Los Angeles[7] and left open the possibility of the San Diego Chargers moving there as well.[8]

Yet, the fact that Los Angeles gained a football team with potential for a second is only one side of the story. The other side is that team ownership in Oakland, San Diego, and St. Louis no longer viewed their smaller markets as viable to support professional football teams. In the words of one prominent economist, St. Louis is "too small of a community" to support an NFL team, as teams "want to be in bigger markets [such as Los Angeles]."[9]

This Note will demonstrate that, in a period of declining municipal subsidies, smaller market NFL teams stand to profit from relocating to larger markets due to several new stadium financing methods. These increasingly common techniques, which help generate revenue through "sports communities,"

---

5. *See, e.g.*, Mike Florio, *The Staggering Taxpayer Costs of Paul Brown Stadium*, PFT (Jan. 18, 2016 10:35 AM), http://profootballtalk.nbcsports.com/2016/01/18/the-staggering-taxpayer-costs-of-paul-brown-stadium/ (reporting Hamilton County, Ohio subsidized both stadium construction and ongoing operating expenses of the Bengals under threat of the team moving, totaling $1.1 billion between 2000 and 2026).

6. CBS News, *Will Los Angeles Finally Get a Football Team? They Might Get Two*, CBS THIS MORNING (Oct. 31, 2015 2:34 PM), http://www.cbsnews.com/news/will-los-angeles-finally-get-a-football-team-they-might-get-two/.

7. Although the team will be called the Los Angeles Rams, the stadium will actually be in Inglewood, California, which is less than nine miles away from downtown Los Angeles. *See* DISTANCE BETWEEN CITIES, http://www.distance-cities.com/distance-los-angeles-ca-to-inglewood-ca (last visited Mar. 14, 2016).

8. Sam Farmer & Nathan Fenno, *NFL Will Return to Los Angeles for 2016 Season*, L.A. TIMES (Jan. 12, 2016), http://www.latimes.com/sports/nfl/la-sp-nfl-la-chargers-rams-20160113-story.html.

9. A.J. Perez, *After Losing Another NFL Team, Unlikely St. Louis Will Be Able to Get Another*, USA TODAY (Jan. 14, 2016), http://www.usatoday.com/story/sports/nfl/2016/01/13/st-louis-rams-nfl-relocation-los-angeles-economics/78741320/ (quoting Allen Sanderson, an economics professor at the University of Chicago).

personal seat licenses, and stadium sponsorships, are far more effective at financing stadiums in larger markets and therefore encourage smaller market teams looking to build new stadiums to move to larger markets. Moreover, the NFL's owners are likely to approve these moves because larger markets generate additional television revenue that is entirely shared among NFL teams. Additionally, the owners collect a relocating free from the moving team. Consequently, this Note will argue that further relocations to larger markets can be expected in the coming years as long as these stadium financing methods continue to be used.

I. THE EVOLUTION OF STADIUM FINANCE

A. *Introduction*

In order to understand the nature of modern NFL stadium finance and its effect on team relocations, it is first necessary to track the historical evolution of stadium finance and describe how each model has impacted NFL teams' incentives with regard to relocating. To properly do so, this Section will venture beyond the NFL and describe the broader evolution of stadium finance across all professional sports, including Major League Baseball (MLB), the National Baseball Association (NBA), and the National Hockey League (NHL).

B. *History*

At the beginning of the twentieth century, the early years of professional sports, teams did not relocate often. Instead, any city that did not have a professional sports team, but could support one, was able to form their own new team (i.e., an expansion team).[10] As a result, teams were left without any leverage to induce stadium subsidies from their local municipalities and were forced to finance their own stadiums.[11] Over time, however, teams with shrinking stadium attendance began to see the benefits of relocating to the quickly-growing cit-

10. MARK CONRAD, BUSINESS OF SPORTS: A PRIMER FOR JOURNALISTS 204 (Lawrence Erlbaum Assocs., 2d ed. 2006) (noting that the New York Giants, Detroit Lions, and Cleveland Browns were all expansion teams).

11. *Id.* at 212.

ies out West, which did not already have their own teams.[12] Financially-pressed teams in struggling markets started to recognize that if they relocated, they could capture the benefits of these burgeoning markets rather than an expansion team.

In the 1950s, teams exhibited a newfound desire to relocate, while a limited supply of teams were allowed in each professional league in order to create territorial monopolies.[13] These conditions produced a different power balance in which teams that were looking for new stadiums held leverage over their municipal governments.[14] If a municipality would not provide financial assistance for the local team's stadium, the team could easily relocate to a municipality that would contribute funding.[15] Initially, elected municipal officials were happy to offer generous financial assistance, claiming that it boosted local economic activity.[16] Moreover, politicians were well aware of the strong "emotional bond" that their constituents had toward local teams and feared the political backlash that they would face if they allowed the team to leave.[17] In other words, the general public supported stadium subsidies, and, without serious public scrutiny, elected officials were able to offer large subsidy packages without fully considering their costs and benefits.[18]

---

12. *Id.* at 205. These markets did not already have their own teams because they were only first becoming accessible to sports leagues with the advent of commercial air travel.

13. Louis P. Cain & David D. Haddock, *Similar Economic Histories, Different Industrial Structures: Transatlantic Contrasts in the Evolution of Professional Sports Leagues*, 65 J. ECON. HIST. 1116, 1121 (2005).

14. Bruce W. Burton & Matthew J. Mitten, *Professional Sports Franchise Relocations from Private Law and Public Law Perspectives: Balancing Marketplace Competition, League Autonomy, and the Need for a Level Playing Field,* 56 MD. L. REV. 57, 97 (1997).

15. Zachary A. Phelps, *Stadium Construction for Professional Sports: Reversing the Inequities Through Tex Incentives*, 18 ST. JOHN'S J.L. COMM. 981, 985 (2004).

16. ?"For politicians eager to embrace sports deals, it's easy to find consulting firms willing to produce glowing 'economic impact studies.'" Neil DeMause, *Why Do Mayors Love Sports Stadiums?*, THE NATION (Jul. 27, 2011), http://www.thenation.com/article/why-do-mayors-love-sports-stadiums/; *see also* Phelps, *supra* note 15, at 1012; Dennis Coates & Brad R. Humphreys, *Do Economists Reach a Conclusion on Subsidies for Sports Franchises, Stadiums, and Mega-Events?,* 5 ECON. J. WATCH 294, 300 (2008).

17. Burton & Mitten, *supra* note 14, at 98.

18. *Id.*

Traditionally, municipal subsidies were offered in one of three ways: (1) by designating the stadium construction bonds as tax-exempt municipal bonds,[19] which allowed teams to pay lower interest payments to bondholders because the bondholders would not be taxed on the interest payments they received; (2) by exempting the stadium property from property taxes;[20] and/or (3) by offering direct cash contributions to help fund the stadium construction.[21]

As public stadium subsidies became increasingly common, economists began to study their effectiveness. The general consensus, nearly universally accepted in the academic community,[22] was that these subsidies were an inefficient way to promote economic development.[23] The studies found that sports stadiums do not actually impact the local economy significantly[24] and that there are much more effective methods to create jobs and boost the local economy with public money.[25] Moreover, stadium subsidies tend to cause municipalities to spend far beyond their means.[26] Meanwhile, team owners benefitted tremendously, as their franchises' values were significantly boosted as a result of public subsidies.[27] A recent study focusing on cities that lost a professional sports team subsequently confirmed that such cities saw "no statistically sig-

---

19. Anoop K. Bhasin, *Tax-Exempt Bond Financing of Sports Stadiums: Is the Price Right?*, 7 VILL. SPORTS & ENT. L.J. 181, 182–83 (2000). Subsequently, the Tax Reform Act of 1986 was passed to curb this abuse. *Id.* at 184.

20. Stephen F. Ross, *Monopoly Sports Leagues*, 73 MINN. L. REV. 643, 649 (1989).

21. Phelps, *supra* note 15, at 1011.

22. Coates & Humphreys, *supra* note 16, at 296 (eighty-six percent of economists surveyed "agreed" or "strongly agreed" governments should cut subsidies to professional sports franchises).

23. Matthew J. Parlow, *Publicly Financed Sports Facilities: Are They Economically Justifiable? A Case Study of the Los Angeles Staples Center,* 10 U. MIAMI BUS. L. REV. 483, 513–17 (2002).

24. *Id.* at 517.

25. *Id.* ("Several studies indicate that cities could benefit more through other investment and development options.").

26. *See, e.g.*, Phelps, *supra* note 15, at 996. In particular, municipal bidding wars often result in the winning municipality offering a subsidy that is beyond its financial means. Burton & Mitten, *supra* note 14, at 61; *see also* Florio, *supra* note 5 (arguing Cincinnati spent well beyond its means when it offered the Bengals a $1.1 billion subsidy over a twenty-six year span).

27. Parlow, *supra* note 23, at 490.

nificant effects" on per capita income or on unemployment in the years after losing the team.[28]

Notwithstanding the cogent argument put forth by economists, many municipalities[29] turned to the initial justifications for stadium subsidies and continued to offer them.[30] They claimed that the economic studies did not paint the full picture, without the ability to capture the effects of many unquantifiable local benefits, such as civic pride[31] and the notion that being a "big-league city" legitimizes the city and helps it attract business.[32] Yet, even those elected officials who accepted the legitimacy of the economic studies were still stuck with a catch-22. Their choice was to either provide the costly subsidy in order to keep the team or show restraint, lose the team to a municipality willing to provide the subsidy, and deal with the fallout from constituents. Despite the growing body of economic literature demonstrating the ineffectiveness of stadium subsidies, municipalities continued to offer subsidies because of the strong leverage held by the teams.[33] In this era of municipal subsidization, a team's decision about where to locate was significantly affected by the subsidies that municipalities offered them. As a result, municipalities that could afford subsidies

---

28. Jesse Stephenson, Letting Teams Walk: Exploring the Economic Impact of Professional Sports Franchises Leaving Cities, 21 (Spring 2013) (unpublished MPA/MPP Capstone Project, University of Kentucky), http://uknowledge.uky.edu/cgi/viewcontent.cgi?article=1024&context=mpampp_etds.

29. Note, however, that municipalities in certain states were never able to offer these sorts of subsidies. For example, municipalities in California were, for all intents and purposes, never able to offer subsidies because "Propositions 13 and 218 require two-thirds of voters to support a special tax levied specifically to finance a specific project, such as a stadium." Mike Swift, *Seeking a Way to Pay For a New 49ers Stadium*, SAN JOSE MERCURY NEWS (Mar. 20, 2007), http://www.mercurynews.com/ci_5477250.

30. *See* Coates & Humphreys, *supra* note 16, at 299–300.

31. Burton & Mitten, *supra* note 14, at 60.

32. *Id.* at 65, 98. Wisconsin State Representative Marlin Schneider highlighted this point in the memorable quote: "Without the Brewers, without the Bucks, without the Packers, [Wisconsin] ain't nothing but another Nebraska." *Quotables*, CHI. TRIB. (Oct. 2, 1995), http://articles.chicagotribune.com/1995-10-02/news/9510020083_1_cubs-fan-law-professor-paul-rothstein-cab-drivers.

33. *See* Roger G. Noll & Andrew Zimbalist, *Sports, Jobs, & Taxes: Are New Stadiums Worth the Cost?*, BROOKINGS (Jun. 1, 1997), http://www.brookings.edu/research/articles/1997/06/summer-taxes-noll.

were much more likely to attract and maintain professional teams.

C. *The Economics of Business Subsidization as Compared to Stadium Subsidization*

To better understand the role and impact of stadium subsidies, it is important to situate them within the broader context of business subsidies. Generally, economists view the competition to offer business and tax subsidies designed to attract specific businesses to their state as costly and unproductive, both to the state offering the subsidy and to the national economy as a whole.[34] Notwithstanding this generally accepted position, "each state finds it difficult to walk away from the competition as long as other states continue to up the ante."[35] Put differently, as long as some states offer tax incentives, it becomes very difficult for other states to refrain from offering similar ones. In particular, businesses have become adept at pinning local governments against one another,[36] and they have come to expect subsidies from states.[37] The forces underlying general business subsidies are thus similar to those underlying stadium subsidies. Both demonstrate how elected officials are essentially strong-armed into offering incentives in order to induce local businesses or teams to stay. Furthermore, in both cases, although the local government may recognize the economic inefficiency of offering these subsidies, they will ultimately relent to the business or team, which retains all the leverage.

Despite the similarities between business subsidies and stadium subsidies, there is a crucial difference between the two. When businesses decide where to locate, they pay little attention to state subsidies. Other factors, such as "wage levels, skill levels, utility costs, accessibility of raw materials and markets, and regulatory stringency," more centrally influence their choices.[38] For sports teams, on the other hand, favorable stadium subsidies play a larger role in their decisions where to

34. Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 380 (1996).

35. *Id.*

36. *Id.* at 395.

37. *Id.* at 394.

38. *Id.* at 391.

locate.[39] This is because stadium financing constitutes a substantial portion of a team's expenses and therefore plays an integral role in their bottom line.[40] In other words, while stadium subsidies may be economically inefficient to the municipality, they at least significantly impact a team's decision where to locate. In that sense, stadium subsidies are not as ineffective as general business subsidies, which are both economically inefficient and, unless enormous in size, unlikely to affect a business's ultimate decision about location.

II.
NEW METHODS OF FINANCE

A. *The Fall of Municipal Stadium Subsidization and Rise of New NFL Stadium Financing Methods*

The recent evolution of NFL stadium finance can now be understood within the context of general stadium financing.[41] As described above in Part I, although the economic arguments against stadium subsidies were widely accepted, NFL stadiums continued to receive subsidies for many years due to the leverage that teams held over municipalities. Consequently, many public officials interested in curbing this abuse of municipal funds wanted to nip the leverage problem in the bud by ensuring that cities did not compete against one another to attract NFL teams.[42] As a result of these efforts, a few different suggestions emerged: (1) deny relocations and require that a certain percentage of television revenue be used to create a stadium trust fund that would help teams pay for their new stadiums;[43] (2) charge a *relocation fee* to teams that move;[44] and/or (3) expand the number of teams in each league to

39. Phelps, *supra* note 15, at 1004–09.
40. *See, e.g.*, *id.*, at 1004; CONRAD, *supra* note 10, at 206.
41. All of the analysis in this Section is NFL-specific. Nonetheless, because the stadium financing methods described in this Section are used to finance all professional sports stadiums, many of the sources cited in this Section are not NFL-specific.
42. Many of these measures were not meant to address the NFL's relocation problem in particular, but to address the relocation problem that faced all professional sports teams.
43. Stadium Financing and Franchise Relocation Act of 1999, 1999 S. 952, 106th Cong. (1st Sess. 1999).
44. Phelps, *supra* note 15, at 1005.

meet the country's demand.[45] Although all of these recommendations were generally viewed as viable, the relocation fee alone was implemented.[46] Although the relocation fee—which in the case of the Los Angeles Rams was reported to be a hefty $650 million to be paid out over twenty years[47]—does limit a team's incentive to move, it clearly does not discourage relocations entirely. This is demonstrated by the fact that the Chargers, Rams, and Raiders were all interested in relocating to Los Angeles in spite of the fee.[48]

Notwithstanding the failure to curb relocations entirely, the supply and size of municipal subsidies has shrunk as a result of the 2008 recession, as cities began looking for ways to tighten their budgets.[49] Yet, even before municipal subsidies began to dry up, teams started experimenting with innovative models to privately finance their stadiums over the past two decades.[50] Since the recession, however, these models have

---

45. Burton & Mitten, *supra* note 14, at 133.

46. Ken Belson, *Rams Moving to Los Angeles Area, and Chargers Could Join Them*, N.Y. TIMES (Jan. 12, 2016), http://www.nytimes.com/2016/01/13/sports/football/rams-moving-to-los-angeles-area-and-chargers-could-join-later.html?_r=0; *see also* Phelps, *supra* note 15, at 1002 (implying that the Franchise Relocation Act of 1999 did not pass because of powerful lobbying by NFL owners and their investment bankers).

