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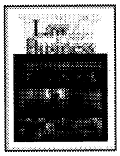

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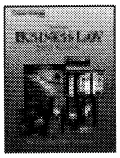

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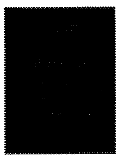

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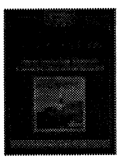

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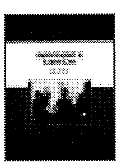

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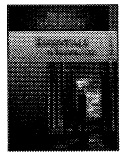

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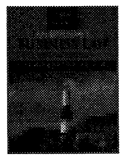

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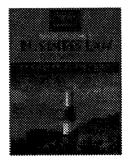

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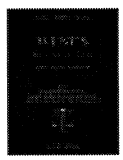

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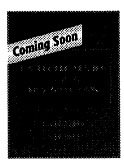

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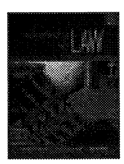

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ARTICLES

PEDAGOGY

INCREASING WAGES IN CHINA: GOVERNMENT MANIPULATION OF WAGE RATES WITHOUT DIRECT REGULATION

by

Christine M. Westphal* and Susan C. Wheeler**

In her 2002 book, *Making Sweatshops*, Ellen Israel Rosen describes in detail the difficulties faced by workers all over the world in the apparel industry who are caught in a downward wage spiral by the "race to the bottom" in garment manufacturing. She argues that as developing countries attempt to attract international capital investment they must offer "concessions to investors designed to reduce the costs of production…"[1] most often by exploiting women workers in garment and light industrial manufacturing. She is but one among a large chorus of writers who have observed that multinational corporations "ruthlessly exploit the factors of production by chasing after ever-cheaper labor and ever laxer environmental regulations."[2] The push by corporations to externalize costs, so that the countries that accept their investment dollars absorb the costs of pollution, degradation of worker health and safety, and human rights violations while the corporation achieves greater profit is at the heart of the "race to the bottom".[3] These problems associated with lax regulations are often made worse by a combination of bribery and corruption which renders the laws of the host country ineffective.[4]

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There has been a concerted effort to force American corporations to internalize more of these costs through corporate codes of conduct[5] but by and large these efforts have not been successful on a large scale.[6] Initiatives such as student anti-sweatshop drives have probably done more to alert the public to the existence of deplorable conditions than to improve the lives or wages of workers.[7] It should be noted that this process of worker

exploitation is not simply a failure of procedural safeguards. The argument that if the "host" country had a more developed legal system workers would have an opportunity to redress their grievances and achieve safe working conditions and prosperity is actually quite hollow. Workers in the Northern Mariana Islands (a United States Territory) have suffered through the same exploitation and abuse as those in countries with a less developed legal system. The attempts to use the Alien Tort Claims Act to increase corporate accountability in the Northern Mariana Islands and elsewhere, while both admirable and interesting, have done very little to actually improve the lot of workers on the manufacturing floors of the developing world.[8]

Even though most writing on the "race to the bottom" focuses on the manufacturing floor, virtually all of the writers cited above trace the "push" propelling this "race" to the retail industry. Rosen describes this as the Wal-Mart Effect[9] noting that "more than 70 percent" of Wal-Mart inventory originates in China.[10] She cites China's "low wage labor and ... advanced technology" along with the production of "quality goods" as the factors that make it the most attractive supplier for retailers such as Wal-Mart[11]. With the end of garment quotas by the World Trade Organization many of the experts in this area expect an acceleration of this downward spiral, and they expect China to dominate the garment trade for the foreseeable future.[12] While there is some argument that China will dominate the garment trade because it has both "state-of-the-art factories" and a "rapidly improving transportation network"[13] other writers simply cite China's huge labor surplus.[14]

China faces multiple challenges in this environment. It is committed to a course of rapid industrial development that requires huge foreign investment. In order to attract that foreign investment it must continue to demonstrate that investing in China provides competitive advantages to manufacturers and the retailers who contract directly with Chinese manufacturers, primarily by providing vast numbers of low wage workers, but those workers are increasingly dissatisfied with their wages and working conditions and are engaging protests.[15] Most new manufacturing has been situated on the coast, and inland provinces are feeling neglected. Their workers migrate to the coastal regions to find work; and they provide the labor for much of the new development without actually receiving much benefit.[16] These migrant workers often do not have access to government services (education, health care, etc.) because they are not considered legitimate residents of the cities where they work.[17]

It is clear that in order to continue to maintain political stability the Chinese government needs to sustain its growth rate, improve the working conditions and the wages of its workers, and move industrial development to the western and rural provinces. How these contradictory goals are being met by a combination of infrastructure improvements, indirect regulations and market forces is the subject of this paper.

THE ROAD TO PROSPERITY

China began to intensify planning its national highway system in the 1990's with a comprehensive highway law that sought to build 57,000 miles of roads from 1995-2000.[18] The Chinese have also planned the construction of a massive expressway system comparable to the interstate highway system constructed by the United States in the 1950's and 1960's.[19] They have completed over 18,000 miles of expressway in the last 15 years.[20] While this is still considerably less than the United States, which has 46,000 miles of interstate, the estimates are that China will overtake the United States in this area by 2020.[21] This is particularly impressive when you consider that in 1988 China had only 11.5 miles of expressway.[22]

The reasons for this massive, growing[23] investment are many. First, the Chinese seek to "connect all of the country's provincial capitals and cities with populations of over 200,000."[24] A further purpose is to cut travel times between cities and provinces and give the entire population access to roads and highways.[25] They believe that expediting transportation by the creation of a comprehensive road network will lower the transportation costs for raw materials and finished goods within China. Presently the government estimates that the transportation of raw materials and finished goods constitutes 20 percent of production costs in China (in the U.S. this represents 3% of product cost).[26] It has also seen an increase in tourism in cities of historical significance to the Chinese[27] and hopes to create the kinds of roadside enterprises that have developed in the United States (i.e. lodging, food, and fuel).[28]

But perhaps the most important goal of this road building frenzy is to spread industrial development to the Western and rural areas of China. The estimates are that "the per capita income in the 12 Western and Central provinces is less than half "of the income on the industrialized coast."[29] This translates into substantial labor cost savings for companies that relocate from the cost to inland provinces.[30] Road construction has been supplemented with other infrastructure improvements including airports (9 billion in the last five years[31]) and power plants.[32]

For the Chinese this investment "pays off" in a number of ways. First it allows China's political leaders to deliver on the promise of its Develop the West policy; second it allows China to retain foreign investment as it raises wages[33] on the industrial coast by offering manufacturers who rely on low labor cost to retain a competitive wage advantage by moving inland, and third, it encourages workers to stay in their home areas instead of migrating to the coast. The Chinese also recognize benefits in food distribution[34] and as an added bonus, it helps shrink the labor force available to coastal employers.

As infrastructure improves (and wages on the coast increase) more and more western investment is flowing to the interior provinces. Fifty percent of the U.S. companies that belong to the American Chamber of Commerce in Beijing have already "invested in second-tier cities"[35] including multinational giants General Motors, Honda, Motorola and Carrefour (a French Wal-Mart competitor).[36] With labor excess in the rural sector exceeding 150 million workers,[37] there is every reason to believe that multinational industrial movement to and investment in China's rural areas will continue to increase.

HOW ARE YOU GOING TO KEEP THEM DOWN ON THE FARM?

This spring both Business Week[38] and the International Herald Tribune[39] ran articles on labor shortages in China. In a country with vast labor surpluses this seems odd at best. But an examination of recent regulatory changes within China and the stated purposes of long term infrastructure improvements in the country's interior suggests that this is the result of a coordinated and well thought out process on the part of the Chinese government. If the goal of the Chinese government is to raise the wages of industrial workers in the industrialized coastal area and encourage foreign investment in the country's interior then the plan seems to be working. The first step, as outlined above, was to create the infrastructure that would allow multinational corporations to move their businesses inland. The second step is to encourage them to make the move. The "creation" of labor shortages causes market driven wage increases, as well as improved working conditions for factory workers in the industrialized coastal areas.[40] This in turn gives interior locations a significant comparative wage advantage for manufacturers.[41]

Li and Park in their article, "Determinants of Locations of Foreign Direct Investment in China"[42], observe that "the traditional view of regional comparative advantages... holds that firms relocate their operations according to variations in production factors, infrastructure and economic policies..."[43] They conclude that the legal environment and other institutional factors such as the protection of property rights should also be given significant weight when analyzing foreign investment decisions.[44] However, they specifically cite garments and shoe manufacturing"[45] as products that do not "require a high level of protection for property rights..."[46] We would suggest that this reinforces the Chinese government's strategy of encouraging the relocation of these industries to the interior provinces in China. Where there is not already significant development the additional infrastructure investments in roads and airports along with artificially created wage differentials caused by coastal labor shortages will have the biggest "pay off" in foreign investment in garment and shoe manufacturing in the interior provinces.