47. Belson, *supra* note 46.

48. *Supra* Introduction.

49. Martin J. Greenberg & Dennis Hughes, Jr., *Sports.comm: It Takes a Village to Build a Sports Facility*, 22 MARQ. SPORTS L. REV. 91, 92 (2011). "The recession has also increased the aggressiveness of public watchdog groups opposed to public subsidies for sports facilities." *Id.* at 160. *But see* Brad Tuttle, *'Fricking Ridiculous' NFL Stadium Seat Fees Cost Thousands—But Fans Pay Up*, TIME (Oct. 6, 2013), http://business.time.com/2013/10/06/fricking-ridiculous-nfl-stadium-seat-fees-cost-thousands-but-fans-pay-up/ (indicating that some subsidies are still being offered after the recession). Moving forward, this paper will assume that large municipal subsidies are a thing of the past. Nonetheless, as the economy continues to recover, this assumption may turn out to be incorrect. It is important to note that the conclusion of this paper is not dependent on this assumption, as the favorable stadium financing available in large markets, see *infra* Part III, may still overcome the municipal subsidies that smaller market municipalities are able to offer. *See infra* Part IV; *infra* text at note 166; Mike Florio, *St. Louis Submits Stadium Proposal to Keep the Rams*, NBC SPORTS: PFT (Dec. 29, 2015, 12:51PM), http://profootballtalk.nbcsports.com/2015/12/29/st-louis-submits-stadium-proposal-to-keep-the-rams/ (noting the over $150 million in public funds offered to finance a Rams stadium in St. Louis).

50. *See infra* notes 51–55.

taken on even greater importance since teams could no longer continue to rely on municipal subsidies as they had in the past. One model, the "sports communities" model ("sports.comm"),[51] involved concurrently building the stadium and developing its surrounding real estate in order to provide an additional income stream to offset the stadium construction costs.[52] Another model involved raising construction funds by selling personal seat licenses (PSLs), or rights to purchase season tickets for a particular seat in the new stadium before construction even began.[53] Finally, stadium sponsorships, the sale of a stadium's naming rights to a sponsor, although not new, have begun to demand substantially higher premiums in recent years and therefore play an increasingly important role in modern stadium financing.[54] These revenue sources,[55] which are used to offset stadium construction costs, will now be described in detail.

B. *Sports.comms*

A new stadium, like any other real estate development, provides an opportunity to revitalize an area. This is especially true when the stadium is built as a part of a "master planned sports and entertainment community," i.e., a sports.comm, that constructs office, retail, residential, and restaurant space based on an area's local needs.[56] To accomplish this, savvy

---

51. Martin L. Greenberg, Symposium, *International Sports Law & Business in the 21st Century: Sports Facility Financing and Development Trends in the United States*, 15 MARQ. SPORTS L. REV. 93 (2004) (coining the term sports.comm).

52. *See infra* Section II.B.

53. *See infra* Section II.C.

54. *See infra* Section II.D.

55. Another such model, created by Greg Carey and Robert Kraft and not considered further in this paper, lowered interest payments on the stadium's financing by combining construction financing and permanent financing in a complicated structure, which: (a) pledged future revenue from ads, naming rights, luxury suites, and concessions; (b) purchased credit enhancement; and (c) guaranteed construction with completion bonds. Greg Farrell & Andrew Martin, *How Goldman Banker Became NFL's Go-to Stadium-Finance Guy*, BLOOMBERG BUS. (Jan. 29, 2015), http://www.bloomberg.com/news/articles/2015-01-29/how-goldman-banker-became-nfl-s-go-to-stadium-finance-guy. Because the benefits provided by this model should not vary much across different markets, it will not be considered further.

56. Greenberg & Hughes, *supra* note 49, at 115.

team owners buy[57] more land than is needed for the stadium alone, knowing that the property will become more desirable once the stadium is built and made more accessible by infrastructure improvements, which typically follow stadium construction.[58] This property is then developed into a broader entertainment community. The sports.comm has proven to be an effective financing method since the property that surrounds the stadium provides the team owner with an additional source of revenue.[59]

Sports.comms also have the benefit of being flexible, in that teams can control the design of the surrounding development, and the advantage of its revenue not being shared among NFL owners in the same way as ticket revenue.[60] Moreover, unlike the traditional stadium revenue stream, sports.comms provide a 365-day-a-year revenue stream from diverse sources, including office, retail, and residential use. In other words, a sports.comm becomes a "super-regional lifestyle destination."[61] Further, the sports.comm is helpful to owners because the revitalizing nature of the development makes cities more willing to contribute to the capital needs of the area, such as roads and sewers.[62] The sports.comm has thus become an increasingly common model for stadium finance, as it provides a source of financing in an era of when government subsidies are minimal[63] and offers financial benefits at the onset of construction to help offset prohibitive construction financing in a way that a stadium's revenue cannot.[64]

---

57. Other procurement methods can be used as well. For example, eminent domain was used to acquire the land around the Barclays Center, an arena that is home to an NBA team and an NHL team, in order to develop the Atlantic Yards sports.comm. 730 Equity Corp. v. N.Y. Urban Dev. Corp., 43 Misc.3d 1226 (N.Y. Sup. Ct. 2014).

58. Greenberg & Hughes, *supra* note 49, at 115–16.

59. *See id.*

60. *See id.* at 116.

61. *Sustainability Initiatives,* PATRIOT PLACE, http://www.patriot-place.com/green-initiatives#.VucTZJMrKfQ (last visited Mar. 14, 2016).

62. Greenberg & Hughes, *supra* note 49, at 121. Note that even municipalities in California, which for all intents and purposes are unable to offer general stadium subsidies due to Propositions 13 and 218, are able to offer these sorts of ordinary capital improvements, which do not require levying any additional special taxes. *See* Swift, *supra* note 29.

63. *See* Greenberg & Hughes, *supra* note 49.

64. *See supra* Section II.A (describing this process in greater detail).

Capturing the sports.comm revenue at the onset of construction can be accomplished in several different ways. The first is via cross-subsidization, whereby the revenue received from the properties surrounding the stadium help pay for the cost of the stadium itself.[65] While this method is straightforward and may help offset the costs of financing the stadium over the long run, it does not help offset the stadium's high construction costs in early years.[66] This is because the properties developed around the stadium are unable to generate much revenue until a few years after the stadium is complete and the market has calibrated to reflect the real estate's new value.[67] Therefore, expensive financing is still required to fund the stadium construction and the surrounding development initially. Nonetheless, having the surrounding development can still provide some benefit in early years. The stadium's construction loan can be secured by the surrounding property, in addition to being secured by the stadium property itself, to lower the stadium's borrowing costs.[68]

The second way to benefit from the future income stream is through tax increment financing (TIF).[69] TIF allows the developer to secure the benefits of the expected increase in property taxes in the area—due to higher property valuations attributable to the sports.comm—in the form of payments from the government.[70] What makes TIF extremely helpful to the developer is the fact that she is given the benefits upfront, even though the increased tax revenues will not be generated until some time in the future. It is important to note that TIF,

---

65. *See* Greenberg & Hughes, *supra* note 49, at 116.

66. Even with construction financing, the financing is still expensive in early years, as interest on the construction loan compounds even if there are no interest payments due.

67. *Cf.* Greenberg & Hughes, *supra* note 49, at 137.

68. This type of loan is often called a blanket mortgage. "Rather than mortgaging each lot separately, a blanket mortgage can be used to reduce costs." QUICKEN LOANS, http://www.quickenloans.com/mortgage-glossary/blanket-mortgage (last visited Mar. 14, 2016).

69. Greenberg & Hughes, *supra* note 49, at 98.

70. CRAIG L. JOHNSON, TAX INCREMENT FINANCING 4 (Nov. 2002) (on file with author). See also *The NFL's Return to Los Angeles*, L.A. TIMES, Slide 6, http://www.latimes.com/sports/nfl/la-sp-sn-the-nfl-in-l-a-20151111-storygallery.html, for a rendering of the extravagant sports.comm, which is likely to fetch a high property valuation, that will surround the Rams' new stadium in Inglewood.

while providing financing upfront, also delivers an *additional* revenue stream, separate from the future revenue stream that the sports.comm itself will generate. Consequently, TIF is very helpful to the developer by lowering construction financing costs. In general, TIF is structured in one of two ways, both of which allow the developer to receive the benefits upfront: (1) the government provides funding for the sports.comm and expects to recoup at least that amount in the future through the higher property taxes;[71] or (2) the stadium owner is promised a right to a certain portion of the increased property tax revenue that the sports.comm is expected to facilitate.[72] Under the latter method, although the benefits do not materialize until after the stadium is complete, the owner can still utilize these benefits immediately by issuing bonds that are securitized by this future receipt of tax revenue.[73] Done properly, TIF presents a viable model for sports.comm financing and helps to substantially reduce stadium construction costs. Furthermore, it presents a more efficient form of government subsidy, as the subsidy amount is capped at the increase in tax revenue that the stadium generates.[74] Yet, the TIF model can run into problems in a situation where the appropriateness of the tax financing method is challenged in court. If the court ultimately rejects the appropriateness of the TIF, the bondholders are left at risk of not receiving the tax revenue. One illustrative contemporary example revolves around the bonds that were used to fund University of Phoenix Stadium, home of the Arizona Cardinals, which, instead of being secured by property taxes, were securitized by a local rented vehicle tax.[75] A few

71. Greenberg & Hughes, *supra* note 49, at 96. The government justifies these subsidies as "expenditures to promote development that would not otherwise be likely to occur." *Id.*

72. *Id.* at 97–98.

73. Jesse S. Ishikawa, *Developer-Funded Tax Incremental Financing: Promoting Development Without Breaking the Ban*k, STATE BAR OF WISCONSIN (May 2006), http://www.wisbar.org/newspublications/wisconsinlawyer/pages/article.aspx?Volume=79&Issue=5&ArticleID=1039.

74. In this sense, TIF is less a subsidy and more a way of allowing the stadium owner to capture some of the positive externality that she creates. *See* Greenberg & Hughes, *supra* note 49, at 96.

75. Aaron Kuriloff, *While Arizona Cardinals Soar, Legal Battle Puts Stadium Investors in Red Zone*, WALL ST. J. (Oct. 24, 2015), http://www.wsj.com/articles/while-arizona-cardinals-soar-legal-battle-puts-stadium-investors-in-red-zone-1445679183.

parties have challenged the legality of using this tax to fund the stadium.[76] In the interim, the bondholders' ability to reach the funds generated by this vehicular tax is uncertain.[77] To conceptualize the issues that TIF faces, if the TIF is secured by too expansive of a tax base—and thus becomes more like a general municipal subsidy than funding that actually captures the revenues that the project generates[78]—it will face the same hurdles that general municipal subsidies face.[79]

There are other ways in which the surrounding sports.comm development can be used to help finance stadium construction, including, the new market tax credit, which offers federal income tax credits for investments in certain low-income communities,[80] and the EB-5 program, which encourages access to cheap foreign capital by offering a green card to its participants.[81]

Overall, the sports.comm model is particularly promising because it is advantageous to both the NFL team owner and to the local municipality. Teams are happy with the favorable financing, and municipalities, meanwhile, appreciate the revitalization of entire urban areas that have fallen into disrepair.[82]

C. *Personal Seat Licenses (PSLs)*

A personal seat license is best described as a "deed to a specific seat in an NFL team's stadium."[83] Similar to sports.comms, the sale of PSLs has proven to be an effective financing method because PSLs allow the stadium owner to raise substantial additional revenue before construction even begins. A PSL entitles its owner to purchase season and post-season tickets for that seat, which can then be used or resold.[84] The PSL is issued by the team itself, and the license holder

---

76. *Id.*
77. *Id.*
78. *See* Greenberg & Hughes, *supra* note 49, at 96.
79. *See supra* Section I.B.
80. Greenberg & Hughes, *supra* note 49, at 98–99.
81. *Id.* at 99–100.
82. *Id.* at 101.
83. Mike Ozanian, *Are NFL Personal Seat Licenses Good Investments*?, FORBES (Nov. 25, 2015, 2:02 PM), http://onforb.es/1R6HiC2.
84. *Id.*

subsequently may resell the license on the secondary market.[85] PSLs are strictly regulated by the league's collective bargaining agreement, and a team can only issue them when it is constructing a new stadium or renovating its current stadium.[86]

In general, PSLs are tremendously beneficial to team owners, as they provide additional means to finance stadiums and lower the amount of funding the owner must contribute.[87] This is a windfall to team owners since they are given these additional funds without giving up anything in return. As a result, a portion of the stadium financing incidence, which would have fallen on team owners themselves before PSLs existed, now falls on the team's fans. Moreover, these revenues are exempt from the league's revenue sharing formula.[88] It is therefore not surprising that NFL teams have recently come to rely more on PSL financing. While PSLs raised $800 million in primary market financing between 1995–2008, they raised over $2 billion between 2009–2014.[89] To date, seventeen NFL teams have used PSL financing to help offset their stadium costs.[90] The Dallas Cowboys raised an astonishing $650 million in PSL financing.[91]

While the advent of PSLs has brought considerable benefits to NFL owners, and has helped reduce teams' reliance on municipal subsidies, it does present some downsides. One negative impact of PSLs is the fact that their resale values typically increase immediately after their issuance, only to taper-off over time and ultimately drop below the initial offering price.[92] Although many purchasers are aware of this trend,

---

85. *Id.* PSLs are thus similar to stocks due to their IPO-like initial sale and fairly liquid secondary market. *See, e.g.*, PSL SOURCE, http://www.pslsource.com/transfer_periods/ (last visited Sept. 27, 2016).

86. Steven H. Salaga, Empirical Essays in Sport Management (2012) (unpublished Ph.D. dissertation, University of Michigan) (on file with author).

87. Ozanian, *supra* note 83.

88. Salaga, *supra* note 86, at 7.

89. Ozanian, *supra* note 83.

90. PSL SOURCE, *supra* note 85.

91. For a complete list of the amount of PSL revenue that each team raised through September 2011, see, for example, *NFL Teams Sold an Average of 48,200 Personal Seat Licenses Last Season*, STREET & SMITH'S SPORTS BUS. DAILY (Sep. 8, 2011), http://www.sportsbusinessdaily.com/Daily/Issues/2011/09/08/NFL-Season-Preview/PSLs.aspx [hereinafter *Average PSLs Sold*].