The Chinese government is playing a pivotal role in creating these labor shortages.[47] Prior to the 1980's China restricted internal migration by a system of "household registration (hukou), rural commune controls, and food rationing"[48]. In the 1980's the government eliminated communes and food rationing, which essentially allowed free migration within the country. While many household registration rules remained in effect, most migrant workers in China simply ignored them. While their non resident status in Coastal and industrial cities limited their access to health care, housing and education most felt that the economic advantages of "western" jobs were worth the sacrifices.

This has caused the government to create incentives in order to encourage rural workers to remain in their home provinces. The biggest changes have involved improving the incomes of farmers. In 1998 the government began giving farmers greater freedom in crop selection which has allowed farmers to move to higher-value crops.[49] It has also increased direct subsidies to farmers.[50] Finally, it has eliminated most farm taxes.[51] Taken together these actions have substantially improved rural incomes.[52] Dexter Roberts quotes a young Chinese worker in his 2005 Business Week article "Most young people in my village don't want to leave because they can make money from the land"[53] In addition, China's one child policy has both limited the workforce and discouraged migration. Most parents do not want their only child to "leave home"[54]. The one child policy was implemented in the 1980's and these are the workers presently entering the workforce. Since "export-oriented manufacturers prefer to hire women from 18 to 25 as factory workers"[55] they are being hit the hardest by this demographic change causing them to move inland first.

Recent changes in the household registration law have also made it easier for workers to move legally to small towns and cities. As a result, young workers can stay close to home and with manufacturing jobs moving to the rural provinces and second tier cities, there is ample opportunity to find work.

MARKET FORCES

It is likely that the Chinese government is seeking to use market forces to lift wage rates for two reasons. The first, is that a government sponsored increase in the minimum wage might encourage a flight of capital investment to lower cost countries such as Vietnam or Bangladesh.[56] The second, and somewhat more complex reason is the inability, or unwillingness, of the Chinese government to enforce its labor laws. Multiple authors have cited lax enforcement of labor and wages laws as a root cause of worker unrest.[57] There have also been serious problems with bribery of local officials that the central government has recently sought to address by an across the board increase in official wages. The hope is that by paying local officials a higher salary there will be less incentive to accept bribes. Only time will tell if they can successfully combat local corruption by supporting and increasing the compensation paid to local officials.[58] However, if workers can "vote with their feet" by leaving employers who do not live up to their promises of fair wages and decent working conditions[59] then lack of government enforcement becomes moot. As Dexter Roberts pointed out in his 2006 article for Business Week, labor shortages will cause high worker turnover rates unless multinational corporations raise wages and improve working conditions.[60]

It is estimated that a 10% increase in average income reduces poverty by 19 to 39 % in China.[61] Labor shortages in the industrialized coastal region are causing market forces to drive up wage rates. While there are serious questions about China's labor statistics[62] and cheery government reports of 14% annual average wage increases seem optimistic[63] it is clear that China's workers are making economic progress. The World Trade Organization estimated that China had cut "poverty from 73 percent in 1990 to 32 percent in 2003.[64] Increases in rural income over the last few years have lowered it further.

In places like Shanghai many companies are paying low skill workers significantly more than the minimum wage.[65] Access to TV sets, e-mail and cell phones has created an awareness of both "rights" and opportunities for Chinese workers[66] and a more vibrant and mobile labor force. With many coastal employers unable to meet their employment goals "voting with their feet" is now a real option for manufacturing workers in the industrial coastal areas.

Since most multinational manufacturers are paying more than the minimum wage it is then possible for local governments to raise the minimum wage without disrupting the flowing of international investment. Shenzenen, one of China's special economic zones, recently raised the local minimum wage by 23% without adverse impact.[67] This kind of trailing regulatory activity where the government manipulates the available number of workers to force a market driven increase in wages, and then raises the official minimum wage to a level just below the new market wage has both public relations value and economic value.