92. Ozanian, *supra* note 83; *see also* Jason Notte, *5 Ways NFL Fans Lost the Personal Seat License Gamble,* THESTREET (Oct. 9, 2015), http://www.thestreet.

they decide to buy the PSLs anyway because even if a poor investment, PSLs are needed in order to buy season tickets.[93] Another related downside of PSLs is their impact on ticket prices. While NFL tickets were already considered unaffordable by many fans, PSLs have only exacerbated the problem. One politician went as far to describe PSLs as "just stealing from the people."[94] Finally, legal complications regarding seat ownership rights can arise once a team decides to relocate. In the case of the Rams, the team's existing PSL holders, from St. Louis, brought an unsuccessful lawsuit to have their PSL rights transferred to the Rams' new Inglewood stadium.[95]

D. *Stadium Sponsorships*

Although stadium sponsorships are not new,[96] the size of these sponsorships has grown tremendously over the past two

---

com/story/13318781/2/5-ways-nfl-fans-lost-the-personal-seat-license-gamble.html.

93. "Despite their risky investment prospects, San Francisco fans are racing to buy PSLs. After all, most fans don't buy PSLs to make money—they buy them to see their favorite teams." Dan Alexander, *NFL PSLs Have Become Very Risky Investments*, FORBES (Sep. 5, 2012), http://www.forbes.com/sites/danalexander/2012/09/05/nfl-psls-have-become-very-riskyinvestments/#d4c9c4712447.

94. Tuttle, *supra* note 49.

95. Although the PSL contract explicitly included the clause, "Licensee acknowledges that this Agreement remains valid only as long as NFL football is played at the Stadium by the Rams," PSL holders claimed that this represented a contract of adhesion, and that their rights to season tickets should be transferable to Inglewood Stadium. Mike Florio, *Rams PSL Contained Language Regarding Relocation, Lawsuits*, PRO FOOTBALL TALK (Jan. 23, 2016, 1:06 AM), http://profootballtalk.nbcsports.com/2016/01/23/rams-psls-contained-language-regarding-relocation-lawsuits/. The judge ruled against this transferability claim, but is requiring the Rams to "refund . . . deposit[s]," whose amounts are to be "determined at a later date." Nathan Fenno, *Rams Must Refund Deposits for Personal Seat Licenses or Offer Tickets to Some in St. Louis, Judge Says*, L.A. TIMES (Sep. 22, 2016), http://www.latimes.com/sports/rams/la-sp-rams-psl-lawsuit-20160922-snap-story.html. Had the plaintiffs won on the transferability grounds, it would have severely limited the Rams' ability to issue new PSLs, as many of the Inglewood seat licenses would already be owned. As it is, should the judge ultimately award large "deposit" damages, much of the revenue advantage of offering new PSLs at Inglewoord Stadium would be undermined. Large damages would also impact some the PSL analysis below. See *infra* Section III.E.1.b.

96. The first modern day stadium sponsorship was agreed to in 1972, for Rich Stadium, onetime home of the Buffalo Bills. Brad Sarna, *Wrigley Field Naming Rights Value*, ABSOLUTE BRAND (Apr. 1, 2008), http://www.absolute

decades.[97] Unlike PSL revenue, however, stadium sponsorships only provide revenue once the stadium is complete.[98] Nonetheless, pledging the stadium sponsorship revenue as collateral can be helpful in offsetting construction costs.[99] Because of the high dollar totals that these sponsorships demand in larger markets, they have come to play an increasingly important role in stadium financing.

III.
THE IMPACT OF SPORTS.COMMS, PSLS, AND STADIUM SPONSORSHIPS ON RELOCATIONS

A. *Do These New Financing Methods Facilitate Relocations?*

This Section will focus on teams' decisions where to locate in light of the increasing importance of sports.comms, PSLs, and stadium sponsorships (collectively, "modern stadium finance") and analyze the impact of a team's location on each of these three components. Regarding the financing methods respectively, the emphasis will be on: (1) the role that the strength of a city's real estate market plays in determining whether it can support a sports.comm; (2) the role that a market's wealth plays in determining its ability to raise substantial PSL funding; and (3) the role that a market's size plays in determining its ability to land a lucrative stadium sponsorship.

Additionally, this Section will examine whether the general shift from the municipal subsidy model to the modern stadium finance model influences teams to no longer relocate or continue to move, with the only difference being their motivation to do so. While previously teams may have relocated to obtain generous municipal subsidies, the current financial model may still encourage teams to move, take advantage of a market's ability to support real estate development, raise addi-

---

brand.com/brand-news/wrigley-naming-rights.asp. Note that Wrigley Field, although named in 1926, was named "after former team owner William Wrigley Jr.," and not the Wrigley Company. *Id.*

97. *Infra* Section III.E.1.c.

98. This is because stadium sponsorships are typically structured as yearly payments, beginning once the stadium is opened. *Infra* Section III.E.1.c.

99. *See* Greenberg & Hughes, *supra* note 49, at 121 (pointing out that stadiums often secure their construction loans with the future revenue stream from the stadium's luxury boxes, the stadium sponsorship, and the parking lots that surround the stadium).

tional PSL funding, and support lucrative stadium sponsorships.

B. *Ramifications of Inquiry*

Before addressing whether the relocation problem that existed in the municipal subsidy era still exists in the modern stadium finance landscape, it is important to note the ramifications of this inquiry. In the past, when subsidies were offered, the tangible threat of relocation was crucial because it could be used to leverage subsidies from the team's local municipality. Conversely, when the team's ability to relocate was limited,[100] the team would lose its leverage and would not be able to coerce a municipality into providing a subsidy. In this sort of environment, taking away a team's ability to relocate was seen as the way to curb inefficient municipal expenditures.

Yet, in the current stadium financing marketplace, where large subsidies are no longer being offered, restricting the ability to relocate no longer has these same ramifications. Put differently, limiting relocations is no longer about regulating the subsidies that a team can strong-arm from its municipality. Instead, limiting relocations mostly impacts the orderings of the private NFL market. Therefore, even if these new financing models do facilitate relocations, they are not a significant concern of local government.[101] Instead, the NFL or its owners should be the ones to intervene, as they are now the main parties that are (potentially) adversely affected by relocations.[102]

100. *Supra* Section II.A.

101. Of course, there is still some impact on local government. In addition to the small subsidies that municipalities sometimes offer, municipalities must also figure out what to do with the relocated team's deserted stadium. *See, e.g.*, James Bartolacci, *After the Crowds Leave: 4 Abandoned Stadiums That Avoided Demolition*, ARCHITIZER (Oct. 3, 2013), http://architizer.com/blog/repurpose-abadoned-stadiums/ (canvassing repurposing proposals for vacant stadiums worldwide).

102. For example, if the NFL decides that alienating its fan base in St. Louis is bad for the sport, then the NFL must be the entity that limits relocations. Nonetheless, in light of the fact that the league ultimately profits from these relocations, it does seem unlikely that the NFL's owners would want to step in and restrict the ability of NFL teams to relocate. *See infra* Section III.E.1.b.

C. *Methodology*

In order to evaluate the impact that modern stadium finance has on a team's decision whether to relocate, this paper will assume that a team will only relocate if it is in the team's best economic interest to do so. To pinpoint a team's economic motivations, one must identify the economic gains provided by relocating. In order to do so, the following methodology will be used: (1) the various components ("variables") that constitute a team's value will be broken out; (2) variables that are expected to change from a relocation ("key variables"), will be considered[103] and the impact that a relocation will have on each of these key variables will be analyzed (3) The aggregate effect that relocating will have on these key variables will then be reviewed. If this aggregate effect is positive, and larger (in dollar terms) than the costs of moving, then a team stands to increase its overall value by relocating. Of course, this conclusion alone will not determine whether a team will ultimately decide to move, for reasons discussed further below, but it does indicate that a team is positioned to gain economically by relocating.

D. *The Various Components that Constitute a Team's Value*

In order to apply the above methodology, the variables that constitute a team's value must be identified. While estimating the value of a professional sports team has been described as "an art as much as it is a science,"[104] traditionally the first step is to discount the team's revenues and expenses into present value terms.[105] The valuation can then be tweaked to account for certain difficult-to-quantify subjective measures, such as the "contender factor," which accounts for the competitveness of a team.[106] To simplify matters, this Note will only

---

103. Variables that are not expected to change from a relocation, or will be assumed not to change for purposes of this Note, will not be considered further. For instance, variables that are constant no matter where the team is located will not have any impact on a team's decision where to locate.

104. Ilhan K. Geckil, Tim Mahon & Patrick L. Anderson, *Sports Franchise Valuation: The Chicago Cubs* 1 (Anderson Economic Group, Working Paper No. 2007–03, 2007) (pointing out that closely held teams, which are not traded on public markets, are difficult to value properly).

105. *Id.* at 2–3.

106. *Id.* at 7–8 (defining the contender factor as "an expectation of future winning seasons"). The contender factor impacts revenue because it "en-

consider a team's revenue and expense cash flows without accounting for these subjective tweaks.[107] A typical team's revenue includes the sale of television broadcasting rights, advertising, game attendance, concession sales, and merchandise sales.[108] A typical team's expenses essentially include stadium financing, team payroll, and general business expenses.[109]

courages ticket and merchandise sales above those expected for a typical franchise in the same league." *Id.*

107. In addition to being complicated, there is no consensus as to the proper way to account for these subjective measures. For example, there is variation between valuations provided by Forbes and Financial World magazines. *Id.* at 3 tbl.1.

108. *Id.* at 5–7; WIS. ST. LEGIS. AUDIT BUREAU, GREEN BAY PACKERS 8 tbl.4 (2005) (outlining historical data for Green Bay Packers' TV rights revenue). In addition to revenue, an NFL team's value can also increase when there is a cap on the number of teams in each league (i.e., team cap value). To a certain extent, the fee that an expansion team pays to join the NFL reflects this amount (since the fee also reflects the fact that a buyer is willing to pay for the positive cash flows that an NFL team can expect). The expansion team fee can be quite substantial, as demonstrated by the Houston Texans' $700 million payment to join the NFL in 2002. *NFL Expansion Fees,* PRO FOOTBALL HALL OF FAME (Jan. 1, 2005), http://www.profootballhof.com/news/nfl-expansion-fees/ (providing a complete list of the NFL's expansion fees over the years). Nonetheless, because the team cap value variable is not affected by relocations, it will not be considered in this Note.

109. WIS. ST. LEGIS. AUDIT BUREAU, *supra* note 108, at 10 tbl.6 (outlining historical data for Green Bay Packers' expenses). General business expenses include game expenses, income taxes, interest expenses, and other operating expenses. *Id.*

E. *Pinpointing the Components that Vary from Market to Market*

This Note will assume, for the sake of clarity, that game attendance,[110] concessions, advertising,[111] and merchandise[112] will be similar from market to market.[113] Similarly, this Note will assume that team payroll and general business expenses

---

110. While this assumption is meant to simplify the analysis, and is not fully accurate, it is not entirely unreasonable either. Every NFL team sold at least seventy-nine percent of their home tickets in the 2015 season. *NFL Attendance-2015*, ESPN, http://espn.go.com/nfl/attendance/_/sort/homePct (last visited Mar. 14, 2016). Moreover, the variance in ticket *revenue* attributable to attendance differences across markets is limited, as only sixty percent of ticket revenue is kept by the home team with the other forty percent shared across the league. Justin R. Hunt, *To Share or Not to Share: Revenue Sharing Structures in Professional Sports*, 13 TEX. REV. ENT. & SPORTS L. 139, 146 (2012). It is important to note, however, that game attendance did vary widely across different markets in the mid-twentieth century, and, at that time, played a significant role in a team's decision whether to relocate. CONRAD, *supra* note 10, at 203.

Although differences in game attendance across markets will not be considered, differences in ticket *prices* across markets will be considered. In other words, although it is assumed that the same number of tickets will be sold in every market, it is not assumed that those tickets are sold for the same price. This latter difference is accounted for in the PSL analysis. *See infra* Section III.E.1.b. In the same way that PSLs will sell for higher prices in larger markets, the tickets themselves will also sell for higher prices in larger markets. This is especially important in the context of premium seating ticket revenue because this revenue is *not* shared among teams and can generate significantly more revenue in larger markets. Hunt, *supra*, at 143. Thus, general ticket revenue, especially the revenue generated by premium tickets, will be greater in larger markets for the same reasons that PSL revenue will be greater in larger markets. Although in reality ticket revenue is separate from PSL revenue—and this matters because PSL revenue, unlike ticket revenue, is generated before construction—to make the organization of this Note more straightforward, ticket revenue will be considered to be a part of PSL revenue. *See infra* Section III.E.1.b.

111. For purposes of this paper, stadium sponsorships will be classified as a component of stadium financing and not as a component of advertising. *See infra* Section III.E.1.c.

112. Although a team that relocates to a new city creates new uniforms and expects to generate additional merchandise revenue, merchandise revenue is evenly shared among NFL teams and is therefore unlikely to factor into a team's decision whether to relocate. *See* Hunt, *supra* note 110, at 143–50 (describing the NFL's revenue sharing arrangement). For a more detailed explanation of this reasoning, as it relates to television revenue, see *infra* Section III.E.2.

113. These represent the revenue items on a team's income statement.

remain generally constant across different markets.[114] Because these variables are unlikely to change from market to market, they will not affect a team's decision whether to relocate and will not be considered further. The remaining variables, stadium financing and television, do stand to vary widely across markets and affect a team's determination whether to move. In other words, a team may want to relocate for one of two main reasons: to gain access to a larger television market or, as discussed earlier, to get more favorable stadium financing. Ultimately, as explained below, it is stadium financing alone, and not television revenue, that impacts a team's decision whether to relocate.

1. *Key Variable #1: Stadium Financing*

In general, teams maximize their income by minimizing their stadium costs. Therefore, teams stand to benefit from all sources of stadium revenue that can be used to offset their stadium construction costs. As discussed above, modern stadium finance provides three such revenue sources: Sports.comm cash flows, funds from a PSL offering, and corporate sponsorship revenue. This Section will analyze the degree to which these sources vary across different markets. Viewing the aggregate variance of these factors can then be used to illustrate the effect that modern stadium finance has on a team's incentives to relocate.[115]

a. Sports.comm Cash Flows

In order to assess the degree to which sports.comm revenue varies across different cities, it is important to first detail the cash flows that sports.comms generate. Real estate development typically generates two main revenue streams, property appreciation and property cash flow.[116] The revenue stream for sports.comm real estate developed around a stadium is no different, and both property cash flow and property

114. These represent the expense items on a team's income statement.

115. The aggregate effect on the stadium finance variable is not the end of the analysis, as the television variable must also be considered. *See infra* Section III.E.2.

116. Aswath Damodaran, Investment Valuation 729 (2d ed. 2002).

appreciation are considered.[117] Yet, it is difficult to accurately quantify revenue steams in an uncompleted sports.comm because the sports.comm creates an entirely new destination hub from scratch.[118] What is clear, however, is that the strength of the broader real estate market surrounding the sports.comm will directly affect its cash flows,[119] and thus a sports.comm in a robust real estate market will produce higher cash flows than a sports.comm in a weaker real estate market[120] In sum, although the exact extent is difficult to determine, it is clear that a sports.comm in a stronger real estate market will generate higher cash flows.

b. Funds from a PSL Offering

It is difficult to properly analyze the degree to which the funds raised by PSL offerings are affected by a team's market size because of the small sample size of PSL offerings, coupled with the fact that these offerings were made over a span of more than twenty years. Nonetheless, when one plots the recent secondary market values of various PSLs against their city's population,[121] one can see a trend in which higher PSL prices appear in larger markets.

117. Of course, only the property cash flow, and not its appreciation, is available to help offset the cost of construction in early years.

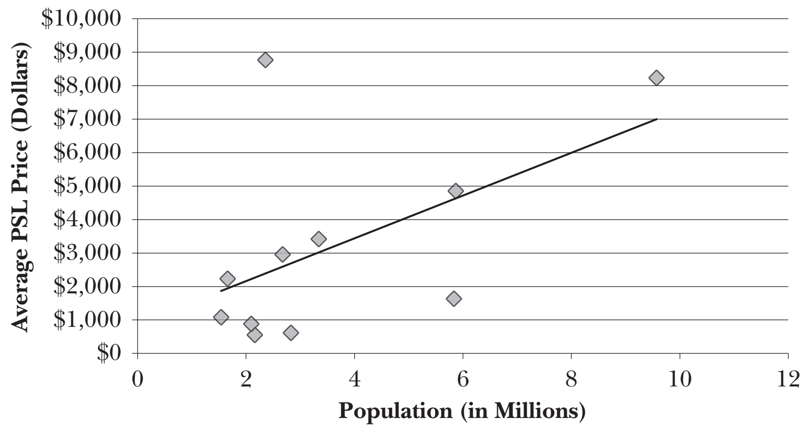
118. Although it is difficult to accurately quantify the cash flow of a sports.comm before it is completed, it is clear that the property's pre-sports.comm cash flow is not reflective of its cash-flow potential. The agglomeration of uses, including residential, retail and commercial, has a positive network effect on the cash flow. For example, a study of Dutch real estate revealed a 1% increase in commercial real estate development leads to a 0.35% increase in demand for residential real estate. Dennis A. J. Schoenmaker & Arno J. Van der Vlist, *On Real Estate Development Activity: The Relationship Between Commercial and Residential Real Estate Markets*, 8 LETTERS SPATIAL & RESOURCE SCI., 219, 227 (2015).

119. Similarly, it is clear that certain markets do not have enough demand for additional real estate to support a sports.comm at all.

120. To simplify matters, this Note will not consider the difference in construction costs in different markets, which, in reality, do impact a sports.comm's cash flows.

121. Salaga, *supra* note 86, at 71 tbl.2.16, 75 tbl.2.20 (providing the data points). Although secondary market PSL transactions do not provide any revenue to teams, they are useful for comparison purposes. This is because they provide a snapshot of the comparative strength of the different PSL markets at a given time.

FIGURE 1.



Due to the small sample size of data this trend has little evidentiary value. However, it does follow the trend that one would expect, based on the basic rules of supply and demand. Because all NFL stadiums have roughly the same fixed supply of seats that can be assigned PSLs, larger markets, which have more people, and therefore more demand, vying for this fixed supply,[122] can anticipate higher average PSL prices.[123] As a result, teams can expect to raise additional PSL revenue, which is not shared with the rest of the NFL, by moving to a larger market.[124] This difference in PSL revenue can be quite sub-

122. Notwithstanding the recent trend of declining college football attendance, NFL attendance has remained fairly steady over the past eight years and PSLs can expect continued demand. Jon Solomon, *College Football Attendance Drops for Fifth Straight Year, but at Slower Rate*, CBS SPORTS (Dec. 18, 2015, 10:45 AM), http://www.cbssports.com/collegefootball/writer/jon-solomon/25418087/college-football-attendance-drops-for-fifth-straight-year-but-at-slower-rate; *National Football League Total Attendance at Regular Season Games 2008 to 2015 (in Millions)*, STATISTA, https://www.statista.com/statistics/193420/regular-season-attendance-in-the-nfl-since-2006/ (last visited Mar. 15, 2016).

123. This price increase is important because even if all cities are able to sell all of their PSLs, cities that can sell their PSLs for higher prices are able to generate substantially more revenue. *See also infra* note 145 (describing how a market's wealthiest individuals will ultimately shape the PSL market).

124. Note that even if, counter-intuitively, PSL revenue does not change by market, the conclusion of Section III.E.1 still stands, as sports.comm and PSL revenue demonstrates that a team stands to improve its stadium financing by relocating.

stantial,[125] and it is therefore a significant draw to larger markets. Moreover, and crucial to those teams that have already offered PSLs for all the seats in their current stadiums, moving to a new stadium in a new market provides a full second round of PSL revenue—an added funding source that would otherwise be unavailable to a team that builds a new stadium in its current market.

c. Stadium Sponsorship Revenue

Many corporations are willing to pay top dollar—$16 million a year being the highest total to date[126]—for a stadium's naming rights. The small data set of NFL stadium sponsorships[127] indicates that sponsorship values are determined by the size of the sponsored team's market. The six largest deals are all for teams that play in the country's ten largest metropolitan areas,[128] while the six smallest are all for teams that play outside of the country's top ten largest metropolitan areas.[129] This is the case notwithstanding the findings of a recent study that a corporate stadium sponsorship's true value is determined by the success of the sponsored team, rather than

125. For example, in 1999, the small market Cleveland Browns sold PSLs for seventy-two percent of their new stadium's seats for $35 million. Meanwhile, in 2009, the large market Dallas Cowboys sold PSLs for seventy percent of their new stadium's seats for $650 million. *Average PSLs Sold, supra* note 91. Moreover, larger markets will provide an even bigger advantage after the stadium is complete and its higher ticket prices, especially for its luxury boxes, are accounted for. *See supra* note 110.

126. MetLife is paying $16 million a year for the naming rights of the New York Jets' and Giants' stadium. Assaf Eisendorf & Elizabeth Kohl, Corporate Sport Sponsorship and Stock Returns: Evidence from the NFL 41 tbl.A-1 (April 2015) (Social Science Research Network) (on file with author).

127. The data size is small because of the relatively small number of NFL stadiums, coupled with the fact that the terms of a few stadium sponsorships have not been made public.

128. The six largest stadium sponsorships are in New York, Houston, Washington, Miami, Foxborough, and Philadelphia. Eisendorf & Kohl, *supra* note 126. These cities are all among the country's ten largest metropolitan areas. American FactFinder, *Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2014*, UNITED STATES CENSUS BUREAU, http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk.

129. The six smallest stadium sponsorships are in Nashville, Detroit, Jacksonville, San Diego, Pittsburgh, and Oakland. Eisendorf & Kohl, *supra* note 126. None of these cities are among the country's ten largest metropolitan areas. American FactFinder, *supra* note 128.

the size of the team's market.[130] Nonetheless, the aforementioned data indicates that teams tend to obtain larger sponsorships in larger markets. The ability to obtain a more lucrative stadium sponsorship, therefore, proves to be a powerful incentive to relocate to a larger market.

d. The Aggregate Effect of These Three Revenue Sources on Stadium Finance

This analysis demonstrates that each form of stadium revenue, whether sports.comm cash flows, funds from a PSL offering, or revenue from a corporate sponsorship, is likely to be larger in bigger markets. Of course, all of the extra stadium revenue provided by larger markets is subject to income tax,[131] and thus, the extent to which it improves stadium financing is lesser than it may appear at first glance.[132] Regardless, all else equal, a team stands to improve its overall stadium financing by relocating to a larger market. The Rams' move to the Los Angeles market illustrates this very point. While the Rams would have only needed to pay $250 million to stay in St. Louis, Rams' owner Stan Kroenke chose instead to go to Los Angeles, where the team is expected to contribute over $3 bil-

130. Eisendorf & Kohl *supra* note 126, at 29. The study's exact conclusion is that sponsorships "are affected by the outcomes of important games played in the stadiums." Obviously, successful teams are more likely to host important games at their stadiums.

131. I.R.C. § 61(a) (1984). Meanwhile, debt financing, which provides an alternative means of financing stadium construction, is tax-deductible. I.R.C. § 163(a) (1954).

132. The following example, which assumes a flat tax rate of forty percent, demonstrates why taxes can significantly impact this analysis and offset some of the benefits provided by modern stadium finance. Suppose that, in a smaller market, a team can raise $500 million toward their stadium from modern stadium financing methods and borrow any additional capital that is needed. Meanwhile, in a larger market, the team could raise $1 billion from modern stadium financing methods. Although the larger market appears to be at a full $500 million dollar advantage, after taxes are accounted for—with taxes incurred on the funds raised by modern stadium financing, but not on the borrowed funds—the larger market actually only provides a $300 million advantage. Moreover if the larger market has higher state income taxes than the smaller market, this advantage may be even further limited.

lion.[133] Although the Inglewood stadium costs are significantly higher to the Rams than costs would be for a new St. Louis stadium, the expected revenue that Kroenke can generate from the stadium and its surrounding sports.comm should more than offset these increased costs.[134]

Had the Rams continued to play in St. Louis, there would not have been any development, aside from the stadium facilities themselves.[135] Meanwhile, the Inglewood stadium has significant additional development in store.[136] In addition to the stadium, Kroenke will be building a 6000-seat performing arts

---

133. Belson, *supra* note 46. This $3 billion price tag is separate from the *additional* $650 million relocation fee that the Rams must pay the rest of the league's owners.

134. In other words, the revenue stream from the surrounding sports.comm can be used as a means of *cross-subsidizing* the stadium's construction costs. TIF, however, is not being utilized to finance the Inglewood Stadium. *See supra* Section III.B (discussing the various ways in which stadiums can utilize sports.comm revenue upfront in order to offset high stadium construction costs).

135. *See* Michael Gaio, *Here's How a $985M Rams Stadium Looks—in St. Louis*, ATHLETIC BUS. (Mar. 2015), http://www.athleticbusiness.com/stadium-arena/new-renderings-released-of-985m-st-louis-nfl-stadium.html. The lack of any additional development is particularly poignant, considering that the blocks around the proposed stadium, in St. Louis proper, have been described as being "striking in their emptiness." Tim Bryant, *Stadium Site Has Obstacles Easy to Overlook,* ST. LOUIS POST-DISPATCH (Jan. 18, 2015), http://www.stltoday.com/business/local/stadium-site-has-obstacles-easy-to-overlook/article_01ee52c4-41a7-50ea-8eb9-6203fdf3053f.html.

136. The development plan actually predated the plan for the stadium itself. The development plans were approved in 2009, and Kroenke first joined with the development venture in 2014, when his Inglewood Stadium plans first came under discussion. *No Horsing Around: Rams NFL Stadium at Hollywood Park*, MYNEWSLA (Jan. 12, 2016), http://mynewsla.com/government/2016/01/12/no-horsing-around-rams-nfl-stadium-at-hollywood-park/. Therefore, it is inaccurate to claim that the surrounding development was designed solely to be a sports.comm. Nonetheless, it is fair to presume that Kroenke was willing to join in the surrounding development due to its potential as a sports.comm. *See* Don Van Natta Jr. & Seth Wickersham, *The Wow Factor, Inside the NFL's Wild, Divisive Sweepstakes to Return to Los Angeles,* ESPN MAG., Feb. 29, 2016, at 34 (demonstrating that Kroenke recognized the particular importance of the surrounding development in the stadium's plans, as Kroenke has said that he is willing to allow a second team as a stadium partner, "though it would not extend to the stadium's design or the *surrounding development*") (emphasis added).

venue at the stadium site.[137] Kroenke[138] will also be developing a shopping center, a 300-room hotel, office space, 2995 residences, multiple parks, and two lakes on the adjoining lot.[139] In other words, it is clear that a sports.comm near Los Angeles has greater potential than any sports.comm near St. Louis possibly could exhibit. This discrepancy can be attributed to the fact that residential real estate in Los Angeles demands prices (per square foot) that are five times greater than that in St. Louis.[140]

Along with these traditional sports.comm revenue sources, the entertainment hub that Kroenke envisions will also take advantage of its proximity to the large, wealthy Los Angeles market in other ways. The venue will be specifically designed to host to a wide range of events, including conventions and the NCAA Final Four.[141] Furthermore, because the stadium is beneath LAX's flight path, its roof will be programmable as "the world's biggest billboard."[142]

In addition to the sports.comm revenue stream, the Inglewood stadium can expect to raise significant additional revenue from its PSL offering and stadium sponsorship deal. Regarding PSLs, while pricing is still to be set,[143] there is a strong

---

137. Sam Farmer, *Stan Kroenke Ready to Show NFL Owners Detailed Inglewood Stadium Plans*, L.A. TIMES (Mar. 21, 2015), http://www.latimes.com/sports/nfl/la-sp-nfl-stadium-inglewood-20150322-column.html.

138. Here, Kroenke acts as a co-developer alongside Stockbridge Capital Group. Adrian Glick Kudler, *Take a Good Look around Los Angele's Future NFL Stadium*, CURBED L.A. (Jan. 13, 2016, 10:24 AM), http://la.curbed.com/archives/2016/01/nfl_stadium_inglewood_los_angeles_rams.php.

139. Eve Bachrach, *Massive Hollywood Park Redevelopment Finally Beginning*, CURBED LOS ANGELES (May 10, 2013, 3:17 PM), http://la.curbed.com/archives/2013/05/massive_hollywood_
park_redevelopment_finally_beginning.php.

140. *Compare Saint Louis Home Prices & Values*, ZILLOW, http://www.zillow.com/saint-louis-mo/home-values/ (last visited Mar. 15, 2016), *with Los Angeles Home Prices & Values*, ZILLOW, http://www. zillow.com/los-angeles-ca/home-values/ (last visited Mar. 15, 2016). *See also How Expensive is Your State*, DISCOVER (Sep. 23, 2014), https://www.discover.com/home-loans/blog/how-expensive-is-your-state (reporting California's state-wide median real estate listing prices at $256 per square foot were more than three times those of Missouri at $92 per square foot at the end of 2014).

141. Kudler, *supra* note 138.

142. *Id.*

143. *LA Rams Anticipate Majority of Seats in 2019 Will Require Personal Seat Licenses*, CBS L.A. (Jan. 18, 2016, 6:53 PM), http://losangeles.cbslocal.com/

likelihood that, unlike the Rams' previous arrangement in St. Louis, all seats in the stadium will have a PSL.[144] Moreover, access to Los Angeles' wealthy market[145] will raise each PSL's price well above what the St. Louis market could have supported.[146] Although a deal has yet to be reached regarding the stadium sponsorship, a sponsorship deal in Los Angeles will likely dwarf the St. Louis offer of $158 million for twenty years (or $7.9 million per year).[147] A 2011 attempt to bring football to Los Angeles had already inked a thirty-year sponsorship worth either $700 million ($23.33 million per year) or $1 billion ($33.33 million per year), depending on whether one or two teams made the move.[148] Once again, this demonstrates the ability of larger markets to generate the revenue necessary to support a stadium in a way that smaller markets cannot.

2016/01/18/la-rams-anticipate-majority-of-seats-in-2019-will-require-personal-seat-licenses/.

144. *Id.*

145. The wealth level of the area's wealthiest inhabitants—or those who will ultimately purchase the PSLs—is more relevant than the area's average wealth in determining the area's ability to raise additional PSL funding. Los Angeles does well in this regard, as the top one percent of wage earners earns $466,895 a year. Kathleen Elkins, *Here's What You Need to Earn to Be in the Top 1% in 13 Major US Cities*, BUS. INSIDER (Aug. 27, 2015, 12:19 PM), http://www.businessinsider.com/income-top-one-percent-us-cities-2015-8.