From the public relations perspective, the government can claim to be protecting Chinese workers from exploitation by multinational corporations. This has also allowed China's government sponsored union, The All-China Federation of Trade Unions (ACFTU), to achieve a higher profile by publicly calling for increased wages. In the longer term it seems likely that the government will push the ACFTU into multinational corporations doing business in China in order to allow for more government and communist party influence on wage and employment practices without the use of either direct or indirect legislation or regulation.[68]

From an economic perspective, increasing the minimum wage in coastal industrialized areas further enhances the comparative labor cost advantages of rural provinces and the wage increase on the coast will help create a larger Chinese middle class.[69] It is this growing class of Chinese consumers that multinational corporations find irresistible. Many companies are committed to future expansion in China and this expansion potential makes them reluctant to leave China for other low cost countries in the region. Wal-mart, in particular, has placed great emphasis on future expansion in China and seems unlikely to anger the Chinese government by "outsourcing" to other developing countries.[70]

CONCLUSION

Faced with a need to both attract foreign investment and increase worker prosperity China has engaged in a systematic process of creating labor shortages in its highly industrialized coastal areas in order to induce market driven wage increases. By manipulating the labor markets on the coast and providing infrastructure support they have managed to "encourage" manufacturers who are seeking low wage workers to move their factories (and investment capital) inland. This has had many benefits from the Chinese perspective and at least on its face has very little down side.

This is not to suggest that success is assured or that Chinese development and labor practice are trouble free.[71] But certainly this piece of regulatory manipulation appears to be successful.

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THE STAKEHOLDER MOVEMENT AND THE SOCIAL RESPONSIBILITIES OF CORPORATIONS: A COMPARATIVE INTERNATIONAL PERSPECTIVE

by

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> One program that played a central role in our [Chase Manhattan Bank's] cultural revolution was the Corporate Social Responsibility Program. Few companies in the 1970s made charitable contributions, and still fewer had programs whereby a panned percentage of annual earnings were contributed to charity....My [David Rockefeller, CEO of Chase] rationale for an active corporate responsibility program was simple: Businesses could not afford to become isolated for the larger society of which they were an integral part....Any business that does not respond creatively to this world and its growing insistence on an improved quality of life is cutting off its future nourishment. For, however, you interpret its role, the corporation depends on

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> the health of its society. Just as society's perception of us molds the laws that govern us, society's health determines whether we will have a vigorous or slack marketplace....[1]

INTRODUCTION

The United States historically has been a nation committed to individualism. Freedom to think, act, and resolve difficulties without governmental interference continues to dominate the American ethos. The same laissez-faire attitude has been transplanted to the American public corporation. Nowhere in the world is it easier to set up a corporation.[2] Corporations are creatures of the state. They are artificial entities that are created and operate within the state of incorporation and beyond its borders. Corporations throughout the world generally have one of two governance models, the "shareholder" model or the "stakeholder" model with variations within each of the models.[3] Both types of entities vary somewhat from country to country. In this article, we will initially examine the major types of corporate entities prevalent in the business world among nations. Thereafter, we will examine the trend of the American "shareholder" model to incorporate and integrate the social responsibilities inherent in the "stakeholder" model in order to produce a corporate social responsibility ("CSR") model.

"SHAREHOLDER" vs. "STAKEHOLDER" MODEL

The Shareholder Model

The classic formulation of the U.S. corporation, clearly described by Adolph A. Berle Jr. & Gardiner C. Means, indicates the relationship that exists between shareholders and managers.[4] In essence, shareholders of public corporations play no role in the management of the corporation but must delegate the role to managers who are in turn supervised by a board of directors elected by the shareholders.

The U.S. and the U. K. exemplify the Anglo-American shareholder system which is defined by the emphasis upon shareholder value to the virtual exclusion of the other stakeholders: employees, customers, suppliers, and the public. Professor Milton Friedman argued that corporations owe a duty to maximize the profit of shareholders within the confines of legal and regulatory enactment and owe nothing to other stakeholders.[5] Friedman's analysis is questioned by many scholars who posit a theory of legal and social responsibility that corporations arguably have to the state and other constituencies.[6]

The U.S. shareholder model indicates that the shareholders ostensibly elect the board of directors and the board selects the managers who perform the day-to-day operations of the corporation. The distinguishing feature of the U.S. model is the large number of shareholders who are widely disbursed nationally as well as internationally. Shares of stock are not ordinarily concentrated in the hands of a limited number of investors but are owned by small and larger shareholders and, in recent years, increasingly by institutional investors. Under the stakeholder model, as discussed hereinafter, there are relatively few shareholders.[7] Investors, under the U.S. model, are really passive investors due to the fact that they have too few shares and are too widely disbursed to act independently. This scenario, however, is changing with the increasing influence of institutional investors who are becoming more actively involved in the selection process.

The board of directors' main role is to monitor the management on behalf of the shareholders. The board, however, often consists of managers who also are on the board. These same management board members select the board members who are to monitor the managers. The chief executive officer is often the chairperson of the board. The composition of the board may then cause the board to neglect its duties on behalf of the shareholders. Proxy contests may act as a check on management but the reality is that 99.6% of corporate boards are elected in uncontested proxy solicitations.[8] CEO pay has risen to a staggering degree as high as 400 or more times that of an employee's salary.[9] Often, the dramatic increase in executive pay is due to the CEO' enormous influence over board members.[10]

The chief officers of the corporation (CEO and CFO) are selected by the board. The major difficulty is that they are essentially insulated from the passive shareholders. This insulation has permitted officers, with impunity, to cut back on research and development, or to make investments to maximize the next quarter's earnings. The officers fail to maintain a "Chinese wall"[11] between analysts and investment banking operations. Managers lobby successfully to have states enact anti-takeover laws which have the effect of insulating poor managers. There have been numerous examples of the lack of ethical behavior on the part of managers that go beyond the Enron and related well publicized scandals.[12]

The Stakeholder Model

The stakeholder model reflects the model most utilized in the non-Anglo-Saxon major industrial nations. There are a variety of subsets of the model but its emphasis varies widely from that of the shareholder model. The stakeholder model emphasizes the social responsibilities to various stakeholders and to society itself. In one form, found previously in Japan, the key feature was corporate assurance of lifetime employment for the employees of the corporation. Employees there had a greater incentive to develop and supply firm-specific human capital, to practice significant loyalty to the firm, to facilitate team effort, and to be willing to make concessions in times of distress. Management's emphasis was on long-term health of the corporation, to benefit the employees and to return a profit to the shareholders. Since the primary holders of corporate indebtedness were banks, there was less need and incentive for immediate profit gains and, therefore, more for long term profitable outlook. Japanese corporate structure is one that is insular and conservative. It protects management from the external pressures of the market and from shareholders. Banks often dominate the board because corporate capital is raised from bank loans rather than from the public sale of securities.

Japanese firms have been part of a *keiretsu.* Competing corporations thereby became united in protecting each other. Board members often consisted of a number of members from competing organizations. When one company had financial difficulties, it would be propped up by the competing companies or by the entering into "friendly" mergers. These companies should have been permitted to expire. The eventual collapse of the Japanese market left only companies with multinational entities and independently operated entities to survive. Japan enacted legislation in 2002 that permitted companies to adopt a U.S.-style method of corporate management. By March 31, 2004, some 71 firms have so adopted these changes.

Other styles of stakeholder models include those of Germany and, to some extent, those of France. The German securities market is essentially underdeveloped. Of two million companies in Germany, about 4.600 are stock companies. Some 825 of the 4,600 companies are truly publicly traded.

The result is that there are rare unfriendly takeovers. The few German shareholders consist mainly of holders of large blocks of shares with long-term interests. Shares are also owned by large financial institutions which provide funding for the corporations.[13] These shareholders control the actions of the corporate managers.

The German corporation is a classic stakeholder model. It consists of two corporate boards, namely, the supervisory board and the management board. The supervisory board (*Aufsichtsrat*) contains a minimum of three members with multiples of three but no more than 21 members. In firms of over 2,000 employees, the shareholders may elect half of the board and the employees the other half of the board members. German supervisory boards must have a minimum of one-third employee membership on the board. The board's primary duty is to appoint and remove members of the management board (*Vorstand*). The Vorstand is responsible for the day-to-day operations of the corporation. It is not subject to the dictates from the general meeting of shareholders. Rather, shareholder demands are to be made to the supervisory board which then makes adjustments and demands upon the management board. The management board must take into consideration the various stakeholders including the shareholders, the welfare of the employees, and the community at large. The profit motive is not the paramount principle governing the corporation's operations.[14]

Members of the management board are prohibited from engaging into any transaction which competes with the corporation except with permission of the supervisory board. The management board's duties include the providing of information to the supervisory board with respect to the corporation's business, condition, policy, and other factors impacting upon the corporation. Management is subject to the strict control and influence by banks which often own large blocks of shares. Such ownership is prohibited in the United States under the Glass-Steagall Act of 1933.[15]