146. Tim Marcin, *NFL Los Angeles: How LA Move Benefits Franchises, League*, INT'L BUS. TIMES (Jan. 13, 2016, 7:50 AM), http://www.ibtimes.com/nfl-los-angeles-how-la-move-benefits-franchises-league-2262172. This revenue increase is also reflected by the fact that the Rams received deposits for their entire 2016 season ticket supply within a month of the announcement that they were moving to Los Angeles. Nick Wagoner, *Los Angeles Rams Get 56,000 Deposits for 2016 Season Tickets*, ESPN (Feb. 9, 2016), http://espn.go.com/blog/st-louis-rams/post/_/id/26774/los-angeles-rams-get-56000-deposits-for-2016-season-tickets.

147. Ken Belson, *Stadium Sponsor Unveiled in Move to Keep Rams in St. Louis*, N.Y. TIMES (Oct. 6, 2016), http://www.nytimes.com/2015/10/07/sports/football/stadium-sponsor-unveiled-in-move-to-keep-rams-in-st-louis.html?_r=0.

148. Arash Markazi, *Farmers to Sponsor L.A. NFL Stadium*, ESPN (Feb. 2, 2011), http://espn.go.com/los-angeles/nfl/news/story?id=6078709. This price range was recently confirmed by the Apex Marketing Group, which stated that "the naming rights alone could command about $25 million annually." Eben Novy-Williams, Scott Soshnick & Harry Weber, *Rams Head Back to Los Angeles, Making NFL Even Richer*, BLOOMBERG BUS. (Jan. 13, 2016, 9:45 AM), http://www.bloomberg.com/news/articles/2016-01-13/for-rams-moving-to-los-angeles-is-a-bargain-at-550-million.

In sum, Kroenke was not bothered by the huge added cost required to construct this Inglewood mega-stadium[149] since the overall project is expected to generate sufficient revenue to offset its high construction costs. As Kroenke proclaimed in his description of the project, "we're long-term investors."[150] St. Louis, on the other hand, was not a great place to make a long-term investment. The Rams' relocation statement made clear that St. Louis' population has low projected growth and GDP growth is "projected to be 26th . . . among NFL markets moving forward."[151] The Inglewood stadium thus illustrates why modern stadium finance tends to truly favor bigger metropolitan areas. Because these cities provide favorable stadium financing, which has a big impact on a team's bottom line,[152] a team can substantially increase its value by moving to them. Therefore, when viewing the stadium financing variable ("Key Variable #1") in isolation, it is clear that modern stadium financing encourages relocations to larger markets.

2. *Key Variable #2: Television Revenue*

Favorable stadium financing is not the only variable that impacts a team's decision where to locate. Another reason that a team may move is to gain access to a larger television market. If the *additional* television revenue provided by one city exceeds the savings provided by favorable stadium financing in another, a team may ultimately decide where to locate based

---

149. It is also important to note that the Inglewood Stadium, in addition to personally costing Kroenke more money than the stadium proposed in St. Louis, is more expensive overall. All else equal, this expense is beneficial to Kroenke, as he is able to receive larger tax deductions from depreciation. *See* I.R.C. § 167 (2007).

150. Sam Farmer & Nathan Fenno, *Q&A: Stan Kroenke Discusses His Picture-Perfect Vision for the L.A. Rams*, L.A. TIMES (Jan. 13, 2016), http://www.latimes.com/sports/nfl/la-sp-nfl-la-kroenke-20160114-story.html.

151. STATEMENT OF REASONS IN SUPPORT OF THE RAMS' APPLICATION TO RELOCATE TO LOS ANGELES 20–22 (Jan. 4, 2016), http://www.gannett-cdn.com/experiments/usatoday/Sports/rams-relocation-statement-010516.pdf.

152. CONRAD, *supra* note 10, at 207 (noting the Rams actually moved from Los Angeles to St. Louis in 1994 because of favorable stadium terms and revenues, *see supra* Section III.E.1, causing the Rams to relocate to Los Angeles for the very same reason).

on the maximization of television revenue, rather than the attainment of favorable stadium financing.[153]

An understanding of the NFL's revenue sharing agreement is essential in order to evaluate the variability of a team's television revenue across different cities. Under the current agreement, all NFL teams share *all* television revenue evenly, unlike many of the local revenue sources.[154] In other words, while each NFL team is individually incentivized to generate local revenue, the entire league shares in the incentive to generate television revenue.[155] Because all television revenue is shared, a team would not want to relocate to a larger city solely to increase its viewership and generate additional television revenue.[156] For example, although the Rams stand to gain from the increased viewership in Los Angeles—an increase of over four million television homes as compared to the St. Louis television market[157]—that gain is shared evenly among all NFL teams.[158] This marginal gain in television revenue is not likely to represent a substantial motivation for the Rams to move.[159] It is, however, likely to encourage NFL owners—who

153. This statement is consistent with the methodology outlined *supra* Section III.C.

154. Local revenue, which is not shared evenly, includes revenue from concessions, local advertising, signage, local sponsors, parking, and novelties. Hunt, *supra* note 110, at 143 tbl.1.

155. The NFL's television revenue is very significant. In 2014, largely as a result of television revenue, the NFL generated $7.3 billion in national shared revenue. Matthew Rocco, *TV Deals Boost NFL Revenue to New Record*, FOX BUS. (July 21, 2015), http://www.foxbusiness.com/features/2015/07/21/tv-deals-boost-nfl-revenue-to-new-record.html.

156. Although this Note is focused on the NFL, it is worth noting that for professional leagues that do not share television revenue evenly, this provides even further incentive for teams to move to larger markets.

157. *Local Television Market Universe Estimates*, NIELSEN (Sept. 26, 2015), https://www.tvb.org/Portals/0/media/file/DMA/2015-2016-dma-ranks.pdf (demonstrating the four million television home gain—from 1,217,370, in St. Louis to 5,489,810 in Los Angeles).

158. The New York Times, for example, was clear about who stands to gain from this increase in television revenue, stating that "with Los Angeles the nation's second-largest television market, the *N.F.L.* has longed for a return to the area." Belson, *supra* note 46 (emphasis added).

159. *See* Neil Paine & Andrew Flowers, *The Rams Won't Get as Much From LA as the Lakers and Dodgers Do*, FIVETHIRTYEIGHT (Jan. 15, 2016, 6:33 PM), http://fivethirtyeight.com/features/the-rams-wont-get-as-much-from-la-as-the-lakers-and-dodgers-do/ (pointing out that television revenue alone cannot be the main reason for the move).

would receive an equal share of this additional television revenue[160] without giving up anything in return—to approve any relocation plan that is proposed.[161]

Conclusion

Ultimately, an NFL team may decide to relocate in order to receive more favorable stadium financing, but it would not relocate solely to receive additional television revenue. Because modern stadium financing presents an opportunity to receive considerably more stadium-related revenue in bigger markets, it certainly encourages teams to relocate to larger markets. This, of course, will only hold true if the marginal increase in stadium revenue exceeds all of the costs associated with moving. These costs, which can be quite large in certain instances, include the relocation fee in present value terms, the cost of constructing a new practice facility,[162] the opportunity cost of declining a smaller municipality's minimal subsidy, should they offer one, and all logistical costs of moving. When the math does work out, however, a team stands to benefit tremendously. For instance, certain projections indicate that the Rams move to Los Angeles could increase their valuation from $930 million to around $3 billion.[163]

Yet, even if a team stands to gain economically from a move, there are still many reasons why a team may decide

160. The relocation fee, which is shared among owners, is also likely to encourage NFL owners to approve a move. Van Natta & Wickersham, *supra* note 136 (suggesting the sharing agreement among owners of the relocation fee was a significant motivation).

161. The NFL's relocation guidelines require twenty-four out of thirty-two team owners to approve a relocation plan before a team can move. Ken Belson, *A Primer on the N.F.L. Relocating a Team to Los Angeles*, N.Y. Times (Jan. 10, 2016), http://www.nytimes.com/2016/01/11/sports/football/nfl-los-angeles-relocation-vote-oakland-san-diego-st-louis.html.

162. The Dallas Cowboys' recently-built practice facility cost an estimated $115 million. Associated Press, *Frisco Council OKs $115M Dallas Cowboys Practice Facility*, NFL.com (Aug. 12, 2013, 11:53 PM), http://www.nfl. com/news/story/0ap1000000229213/article/frisco-council-oks-115m-dallas-cowboys-practice-facility. Of course, the cost of a new practice facility should only be characterized as a cost of moving if the team's current practice facility does not need to be replaced itself.

163. Cork Gaines, *The St. Louis Rams Would Be Worth $2.5–3.5 Billion the Moment They Moved to Los Angeles,* Bus. Insider (Jan. 5, 2015, 3:43 PM), http://www.businessinsider.com/st-louis-rams-los-angeles-value-2015-1.

against moving. For one, a team owner may decide that she is uninterested in relocating. While a $2 billion valuation increase, like that predicted for the Rams, may incentivize any team to move, smaller valuation increases may not be sufficient to compel a team to relocate. Many owners invest in a team as a hobby, and they are more concerned with winning and pleasing their fan base than they are with maximizing value.[164] Such owners are less likely to move and upset local fans unless confronted with tremendous financial incentives to do so. Second, a team may be locked into a long-term deal in its current stadium that prevents it from relocating. Third, for the many teams that already play in fully modern stadiums, there is little benefit to attaining favorable stadium financing and thus less reason to relocate. Finally, even if a team is interested in moving, it may not be able to obtain the necessary ownership vote to approve its relocation.[165]

Overall, it is likely that many owners who stand to increase their team's valuation by relocating will decide to move. Consequently, as long as these modern stadium financing techniques continue to be used, further relocations to larger markets can be expected.[166] Smaller markets must recognize this likely outcome in order to understand the forces that they are competing against when attempting to retain local teams. Moreover, if this outcome is troubling to the NFL, it must address the issue by altering relocation rules. Otherwise, the cur-

164. For example, Micky Arison, an NBA team owner, has claimed that "this is a hobby of passion, it's not a business." Kelly Dwyer, *Miami Heat Owner Micky Arison: Owning a Team 'Is a Hobby of Passion, It's Not a Business,'* YAHOO! SPORTS (Jul. 3, 2012, 12:30 PM), http://sports.yahoo.com/blogs/ball-dont-lie/miami-heat-owner-micky-arison-owning-team-hobby-163352251—nba.html.

165. This was the result of the Raiders' bid to move to Los Angeles.

166. Note that even if large municipal subsidies do return, and they are offered by smaller markets, relocations to larger markets may still continue. In the words of Gregory Carey, "there is only so much public money that can be used to overcome [these market forces]." Telephone Interview with Gregory Carey, Chairman of the Public Sector and Infrastructure Group, Goldman Sachs (Feb. 10, 2016). Furthermore, if multiple teams become interested in relocating to the same large markets, a race may ensue. *See* Van Natta Jr. & Wickersham, *supra* note 136 (demonstrating how the Chargers and Raiders jockeyed against the Rams in order to reach the necessary twenty-four votes to relocate).

rent market created by modern stadium finance will only continue to encourage these relocations.

In short, this paper set out to determine the impact of modern stadium finance on team incentives to relocate. Ultimately, because stadium financing varies widely across markets with a big impact on a team's bottom line, a team can substantially increase its value by moving to a market that provides favorable stadium financing. Given that modern stadium finance, which harnesses sports.comm, PSL, and stadium sponsorship revenue, is most favorable in larger markets, teams can increase their valuations by moving to these larger markets. As a result, with the continued use of these stadium financing methods, further relocations to larger markets can be expected in the coming years. In all likelihood, the Rams will only represent the start of the modern relocation trend.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 13 FALL 2016 NUMBER 1

THE HAGUE PRINCIPLES ON CHOICE OF LAW IN INTERNATIONAL COMMERCIAL CONTRACTS: ENHANCING PARTY AUTONOMY IN A GLOBALIZED MARKET

JONATHAN LEVIN*

INTRODUCTION 272
I. WHAT IS "PARTY AUTONOMY" AND WHY DID THE HCCH SEEK TO ENHANCE IT? 273
II. SELECTED PROVISIONS OF THE PRINCIPLES AND THEIR RELATIONSHIP TO THE E.U. FUNDAMENTAL FREEDOMS 279
A. *The Internationality Requirement and the Use of the Term "Establishment" as a Metric*........... 279
B. *The Lack of Underlying Nexus Requirements for Choice-of-Law Provisions* 283
C. *The Ability to Choose "Rules of Law" Rather than State Law* 288

* Copyright © 2016 by Jonathan Levin. J.D. expected, May 2017, New York University School of Law. I am grateful to Marta Pertegás, First Secretary of the HCCH, for allowing me the opportunity to conduct a comprehensive comparative analysis of the Principles with the help of Theodore J. Folkman, Partner at Murphy & King and author of the popular legal blog, *Letters Blogatory*, during my summer internship with the Permanent Bureau of the HCCH. Through this study (cited later in this Note), I was able to discern how the Principles provided a marked departure from the rather outdated rules proposed by the *Restatement (Second) of Conflicts of Law*. Beyond her guidance with this analytical project, Ms. Pertegás has given invaluable advice, as the lawyer with primary responsibility over the Principles, with regard to exploring the connection between the instrument and the TFEU Fundamental Freedoms.

III. Support from the International Community for the Principles and the Possibility of Transposing E.U. Company Law to Non-E.U. Fora 292
Conclusion 293

Introduction

The Hague Conference on Private International Law (HCCH, also known as la Conférence de La Haye de droit international privé) recently approved its first non-binding soft-law instrument, *The Hague Principles on Choice of Law in International Commercial Contracts* ("the Principles"). The promulgation provides an opportunity to discuss how the instrument may be utilized by the European community and other regions to advance the aims behind the Fundamental Freedoms found in the Treaty on the Functioning of the European Union (TFEU). The Principles represent the concerted effort by the HCCH and the instrument's drafters to grant further party autonomy in the field of international commercial law, a guiding principle in the commercial sphere that has been held in high regard by states within the European Union and abroad. This Note argues that companies with their principal places of business, affiliates, and subsidiaries located in jurisdictions outside the European Union, specifically Latin America, would have much to celebrate if these Principles were adopted by their respective sovereign states. Through such a legal transposition into the domestic regimes of those states where party autonomy is restricted, the HCCH enhances the reach of the TFEU Fundamental Freedoms beyond the confines of the European Union.

Part I of this Note presents a brief overview of the term "party autonomy" and introduces the legislative history behind the Principles concerning the need for a choice-of-law instrument that enhances party autonomy. Part II analyzes the chief innovations of the instrument and demonstrates their compatibilities with the TFEU Fundamental Freedoms in lifting impediments to efficient commercial markets and contractual ventures. Part III examines the potential of the Principles to export the flexibility that companies enjoy under E.U. company law, and ultimately, to eliminate some barriers to intranational and international commerce through recognition by in-

ternational trade bodies. Part III also reviews Paraguay's adoption of the Principles as a non-E.U. Member State in Latin America.