The principal advantage of the German model is management accountability. The banks demand significant control over management.[16] Both the management and the board seek the firm's long-term health and profitability. Banks receive added information to better react to technology-driven and rapidly changing markets. They, therefore, add their expertise to the decisonmaking process. The cost of capital acquisition is less because as banks are more amenable to grant new loans or restructure existing loan agreements. Lower dividend payout ratios result because of money retained for conservative research and development for factory improvements, equipment, and employee training. It appears that the German system is less efficient and flexible than the United States system. Companies are not subject to diverse shareholder input. Businesses are not vulnerable to takeovers; inefficient firms, therefore, continue their poor performance. Significant bank influence tends to cause management to invest in safe operations and impede investments in new ventures that may have significant risk.

The disadvantages of the German and Japanese stakeholder models are considerable. Corporations following the models now are rethinking their effectiveness in the emerging global marketplace. Due to conservative banking financing, there is an inherent bias against startups, ground-breaking research and development, and human-capital industries By way of comparison, the average age for a listed firm on the New York Stock Exchange in the U.S. is 14 years; the average for a company on the German stock exchange is 55 years. In the U.S., 40% of the listed firms are less than 10 years old but in Japan it is .7%. There is a tendency towards overinvestment in capacity, excessive risk avoidance, and insufficient attention to the creation of shareholder wealth. There is less creativity, initiative and adaptiveness. The cost of attending to constituencies other than shareholders is illustrated by the fact that the 1996 cost of labor in the U.S. was $17.75 per hour as contrasted with $32 in Germany and $21 in Japan. Also, legal standards with respect to disclosure of information to shareholders tend to vary greatly in the U.S. and U.K. models as opposed to that of Japan and Germany.[17]

In France, the Paris capital market is the fourth largest in the world. Stock holdings tend to be concentrated. The French Stock Exchange, institutional investors, companies, foreign investors, and friendly shareholders (30-50% of shares) hold most of the shares. Similar to Germany, French banks dominate shareholders with much power over boards and corporate policies. Bank controls prevent many hostile takeovers. Non-bank shareholders do have rights under French law. A shareholder possessing 5% or more of the corporation's capital, for example, may request the appointment of a management expert by a judicial court whose report is given to the shareholders and to the Commission des Operations de Bourse. Shareholders are required to appoint an auditor whose role is to control the financial statements of the corporation and assess the legality of the corporation's operations. French corporations are stakeholder entities accountable to a variety of stakeholders beyond that of the shareholders.[18]

In 2001, the French Assembly passed a law which required annual social and environmental impact reports from businesses. The law requires *premier marche*[19] corporations to issue the reports based on designated social indicators encompassing human resources, community, and labor standards. In addition, mandatory reporting is required concerning the implementation of management systems for health, safety, and the environment including consumption of energy, water and raw materials, and other requirements.[20]

A Possible Third Way – The Convergence Hypothesis

Many scandals have arisen from corporate malfeasance within the U.K. and the U.S. Scholarly research and reports by a number of corporate and government committees in the U.K., have suggested a third way of evaluating corporate decisions.[21] The Anglo-Saxon shareholder model must recognize the need to take into account the effects of corporate decisions upon other stakeholders.[22] This convergence process towards a common set of principles and objectives aims as analyzing the standards of each of the systems in order to discover a best standard.[23] Initiatives for the convergence of the two basic theories of corporate governance include the Sarbanes-Oxley Act of 2002; the New York Stock Exchange Report of the Corporate Accountability and Listing Standards and its Rules of 2003; the 2003 Higgs Review of the role and effectiveness direction and the Smith Report of Audit Committees in the United Kingdom; the 2002 German Code on Corporate Governance; the 2002 law on reforming the Japanese corporate governance system; and the 2002 consultative document of the High Level of Company Law Experts in the European Union.[24]

The convergence theory finds a common bond between the shareholder and stakeholder models.[25] The focus has shifted to one of "enlightened shareholder value" that requires companies and shareholder components to recognize and report the effects of business decisions on extended stakeholder constituencies including employees, suppliers, communities, and the environment. A problem, however, arises: the U.S. and U.K. systems rely essentially on legal enforcement for the protection of shareholders; German, French, and Japanese corporate governance systems rely upon concentrated equity ownership rather than the law to curb undesirable managerial conduct.[26]

CORPORATE SOCIAL RESPONSIBILITY (CSR)