I. WHAT IS "PARTY AUTONOMY" AND WHY DID THE HCCH SEEK TO ENHANCE IT?

In the field of international commercial relations, it is important to define the doctrine of "party autonomy" and discuss why it is regarded as an important value in cross-border transactions in order to understand the HCCH's interest in a normative choice-of-law instrument. As technological advances moved contemporary commercial dealings further into a globalized market, early commentators noted the need to respect the ability of parties to choose the law applicable to a given transaction.[1] Party autonomy, as Professor Mo Zhang stresses, implicates "two fundamental and interrelated elements: autonomy and mutuality."[2] Even though autonomy is of central importance to party autonomy, "the *exercise* of the autonomy must be based on mutuality."[3] Thus, party autonomy involves the power that commercial actors maintain in se-

---

1. *See, e.g.*, Morris. J. Levin, *Party Autonomy: Choice-of-Law Clauses in Commercial Contracts*, 46 GEO. L.J. 260, 261 (1957–1958) ("As science has made great strides in diminishing the distances between state and national borders, the conflicts problems have increased proportionally . . . there can be no doubt that there will be an increase in commercial transactions among parties of different jurisdictions. The rules of conflict of laws must keep abreast of these changing conditions . . . ."). For Levin, the term "party autonomy" addresses situations involving "commercial contracts in which the parties have expressly stipulated for a governing law which has a substantial connection with the transaction." *Id.* at 260; *see also* Edith Friedler, *Party Autonomy Revisited: A Statutory Solution to a Choice-of-Law Problem*, 37 U. KAN. L. REV. 471, 471 (1989) (explicating the historical fascination with which legal scholars have addressed party autonomy); Robert Johnson, *Party Autonomy in Contracts Specifying Foreign Law*, 7 WM. & MARY L. REV. 37, 37–38 (1966) (providing early case law in English and American courts that laid down the foundations for the doctrine of party autonomy); Symeon C. Symeonides, *Party Autonomy in International Contracts and the Multiple Ways of Slicing the Apple*, 39 BROOK. J. INT'L L. 1123, 1123–26 (2014) (explaining that while party autonomy is an "ancient principle," it only began to receive legislative support in the twentieth century, especially in the last fifty years).

2. Mo Zhang, *Contractual Choice of Law in Contracts of Adhesion and Party Autonomy*, 41 AKRON L. REV. 123, 130 (2008).

3. *Id.* (emphasis added).

lecting, based on mutual agreement, the governing law of a contract. This capacity, in turn, transforms the contract into the "instrument of party autonomy."[4] Upholding the sanctity of such party autonomy in choice-of-law clauses has been routinely advocated by the relevant literature, citing the increased control and predictability that it allows in commercial transactions, domestic and otherwise.[5]

Prior to the creation of the Principles, the HCCH had produced several conventions relating to specific contracts, but none governed contracts generally.[6] After conducting a feasibility study over thirty years ago that revealed little chance of ratifying a choice-of-law convention for contracts, the HCCH abandoned the project and did not return to it until 2006.[7] The timeline, included hereafter, lays credence to the thoroughness of the process that the HCCH employed in creating the Principles, demonstrating that the instrument represents a concerted effort to address concerns from principal actors who preferred an enhancement in party autonomy.

In June 2006, the Special Commission on General Affairs and Policy of the Conference invited the Permanent Bureau to prepare another feasibility study on the development of an instrument for choice-of-law provisions in international contracts.[8] However, this time the mandate was far less comprehensive. The HCCH was tasked with the responsibility of creat-

---

4. Stefan Grundmann, *Information, Party Autonomy and Economic Agents in European Contract Law*, 39 COM. MRKT. L. REV. 269, 270 (2002).

5. *See, e.g.*, Friedler, *supra* note 1; Zhang, *supra* note 2, at 130–31 ("It is believed that by letting the parties choose which law governs their contract, the objectives of protecting the justified expectations of the parties and enabling the parties to foretell with accuracy what their rights and liabilities are under the contract will be best attained."); Mo Zhang, *Party Autonomy and Beyond: An International Perspective of Contractual Choice of Law*, 20 EMORY INT'L L. REV. 511, 512 (2006) ("[Many practitioners in international business transactions] believe that allowing the contractual parties to determine the law that applies to the disposal of their rights and obligations will help achieve efficiency, certainty, predictability, and protection of the parties' expectations—the conflict of laws values that have particular importance in today's global economy." (brackets added by author)).

6. *See* Symeon C. Symeonides, *The Hague Principles on Choice of Law for International Contracts: Some Preliminary Comments*, 61 AM. J. COMP. L. 873, 874 (2013).

7. *Id.*

8. THE HAGUE CONFERENCE ON PRIVATE INT'L LAW, PRINCIPLES ON CHOICE OF LAW IN INTERNATIONAL COMMERCIAL CONTRACTS 9 (2015), http://

ing a *non-binding instrument* that would entail only contractual choices of law rather than a more exhaustive convention.[9]

After conducting a series of feasibility studies from 2006 to 2009, the Permanent Bureau issued a *Report on Work Carried Out and Suggested Work Programme for the Development of a Future Instrument* in March 2009.[10] This research led the Council on General Affairs to invite the Permanent Bureau to form a working group of experts in private international law, international commercial law, and international arbitration law in order to further the development of a draft non-binding instrument that would promote greater party autonomy in international commercial contracts.[11] The Working Group met for the first time in The Hague in January 2010 to define the scope of the proposed instrument.[12] By November 2012, a Special Commission was convened and unanimously approved a revised form of the Principles, with the Council on General Affairs giving its preliminary endorsement of the working draft in April 2013.[13] In January 2014, the Working Group met for the fifth time to finalize its drafting of the Commentary to the Draft Hague Principles and, by April 2014, a written consultation procedure was produced, which invited Members to submit their comments on the draft.[14] On March 19, 2015, after the completion of the written procedure, and facing no additional objections, the Principles were formally approved, becoming the HCCH's first normative non-binding soft-law instrument.[15]

The Principles were drafted with an eye to fulfilling the organization's statutory mission to seek the continued harmonization of private international law (PIL).[16] To this end, Christophe Bernasconi, current Secretary General of the HCCH, wrote about how legislators and courts should concep-

---

www.hcch.net/index_en.php?act=publications.details&pid=6353&dtid=3 [hereinafter PRINCIPLES].

9. *Id.* at 10.

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.* at 11–12.

14. *Id.* at 12.

15. *See id.*

16. *See* STATUTE OF THE HAGUE CONFERENCE ON PRIVATE INTERNATIONAL LAW, art. 1 (1955) ("The purpose of the Hague Conference is to work for the progressive unification of the rules of private international law.").

tualize the value and purpose behind their creation and the envisaged uses in his foreword to the Principles:

> At their core, the Hague Principles are designed to promote party autonomy in international commercial contracts. By acknowledging that parties to a contract may be best positioned to determine which set of legal norms is most suitable for their transaction, party autonomy enhances predictability and legal certainty—important conditions for effective cross-border trade and commerce. At the same time, the Hague Principles also set balanced boundaries to party autonomy and thus may provide a refinement of the concept where it is already accepted. In essence, the Hague Principles may be considered to be an international code of current best practice in relation to party autonomy in international commercial contracts.[17]

The Principles' primary goal can therefore be summarized as pursuing the further unification of choice-of-law regimes in order to increase party autonomy in the area of international commercial contracts.

Some critics fail to see the purpose behind such an instrument, especially in light of the widely held esteem for party autonomy within the PIL traditions found across the European Union and beyond.[18] However, a "high degree of convergence"[19] does not devalue efforts in the form of soft-law instruments like the Principles to foster the party autonomy af-

---

17. Christophe Bernasconi, *Foreword* to PRINCIPLES ON CHOICE OF LAW IN INTERNATIONAL COMMERCIAL CONTRACTS 7 (2015), http://www.hcch.net/index_en.php?act=publications.details&pid=6353&dtid=3.

18. *See, e.g.*, Symeonides, *supra* note 1, at 1123–24 (citing Alfred E. von Overbeck, *L'Irrésistible Extension de L'Autonomie de la Volonté en Droit International Privé*, *in* NOVEAUX ITINÉRAIRES EN DROIT: HOMMAGE À FRANÇOIS RIGAUX 619 (1993) (an "irresistible" principle); Erik Jayme, *Identité Culturelle et Intégration: Le Droit International Privé Postmoderne*, 251 RECUEIL DES COURS 147 (1995) (characterizing party autonomy as a "fundamental right"); Ole Lando, *The EEC Convention on the Law Applicable to Contractual Obligations*, 24 COMMON MKT. L. REV. 159, 169 (1987) ("the common core of the legal systems"); Russell J. Weintraub, *Functional Developments in Choice of Law for Contracts*, 187 RECUEIL DES COURS 239, 271 (1984) ("perhaps the most widely accepted private international rule of our time")).

19. Symeonides, *supra* note 6, at 876 ("At least in the area of contracts, there is a high degree of convergence among the various systems in honor-

forded to commercial parties under such regimes. This is particularly true with regard to pushing beyond the "limitations" currently in place in most domestic PIL rules. As the Commentary to the Preamble of the Principles makes clear, the provisions of the instrument may be utilized in "the continued development and refinement of the concept [of party autonomy] where it is already accepted."[20]

In addition to the expansion of party autonomy in regions that currently appreciate its importance, the Principles are an "international code of current best practice."[21] They should serve as a starting point for those domestic settings where such autonomy is discouraged and restricted. From their provisions, the drafters conceived that, in those systems where party autonomy does not exist, the idea may be realized and codified through the Principles in the hope of facilitating enhanced cross-border commerce.[22] Indeed, there are countries, primarily within Latin America, where lawmakers and judiciaries still do not recognize party autonomy in commercial contractual situations.[23] The Principles are addressed to these constituencies as well, encouraging them to "interpret, supplement and develop rules of private international law . . . [that] may [or may not] exist on a national . . . regional, supranational or international level."[24]

The drafters' vision of the Principles as stimulating harmonization and advancing party autonomy within the international commercial sector exemplifies the HCCH's commit-

---

ing party autonomy. Whatever differences exist, they mostly concern the limitations, and to a lesser extent the modalities, of this principle.").

20. The Hague Conference on Private Int'l Law, Commentary to Principles on Choice of Law in International Commercial Contracts § I.4, at 23 (2015), http://www.hcch.net/index_en.php?act=publications.details&pid=6353&dtid=3 [hereinafter Commentary] (brackets added by author).

21. Bernasconi, *supra* note 17.

22. Commentary, *supra* note 20, § P.3, at 27 ("The objective of the Principles is to encourage the spread of party autonomy to States that have not yet adopted it, or have done so with significant restrictions . . . . Party autonomy enables the parties to choose a neutral law or the law they consider most appropriate for the specific contract. The Principles therefore affirm the freedom of parties to an international commercial contract . . . to choose the law applicable thereto . . . .").

23. *See, e.g.,* María M. Albornoz, *Choice of Law in International Contracts in Latin American Legal Systems*, 6 J. Priv. Int'l L. 23 (2010).

24. Commentary, *supra* note 20, § P.5, at 28 (brackets added by author).

ment to continue its efforts to remove obstacles to transnational trade and commerce.[25] By advocating for additional developments, both at the legislative and judicial levels, to allow for a greater degree of contractual free choice (at least with respect to choice-of-law provisions), the HCCH, through its Principles, contributed to the recognition of party autonomy as an important pillar of PIL and contractual relations. Some skeptics charge that the promotion of party autonomy may produce undesirable effects in the markets.[26] Yet, in granting parties the autonomy to make such choices, legislators and judges incentivize commercial actors to enter more freely into new business ventures with the confidence of knowing that their choice-of-law provisions will be given due accord (subject to certain limitations and overriding mandatory principles, of course). Thus, the legislative history and specified uses for the Principles demonstrate how they serve commercial interests in the ever-growing global economy if adopted at the national level by State actors.

---

25. It should be noted that the use of the term "commercial" excludes consumer and employment contracts from the scope of the instrument. *See* PRINCIPLES, *supra* note 8, art. 1(1), at 17 ("These Principles apply to choice of law in international contracts where each party is acting in the exercise of its trade or profession. They do not apply to consumer or employer contracts."). This term's inclusion within the title of the instrument itself proved to be a source of contention during the drafting period. *See* Jonathan Levin & Theodore J. Folkman, *A Comparative Look at the New Hague Principles on Choice of Law and the Restatement (Second) of Conflict of Laws: First Post*, LETTERS BLOGATORY (July 30, 2015), https://lettersblogatory.com/2015/07/30/a-comparative-look-at-the-new-hague-principles-on-choice-of-law-the-restatement-second-of-conflict-of-laws-first-post/ ("This word was quite divisive in the negotiations. Speaking broadly, to many in Europe the use of the word 'commercial' excludes consumer and employment contracts, since to them the word 'commercial' implies a business deal among parties with roughly equal bargaining power. From the American perspective, on the other hand, the word 'commercial' has no such connotation. A contract of adhesion, in the American way of looking at things, may still be 'commercial.' But in the end the states participating in the negotiations reached a consensus in light of the fact that the term 'commercial' had previously been used in UNIDROIT principles that had received wide support throughout the world.").

26. *See, e.g.*, Symeonides, *supra* note 6, at 878 (expressing skepticism over the promotion of party autonomy and its use as a "euphemism for taking advantage of weak parties").

II.
Selected Provisions of the Principles and Their Relationship to the E.U. Fundamental Freedoms

Since the Principles endeavor to assure the furtherance of party autonomy, this Part will address three important features of the instrument: the use of "establishment" in its internationality requirement, the lack of a nexus requirement in selecting a foreign law, and the ability of parties to choose non-sovereign law as the governing law of a contract ("rules of law"). Beyond identification of the actual "principles" that function to promote the contractual doctrine, the analysis will delve deeper into how these policies connect to the TFEU Fundamental Freedoms in supporting businesses within the European Union.[27] Chiefly, the overarching premise of this comparative study is that, by granting enhanced party autonomy via choice-of-law provisions to commercial actors, the Principles further the aims of the E.U. Fundamental Freedoms (particularly, the Free Movement of Goods,[28] Free Movement of Services,[29] and Freedom of Establishment[30]) by motivating parties, *ex ante*, to more freely enter into contractual relationships. In turn, this encouragement could potentially create more profitable commercial ventures and more fluid, efficient markets.

A. *The Internationality Requirement and the Use of the Term "Establishment" as a Metric*

Similar to internationality requirements set forth in other international conventions,[31] the Principles set out an important restriction to their application in commercial settings by

---

27. For an explanation of the connection between party autonomy and the Fundamental Freedoms, see generally Grundmann, *supra* note 4.

28. Consolidated Version of the Treaty on the Functioning of the European Union arts. 28, 30, 34, 35, Oct. 26, 2012, O.J. (C 326) 47 [hereinafter TFEU].