Capitalism has advocated the creation of wealth, opportunity, and technological advances. Nevertheless, capitalism has been accompanied by a lack of concern for the many persons involved in the accumulation process. Shareholder vs. stakeholder concerns had tipped the scales in favor of the former due to the immense success of the U.S. system. But Enron[27] and other scandals left constituencies paying for the errant ways of corporate management. The corporation is now looked upon as an entity capable of not only doing good for shareholders but also capable of creating harm to diverse persons, especially to workers who directly participated in wealth creation. Thus, the movement towards corporate social responsibility has emerged.[28]

CSR has caused managers to look beyond short-term corporate profits to longer term goals of sustainable development, equitable employment practices, and long-term social and environmental well-being. The failure to heed such concerns may cause companies to sustain significant and catastrophic losses. U.S. automakers' near total lack of concern for environmentally helpful fuel efficient automobiles, for example, has greatly affected profitability.

U.S. Governmental Responses to Corporate Lack of Social Responsibility

The failure of corporations to attend to responsibilities, other than the making of profit for shareholders, has caused the creation of federal and state agencies to address the problems attendant to wealth creation. The Occupational Safety and

Health Administration (OSHA) was created to address the problem of employee injuries due to the lack of safe working conditions; the Consumer Product Safety Commission assures that products manufactured in the U.S. and in foreign countries meet safety standards to prevent caused untold numbers of injuries to consumers; and the Environmental Protection Agency was created to address the pollution and harm to the environment by careless corporate entities such as General Electric whose decisions spoiled the Hudson River.[29]

The Emergence of Suggested U.S. Multinational Corporate Codes of Conduct

In the U.S., codes of conduct have been in existence for several decades. The Rev. Leon H. Sullivan, for example, who was a member of the Board of Trustees of General Motors Corporation, proposed six basic principles for dealing with the apartheid policies of the Union of South African regime. Among the principles included are the prohibition of racial segregation in eating, comfort, and work facilities, and the increase of non-whites in managerial and supervisory positions.[30]

The earlier Sullivan Code of the 1980s led to the evolving of a more general code of conduct known as the Global Sullivan Principles of Social Responsibility. The Code enunciated principles by which multinational corporations pledged to: (1) respect the employees' freedom of association; (2) compensate employees so as to enable them to meet at least their basic needs; (3) provide a healthy workplace environment; (4) protect human health and the environment; and (5) promote sustainable development. Numerous multinational corporations have signed onto the Code. They did so in part to forestall governmental rulemaking in this arena.[31]

Selected International Codes of Corporate Social Responsibility

International codes of conduct are inherently voluntary and concern employee, environmental, or human rights issues. They are designed to make corporations more accountable to those persons directly or indirectly affected by their production. The difficulty has been that such codes are most often ignored in developing countries due both to their desire to encourage corporate investment and as a result of bribery of governmental officials by foreign business entities.[32]

Voluntary Governance:

The needs of impoverished nations for capital investment and employment have caused them to permit multinational corporations to own and manage large segments of industries critical to the needs of the inhabitants. The problems affecting these nations include extensive poverty, poor working conditions, child labor, lack of employee protection, and low environmental standards. Multinationals have threatened to go elsewhere unless these nations permit them to exploit their natural and human resources. Major companies, such as Nike, looked the other way in the exploitation of employees until they were called to task with highly unfavorable publicity. Codes of conduct for corporations operating in both undeveloped and developed countries appeared. The codes, for the most part, have been voluntary and lacked enforcement absent adverse publicity. They varied and were either general in nature or specific to a particular industry. They were in accordance with suggested international norms or were based on the laws and regulations of the particular nation or subdivision thereof. The codes could be formulated by nations, international organizations, with or without the input of various stakeholder groups such as religious, environmental, labor, and others.

Compliance with the codes by corporations both aided them and impeded their planning and goals. Negative aspects of the codes include added costs, higher wages, furnishing of better working conditions, lessening pollution emanating from their plants, and changing their internal policies and those of the managers with respect to adherence to the codes. Benefits include worker satisfaction and elimination or lessening the possibilities of strikes and other related actions, lack of adverse publicity, possible lower insurance premiums, a more productive workforce, avoidance of consumer boycotts, and better relations with local and state governments.[33]

Institutional Governance:

An emerging trend that has significant potential influence over corporate governance is the growth of the institutional investor. There has been an unprecedented expansion of power being exercised by such investors. Pension funds, mutual funds, and insurance companies, and asset management firms have a total equity of well over a trillion dollars.[34] Their emergence has been assisted by cross-border equity flows, technological innovation, and financing needs of European Union and other countries. The investors demand that their funds, consisting in large part of retirement savings, be invested in companies that are well managed. These institutional investors bring a great deal of capital to their investments. They also have the capability of overseeing the governance of corporations and the use of tools necessary for proper governance maintenance.[35] Accordingly, organizational and governmental proposed codes of conduct have proliferated. These codes and principles include the ones stated hereinafter.