29. TFEU art. 56.

30. TFEU arts. 49, 54.

31. *See, e.g.*, United Nations Convention on Contracts for the International Sales of Goods art. 1(1), Apr. 11, 1980, 1489 U.N.T.S. 3 ("This Convention applies to contracts of sale of goods between parties whose places of business are in different States.") [hereinafter CISG].

stipulating an international threshold in Article 1(2).[32] In drawing such a limitation, however, the instrument allows for two situations in which the internationality prong may be satisfied.[33] Article 12, relatedly, provides for situations whereby a party has more than one establishment for the purposes of determining internationality: "If a party has more than one establishment, the relevant establishment for the purpose of these Principles is the one which has the closest relationship to the contract at the time of its conclusion."[34]

As the Commentary to the Principles (the "Commentary") explains, the need for an internationality requirement is made obvious where PIL is implicated.[35] It is important to note that, within the negative definition employed by the drafters, the provision specifically references "establishment" as the preferred metric. While the use of establishment as a test for internationality is itself not one of the more prominent innovations that the Principles advance, the drafters' choice to employ the term "establishment" rather than "place of business" prompts an interesting discussion about the consequences of such a linguistic decision for enhancing party autonomy.[36] After all, numerous international conventions have utilized

32. PRINCIPLES, *supra* note 8, art. 1(2), at 17 ("For the purposes of these Principles, a contract is international unless each party has its establishment in the same State and the relationship of the parties and all other relevant elements, regardless of the chosen law, are connected only with that State."). *See also* COMMENTARY, *supra* note 20, § 12.3, at 81 (defining establishment as "a business location in which the party has more than a fleeting presence. It encompasses a centre of administration or management, headquarters, principal and secondary places of business, a branch, an agency and any other constant and continuous business location. The physical presence of the party, with a minimum degree of economic organisation and permanence in time, is required to constitute an establishment. Hence, the statutory seat of a company without more does not fall within the notion of establishment.").

33. COMMENTARY, supra note 20, §§ 1.16–1.18, at 32 (describing the two tests outlined by the drafters for fulfilling internationality of the contract).

34. PRINCIPLES, *supra* note 8, art. 12, at 20.

35. *See* COMMENTARY, *supra* note 20, § 1.13, at 31 ("To fall within the scope of the Principles, the contract must qualify as an 'international' contract. This requirement is consistent with the traditional understanding that private international law applies only to international cases. The definition of 'internationality' varies considerably among national and international instruments.").

36. *See* Symeonides, *supra* note 6, at 879 n.26 (detailing that the term "establishment" was selected during the Special Commission "to replace the term 'place of business' which was used in the draft of the Working Group").

"place of business" as the standard geographic measure for purposes of satisfying internationality.[37]

At first glance, the choice to use "establishment" could seem to make little difference. Indeed, the distinction may be deemed trivial because the two terms can be seen as synonymous and interchangeable. Yet, such a reading precludes a subtle nuance that may have larger implications for contractual relationships falling within the scope of the Principles. Specifically, the fact that "place of business" appears in the Commentary's definition of "establishment"[38] suggests that it would be improper to assert that the two terms are granted equal weight by the drafters. The necessary conclusion to be drawn from such a textual analysis is that "establishment" is to be read *more* expansively than "place of business" in light of the Commentary providing a list of possible locations that may be utilized: "[establishment] encompasses a centre of administration or management, headquarters, principal and secondary places of business, a branch, an agency, and any other constant and continuous business location."[39]

The drafters' choice to incorporate the term "establishment," rather than "place of business," implicates the Freedom of Establishment provided by Article 49 of the TFEU, which states:

> Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.[40]

This provision of the TFEU has been interpreted by European Court of Justice (ECJ) precedent[41] to mean that companies (as defined by Article 54 of the TFEU)[42] will enjoy the same rights

37. *See, e.g.,* CISG, *supra* note 31.

38. COMMENTARY, *supra* note 20, § 12.3, at 81.

39. *Id.*

40. TFEU art. 49.

41. *See, e.g.,* Case C-55/94, Gebhard v. Consiglio, 1995 E.C.R. I-4165; Case 2/74, Reyners v. Belgium, 1974 E.C.R. 631.

42. TFEU art. 54 ("'Companies or firms' means companies or firms constituted under civil or commercial law, including cooperative societies, and

to carry out commercial activity as nationals within any Member State of the European Union. These commercial enterprises are accordingly protected from discrimination based on their nationality or chosen method of incorporation.

The Principles, in referencing "establishment," arguably manifest the Freedom under Article 49 of the TFEU by inserting the term into the internationality requirement. In addressing the E.U. situation regarding company establishment, the instrument reinforces the ability of corporate entities and professionals to establish themselves across the "internal market" by granting such non-domestic establishments due credence. This concept of "credence" dictates that the Principles permit recognition of such "establishments" (even if they are not "places of business") so long as they are not merely "statutory seats."[43] Consequently, parties are able to assert the non-domestic nature of their contractual relationship more easily under the Principles due to the ability to point to a variety of locations, which may have been foreclosed by other international conventions and model laws that employ the more limited term "place of business." Therefore, the parties are able to trigger the necessary internationality more freely. The flexibility inherent in the "establishment" term, given its catch-all phrase ("and any other constant and continuous business location"), allows for commercial parties to be unfettered in crafting choice-of-law provisions.

Overall, the use of "establishment" in the internationality requirement is a unique feature to be found at the very outset of the Principles. By implicating the TFEU's Freedom of Establishment clause through its inclusion of the broader term "establishment" as a threshold measure of internationality, the Principles further the objectives of the E.U. legislators. Expanding the possibility of triggering internationality, in turn, allows for the parties to more readily dictate the law that will govern their interactions upon entering into an international commercial agreement. If national legislators of the various E.U. Member States were to embrace the Principles, cross-border commerce would increase in light of the enhanced pre-

other legal persons governed by public or private law, save for those which are non-profit-making.").

43. *See* COMMENTARY, *supra* note 20, § 12.3, at 81 (referencing the distinction between "establishment" and "statutory seat").

dictability and certainty in selecting the applicable law to a contract. Given the ability to more easily establish an entity beyond national borders with recognition for the purposes of internationality, the parties can feel confident that their autonomous decision about the governing law will be respected by the courts of that State.

B. *The Lack of Underlying Nexus Requirements for Choice-of-Law Provisions*

The lack of a nexus feature found in Article 2(4) of the Principles extends autonomy for parties in the pursuit of their commercial ventures.[44] This facet of the Principles falls in line with the growing trend in PIL of greater party autonomy. Initially, the Principles appear to be no different from instruments like the Rome I Regulation, which addresses "Freedom of Choice" provisions in Article 3.[45] However, the Principles go further than Rome I, where parties have made a choice of law, either explicitly or implicitly.[46] One principal distinction concerns the texts of both instruments. While Rome I provides no

---

44. PRINCIPLES, *supra* note 8, art. 2(4), at 18 ("No connection is required between the law chosen and the parties or their transaction."). *See generally* Marta Pertegás & Brooke A. Marshall, *Party Autonomy and its Limits: Convergence through the New Hague Principles on Choice of Law in International Commercial Contracts*, 39 BROOK. J. INT'L L. 975, 988–92 (2014) (describing the absence of a connection between the contract and/or parties with the law designated).

45. Regulation 593/2008, of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations (Rome I), art. 3(1), 2008 O.J. (L 177/6) (EC) [hereinafter Rome I] ("A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to party only of the contract.") As the title of the regulation suggests, Rome I governs choice-of-law provisions in the European Union. Replacing the preceding Convention on the Law Applicable to Contractual Obligations 1980 (the "Rome Convention"), Rome I largely replicates much of the Rome Convention's language regarding party autonomy.

46. *See* COMMENTARY, *supra* note 20, § 1.4, at 29 (explaining why the drafters decided to not address applicable law in the absence of choice, but noting that such a preclusion would not prevent the HCCH from developing such rules at a later time). For a comparative analysis of the Draft Principles and Rome I, see Ole Lando, *The Draft Hague Principles on the Choice of Law in International Contracts and Rome I, in* A COMMITMENT TO PRIVATE INTERNATIONAL LAW: ESSAYS IN HONOUR OF HANS VAN LOON 299 (2013). An important limitation of the Principles, thus, is that, unlike Article 4 of Rome I, it

express statement concerning the disavowal of a nexus justification based on the choice of law,[47] the Principles explicitly specify this repudiation in Article 2(4).[48] The Commentary to the Principles reinforces the extensive scope of freedom granted under this feature, addressing the "increasing delocalisation of commercial transactions" and the adoption of a "more expansive concept of party autonomy," unlike "some States which require such a connection or another reasonable basis for the parties' choice of law."[49]

Another point of departure between Rome I and the Principles relates to derogation from mandatory principles. Of course, both instruments subject potential contracting parties to certain limits, instructing them that the forum will still give due consideration to overriding mandatory provisions and *ordre public*.[50] Beyond this, Rome I subjects parties to the potential intervention by another country's provisions of law or, more generally, E.U. Community Law when all other relevant elements of the contract point either to a country different from the one whose law has been chosen or to one or more E.U. Member States.[51] Arguably, the overriding feature of Articles 3(4) and 3(5) of Rome I further limits the choice of law by acknowledging such superseding considerations. The Principles, by contrast, impose no similar bar to the parties' choice. Once the forum is satisfied that the decision violates neither

---

does *not* provide the law applicable where a choice of law is absent from the contract.

47. Though Article 3 does not contain an express provision regarding the lack of nexus requirement, it has been universally understood by numerous commentators that such an interpretation is correct in reading Rome I in light of the drafters' intention. *See, e.g.*, Volker Behr, *Rome I Regulation: A–Mostly–Unified Private International Law of Contractual Relationships Within—Most—of the European Union*, 29 J.L. & COM. 233, 241–42 (2011) ("[T]here are no additional restrictions as to which law parties may choose like under U.S. law. There is no requirement of the chosen law to bear some 'reasonable' or 'substantial' relationship to the parties or the transaction. Contract law being mostly about parties', and hence private, interests, under the European concept there seems to be no need to limit party autonomy in general. This unlimited acknowledgment of parties' choice of law significantly contributes to the general objective of the Regulation: to provide for legal certainty and foreseeability.").

48. *Supra* note 44.

49. COMMENTARY, *supra* note 20, §§ 2.14–2.15, at 39–40.

50. *See* PRINCIPLES, *supra* note 8, art. 11, at 20; Rome I art. 9, at 13.

51. Rome I arts. 3(4), 3(5), at 10–11.

overriding mandatory principles of the forum nor public policy, the choice is granted deference. Thus, while Rome I, on the whole, is more exhaustive given its status as a European Community regulation, the Principles' lack of connection feature is less restrictive and grants more certainty than Rome I in removing obstacles to selecting the applicable law.[52]

The Principles' disavowal of the requirement that the chosen law have a connection to the underlying transaction (unlike, for example, the Restatement (Second) of Conflicts of Law in the United States),[53] includes a significant caveat. When Article 1(2)[54] is read in light of the corresponding Commentary,[55] that choice of law, standing alone, *cannot* be enough to trigger the requisite internationality set forth by the instrument. Therefore, while the Principles do not impose any rational nexus for the decision made by the parties, provided they meet the internationality requirement, the boundaries of such autonomy are delineated by proscribing the use of the clauses as a means of circumventing the internationality prong *in toto*.

Moving past this important carve-out, it is imperative to analyze how freedom from a nexus threshold[56] helps companies in the E.U. landscape. Similar to the goal that underlies

---

52. This interpretation of the relationship between Article 11 of the Principles and Article 9 of Rome I is shared by Symeonides. *See* Symeonides, *supra* note 6, at 886–88.

53. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2) (AM. LAW INST. 1971) ("The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless . . . the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice").

54. PRINCIPLES, *supra* note 8, art. 1(2), at 17.

55. COMMENTARY, *supra* note 20, § 1.21, at 33 ("The phrase 'regardless of the chosen law' in Article 1(2) means that the parties' choice of law is not a relevant element for determining internationality. In other words, the parties may not establish internationality of the contract solely by selecting a foreign law, even if the choice is accompanied by a foreign choice of court or arbitral tribunal, when all the relevant objective elements are centered in one State . . . .").

56. Note further that parties are allowed to make decisions that not only subject the entirety of the contract to the law chosen, regardless of the connection to the underlying contract, but also utilize only partial choices of law or employ *dépeçage*. *See* PRINCIPLES, *supra* note 8, art. 2(2), at 18.

the Free Movement of Goods and Services, this independence from a connection reinforces the concept that commercial parties should not be subject to restrictions that would limit their mobility across the internal market. By allowing parties to make such unencumbered choices of law, the Principles incentivize companies and other persons acting within the scope of their profession to take advantage of more business opportunities.

Parties are better equipped to take advantage of the freedoms addressed above when they agree on a law that is more favorable to their dealings than the available law in domestic fora. With regard to the Free Movement of Goods, the elimination of discriminatory practices against foreign products entering domestic markets strengthened the idea put forth that the European Union should "ensure normal conditions of competition and . . . remove all restrictions of a fiscal nature capable of hindering the free movement of goods within the Common Market."[57] The ability to voluntarily choose the law applicable to a contract for imported goods would bolster the Free Movement of Goods by permitting parties to escape the United Nations Convention on Contracts for the International Sale of Goods (CISG),[58] for example, or, if CISG would be inapplicable[59] and no choice of law is made, the inhospitable laws of an

57. Case 27/67, Fink-Frucht GmbH v. Hauptzollamt München-Landsbergerstrasse, 1968 E.C.R. 230, 233.

58. *See* CISG, *supra* note 31, art. 6 (allowing for parties to opt-out of the Convention where it would otherwise apply). However, as Dr. Franco Ferrari, Director of the NYU School of Law Center for Transnational Litigation, Arbitration and Commercial Law, advises, parties who wish to exclude the CISG from otherwise applying to the contract should specifically write into their contract that they wish for the *domestic* law of a country to apply. Stating a choice in favor of French law, for example, may not be enough given that the CISG is, in fact, part of French law given its status as a Contracting State. *See* Franco Ferrari, *Remarks on the UNCITRAL Digest's Comments on Article 6 CISG*, 25 J.L. & COM. 13, 25–27 (2005) (citing numerous court decisions and arbitral awards that confirm that a selection in favor "of the law of a Contracting State, if made without particular reference to the domestic law of that State . . . does not *per se* exclude the Convention's application.").

59. For example, if the forum was located in Portugal or the United Kingdom, the CISG would not be applicable, even if the two parties had their places of business located within Contracting States. Portugal and the United Kingdom are the only E.U. Member States that are not Contracting States to the CISG. Apart from this, there are numerous other reasons why

exporter country (the law of the seller).[60] Hence, the Principles promote the goal of freeing goods from discriminating policies by granting these parties the opportunity to escape laws that are potentially unfavorable to such contracts without requiring them to submit their choice to a "reasoned basis" scrutiny standard. This same reasoning can be extrapolated to the Free Movement of Services, though service contracts are not governed by the CISG. Service providers, analogous to those commercial parties who supply and purchase goods, need the ability to readily make such choices of law with their clauses enforced and recognized by courts and tribunals. The Principles lend service providers certainty and predictability where they may otherwise be wary of extending their business outside of their domestic settings. They may seek laws beyond their national jurisdiction as a means of expanding their interests without the concern that their decision has no relationship to any other factors of their international service contracts.

Apart from motivating actors to enter into profitable cross-border commercial contracts, the Principles, through their adoption by Member States' PIL regimes, could also benefit free parties, both in their *ex ante* negotiations and *ex post* litigations, from the restrictions imposed by Rome I, namely those concerning the escape from non-overriding mandatory provisions. Some critics charge that parties are allowed to more easily elude these provisions, but parties would not necessarily use the Principles to evade responsibilities that would otherwise be imposed.[61] It could be possible, for example, that the law chosen by the parties is *more* developed in an area al-

---

the CISG might not be applicable, chief among these being the exclusions found in Article 2 of the Convention.

60. *See* Rome I, art. 4(1)(a).

61. It is important, at this point, to remind the reader of this Note that the Principles concern *only* "commercial" contracts. They cannot be used within the realm of consumer or employment contracts, as expressly stated in the Introduction to the Principles and in the Commentary to Article 1(1), given the assumption that commercial parties, unlike consumers or employees, are sophisticated and maintain equal bargaining power. Therefore, the concern that this paragraph addresses is somewhat ameliorated by the fact that the Principles would still not allow for parties to escape those protections addressing consumers and employees, as afforded by the various E.U. legislative directives or regulations, such as The Directive on Consumer Rights (2011/83/EC).

ready governed by E.U. Community law. In that situation, the parties would be unduly prevented from opting out of those provisions even when doing so would not implicate uneven bargaining power and where market efficiency could be enhanced.

By allowing parties to voluntarily choose the governing law and not subjecting that choice to further scrutiny, the Principles enable commercial parties within the European Union to more freely engage in transactions with the assurance that their choice of law will be respected by both State courts and arbitral tribunals, effectively advancing the purpose of the Free Movement of Goods and Services. Parties are able to opt out of laws that would otherwise be applicable to their goods or service agreements, thus incentivizing greater commercial activity with this commensurate increase in party autonomy.

C. *The Ability to Choose "Rules of Law" Rather than State Law*

Arguably, the most progressive (and contested) provision of the Principles is found in Article 3: "The law chosen by the parties may be rules of law that are generally accepted on an international, supranational or regional level as a neutral and balanced set of rules, unless the law of the forum provides otherwise."[62] By referring to "rules of law," the HCCH drafters meant to address those legal norms that do not emanate from a State source.[63] These include choices in favor of international treaties, conventions, non-binding instruments, and even model rules deriving from expert groups.[64]

The Principles limit such choices in favor of non-state rules by imposing a threefold requirement for them to be considered valid. First, the chosen rules of law must constitute a "set of rules." The Commentary details that this requirement does not call for a test of exhaustiveness. Instead, the chosen rules "must be such as to allow for the resolution of common contract problems in the international context."[65] The second and third attributes refer to the "neutrality" and "balanced"

62. PRINCIPLES, *supra* note 8, art. 3, at 18.

63. *See generally* Pertegás & Marshall, *supra* note 44, at 996–98 (discussing the Principles' allowance of non-state rules of law to be chosen as applicable law).

64. COMMENTARY, *supra* note 20, §§ 3.5–3.7, at 40–41.

65. *Id.* § 3.10, at 41.

nature of the set of rules.[66] The rationale behind these preconditions is that the drafters wanted to ensure that parties are mindful to select rules that derive from sources that are favorable to parties on either side of a transaction[67] and "represent diverse legal and economic perspectives."[68] With this three-pronged test, the drafters guaranteed that parties are selecting only those rules that *resemble* State law so that courts are not left sifting through a cherry-picked mélange of divergent legal norms.

Decisions in favor of such non-State sources of law are not novel in the context of arbitral proceedings, but they are quite radical when discussed within the framework of traditional litigation before State courts.[69] Critics charge that, while the Principles purport only to allow for those choices of rules that resemble "real" rules of law, such rules lack the essential characteristics of State law given that they do not arise from the will of a democratic and legislative process, judicial pronouncement, or custom.[70] Thus, it is no surprise that certain Member States to the HCCH presented strong objections to the inclusion of such a provision in the Principles.[71]

This resistance to the incorporation of a non-State norm regime into the Principles, however, may not be well-founded. In Article 3, the drafters added the secondary qualification to the three-pronged test: "unless the law of the forum provides otherwise."[72] Despite the Principles' status as a non-binding soft-law instrument, this stipulation is still necessary to the extent of providing assurances to States who choose not to recognize such norms as valid choices of law.[73] The Principles do not seek to override the authority of the forum. Only if the

66. *Id.* § 3.9, at 41.
67. *Id.* § 3.12, at 41.
68. *Id.* § 3.11, at 41.
69. *See* Genevieve Saumier, *The Hague Principles and the Choice of Non-State "Rules of Law" to Govern an International Commercial Contract*, 40 BROOK. J. INT'L L. 1, 19 (2014) ("In other words, even if parties have included a choice of law clause in their contract designating, for example, the UPICC to govern their contract, this choice would not be effective if a dispute is brought before a State court.").
70. *See* Symeonides, *supra* note 6, at 892.
71. *See id.* at 893 (discussing the European Union's strongly oppositional stance to the allowance of parties to choose non-State norms).
72. PRINCIPLES, *supra* note 8, art. 3, at 18.
73. *See* Symeonides, *supra* note 6, at 894.

forum is located within a State where legislators have adopted such a provision can parties reasonably rely on such choices to be granted deference. Accordingly, it could be said that a choice of law favoring non-State rules is still subject, in a sense, to a democratic and legislative process. This view is further bolstered by the argument that, as previously mentioned, States have no issue permitting arbitral tribunals to take full advantage of non-State norms in resolving disputes arising out of international commercial contracts.[74] While the arbitral process appears wholly separate from litigation, parties still rely on State courts for the enforcement of such arbitral awards. If States implicitly assent to the validity of rules of law through recognition and enforcement of such awards, they should not hesitate to recognize this legitimacy *explicitly* in litigations brought before their own courts at the outset.[75] Therefore, while Article 3 may appear, on its face, to require a drastic change to PIL regimes currently in place, the acceptance of such non-State norms as choices of law has already occurred at the State court level, albeit indirectly.

Article 3 further enhances the Free Movement of Goods and Services by granting parties the ability to choose rules of law that may be more attuned to and compatible with the underlying transaction. This analysis will focus on the effect of the Principles on contracts for the movement of goods throughout the European Union, though the analysis is still relevant for service providers as well. Take, for example, two parties who, both having their establishments in France, desire to conclude a contract for the sale of goods that would be governed by the CISG. Let us also suggest that multiple factors, such as the place of conclusion of the contract, the place of performance, and one of the party's nationalities, point to the Netherlands.[76] Hence, this contract, regardless of the fact that both France and The Netherlands are Contracting States to

74. *See* Saumier, *supra* note 69, at 20.

75. *Id.*

76. The example purposefully utilizes the expansive internationality test set forth for the Principles' applicability. Here, it is obvious that the parties in question fail to automatically have their contract considered international given that they have their places of establishment located in the same state (France), but the Principles may still consider such a contract international. The fact that all other relevant elements (place of conclusion of the contract, place of performance, and party nationality) points outside of France

the CISG, cannot be governed by the Convention because it fails the internationality test as set forth by Article 1(1).[77] Under current PIL regimes as well, even if the parties were to "opt in" to the CISG, that decision would not constitute a choice of law.[78] With the adoption of the Principles, however, opting in to the CISG could now constitute a valid choice of law for these parties, letting them proceed with their transaction under the auspices of the CISG and take full advantage of the TFEU's Free Movement of Goods provision where they might otherwise be dissuaded from entering into a contract.

The incentive effects that the Principles would have on stimulating cross-border exchanges of goods and services within the European Union by allowing potential parties to choose "rules of law" would, of course, need to be quantified after a State adopts the instrument into its own PIL regime. Nonetheless, it would seem that in granting parties such autonomy, as the example above illustrates, there is the potential that there would be an increase in such activities. Rules of law, like the CISG, are attractive to parties who view them as more closely aligned with their own commercial interests, especially when they wish to expand their business outside of their domestic setting. The drafters' allowance of choices in favor of rules of law, while controversial to State legislators and courts, may be a way to further eliminate the discriminatory practices that inhibit unfettered movement of goods and services across the European Union.

(to the Netherlands) would arguably be considered enough to trigger the requisite internationality.

77. CISG, *supra* note 31, art. 1(1).

78. *See* Ferrari, *supra* note 58, at 36 ("[T]he choice of the CISG in contracts to which it would otherwise not apply does not constitute a 'choice of law,' as there are no private international law rules that allows such a 'choice' to have a different value."); *see also* Ostroznik Savo, legal representative of Vzerja Kuncev, and Eurotrafic S.r.l. v. La Faranono soc. Coop. A.r.l. and Banca di Credito Cooperativo di Roveredo di Guà, Tribunale di Padova, Italy, (Jan. 11, 2005), http://cisgw3.law.pace.edu/cases/050111i3.html (advising that a choice in favor of the CISG where it would otherwise not be applicable to a contract cannot be considered a "choice of "law," since the Convention itself does not allow for choices of law to refer sources outside of state law).

III.
SUPPORT FROM THE INTERNATIONAL COMMUNITY FOR THE PRINCIPLES AND THE POSSIBILITY OF TRANSPOSING E.U. COMPANY LAW TO NON-E.U. FORA

The foregoing section reveals the many potential benefits of the Principles and how they may help reinforce the current TFEU Fundamental Freedoms. Yet, the true test of the Principles' effectiveness relies on the consensus from the E.U. community and global economy.[79] As previously mentioned in this Note, the envisaged usages of the instrument are outlined forthright in the Preamble:

> [The Principles] may be used as a model for national, regional supranational or international instruments. They may be used to interpret, supplement and develop rules of private international law. They may be applied by courts and arbitral tribunals.[80]

The Preamble, therefore, highlights the drafters' awareness that the Principles are only as successful as the support received outside the HCCH.

To the credit of the instrument, since its formal approval, the HCCH has been able to cite its endorsement by two internationally renowned trade organizations, the United Nations Commission on International Trade Law (UNCITRAL)[81] and the International Chamber of Commerce (ICC).[82] The Principles mark the first HCCH instrument to be officially endorsed by UNCITRAL. In combination with the support of the ICC, the largest and most diverse business organization in the world, these signals from the wider international commercial

---

79. *See* Symeonides, *supra* note 6, at 899 ("Like any collective work, an international convention is as good as the consensus of the participating delegations will allow it to be.").

80. PRINCIPLES, *supra* note 8, at 18.

81. U.N. Comm'n on Int'l Trade Law, Rep. on the Work of its Forty-Eighth Session, U.N. Doc. A/70/17, at ¶¶ 238–40 (2015). In my capacity as a legal intern for the HCCH, I had the distinct pleasure to prepare Ms. Pertegás' address to the Assembly seeking the Principles' endorsement by UNCITRAL at its 48th Session in Vienna on July 8, 2015.

82. Int'l Chamber of Commerce, *ICC Appeals to Authorities to Strengthen Legal Certainty for International Contracts by Implementing the Newly Approved Hague Principles* (Nov. 4, 2015), http://www.iccwbo.org/News/Articles/2015/ICC-appeals-to-authorities-to-strengthen-legal-certainty-for-international-contracts-by-implementing-the-newly-approved-Hague-Principles/.

community cannot be ignored: there is a distinct desire from these experts for the incorporation of such Principles into domestic and regional PIL regimes.

A codification of the Principles has already been accomplished at the State level in Latin America, of all regions, well-known for placing limitations on regional commercial actors' ability to freely choose applicable law to contracts.[83] On January 15, 2015, Paraguay promulgated Law No. 5393 on the Law Applicable to International Contracts, which implements the Draft Hague Principles.[84] Thus, the HCCH may now point to evidence of the Principles' potency by virtue of its adoption by a State legislature in a region acknowledged for its lack of contractual party autonomy.

CONCLUSION

The international encouragement that the Principles have received thus far is promising. As this Note has attempted to demonstrate, many reasons exist for E.U. legislators to embrace its provisions based on the Principles' ability to advance the TFEU Fundamental Freedoms for commercial parties. Moreover, the promulgation in Paraguay illustrates how adoption of the Principles outside an E.U. context could help promote the Fundamental Freedoms abroad, leading to less restricted cross-border commerce in areas such as Latin America. The acceptance of the Principles "depends in large part on its intrinsic value rather than on sovereign choice and

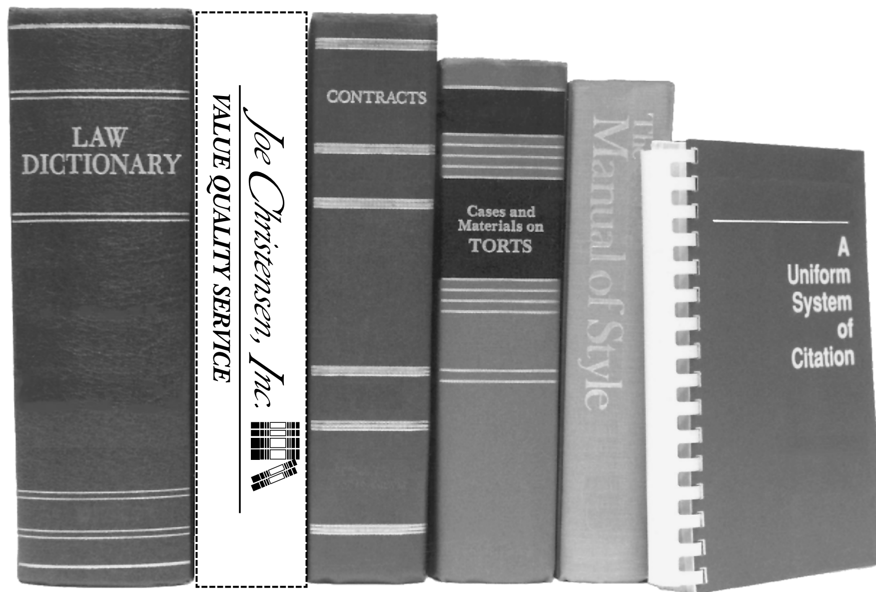
---

83. For more on the limitations of party autonomy in Latin America, see, for example, Albornoz, *supra* note 23.

84. The Hague Conference on Private Int'l Law, *Paraguay Promulgates the Law based on the Draft Hague Principles on Choice of Law in International Commercial Contracts* (Jan. 20, 2015), http://www.hcch.net/index_en.php?act=events.details&year=2015&varevent=392 ("In line with the Draft Principles, this Law accepts party autonomy for choice of law in international contracts, which enhances legal certainty and predictability in the contractual dealings concluded between Paraguayan companies and companies from around the world. It therefore will contribute to the facilitation of foreign investment and trade in Paraguay. In addition to confirming the pioneering role played by Paraguay in bringing the Draft Principles into operation, the enactment of the Law affirms the objective of the Draft Principles as a guide to 'best practices' with regard to the choice of law in international commercial contracts."); *see also* José Antonio Moreno Rodríguez, *The New Paraguayan Law on International Contracts: Back to the Past?, in* EPPUR SI MUOVE: THE AGE OF UNIFORM LAW–FESTSCHRIFT FOR MICHAEL JOACHIM BONELL (2016).

compulsion."[85] Though they are not as exhaustive as other HCCH uniform substantive conventions, the Principles definitively contain this "intrinsic value," embodying a vigorous and progressive step forward in the expansion of commercial party autonomy in the European Union and beyond.

85. *See* Symeonides, *supra* note 6, at 899.



We Complete the Picture.

In 1932, Joe Christensen founded a company based on Value, Quality and Service. Joe Christensen, Inc. remains the most experienced Law Review printer in the country.

Our printing services bridge the gap between your editorial skills and the production of a high-quality publication. We ease the demands of your assignment by offering you the basis of our business—customer service.

1540 Adams Street
Lincoln, Nebraska 68521-1819
Phone: 1-800-228-5030
FAX: 402-476-3094
email: sales@christensen.com

Value

Quality

Service

Your Service Specialists