The U.N. Code of Conduct for Transnational Corporations:

The draft contains four parts: (1) The activities of multinational corporations must comply with local laws and traditions, respect human rights, avoid corruption, disclose information, and be in accord with economic, financial, and social rules; (2) The treatment of multinational corporations requires host states to protect these entities; (3) Intergovernmental cooperation fosters exchange of information and consultations; and (4) The implementation of the Code requires dissemination of the Code to the affected nations and report to the U.N. Commission on Transnational Corporations.[36]

The 1977 ILO Tripartite Declaration of Principles:

The International Labor Organization (ILO) is composed of employers, employees, and government. Its Declaration of Principles aims to guide multinational corporations and other stakeholders to develop policies aimed at social process. Multinationals are called upon to promote equal opportunity, security, and collective bargaining in employment as well as the preclusion of arbitrary dismissal, strike-breaking, and other unfair labor practices. Multinationals are compelled to obey local laws and regulations and to respect the Universal Declaration of Human Rights, the International Covenant on Civil and Political Rights, the International Covenant on Economic, Social, and Cultural Rights, the ILO's Constitution, and other ILO conventions. It serves, however, as a voluntary guide for appropriate multinational behavior. Unless corporations and nations act in accordance with the Declaration of Principles, there are no effective mechanisms for effective enforcement thereof.[37]

The 2003 U.N. Sub-Commission on Human Rights Code on Transnational Corporations:

The Code is concerned with the rights and obligations of both governments and transnational corporations. It requires multinationals to adopt rules of operation to comply with, report on implementation, and incorporate the Code into their contracts with suppliers, distributees, licensees, and other actors. Transnational corporations are to be subject to transparent and independent monitoring and verification by the U.N. and other international and national agencies. The Code requires states to create the legal framework necessary for implementation of the Code. The Code sets for six types of rights or obligations of multinationals: (1) the right to equal opportunity and non-discriminatory treatment; (2) the right to security of persons; (3) the rights of workers including rights against forced or child labor, remuneration that ensures an adequate standards of living, and collective bargaining; (4) respect for national sovereignty, e.g., refraining from bribing public officials, and human rights, e.g., food and drinking water; (5) consumer protection; and (6) environmental protection, including compliance with national and international laws. The Code is voluntary in nature, without enforceable mechanisms.[38]

The OECD Guidelines for Multinational Corporations:

The 1976 declaration on international investment and multinational enterprises by the Council of Ministers of the 33-member Organization of Cooperation and Development (OECD) as amended in 2000 consists of standards of good conduct for all multinational corporations operating in or from OECD nations. The Code prescribes conduct concerning taxation, financing, and information disclosure. The Code has a section of employment and industrial relations which prohibits discrimination in employment and promotion of personnel, respect of the right of employees to be represented by trade unions, and other worker protections. The section on environmental protection provides that multinational enterprises (MNEs) must avoid creating environmentally-related health problems and must respect the human rights of those affected by their activities consistent with the host government's international obligations and commitments; MNEs are to apply principles of corporate conduct compatible with the guidelines with respect to business partners, suppliers, subcontractors, and other third parties with whom they deal; parties must eliminate child labor and forced labor. They must improve environmental management and provide a contingency plan respecting environmental impacts. They also must incorporate disclosure and transparency by encouraging social and environmental accountability. Additional sections seek to combat corruption.[39]

As with other codes of institutional governance, the OECD Code is not legally mandatory on the OECD countries but rather is a political commitment to foster corporate conduct. Disputes, however, are referable to the OECD's Committee on Investment and Multinational Enterprises. Committee recommendations have caused pressure on MNEs for compliance particularly due to the numerous complaints that have been filed with the said Committee.

The 1999 UN Global Compact:

The Global Compact seeks to promote good corporate governance in human rights, labor, and the environment. It draws upon the Sullivan Principles, the Universal Declaration on Human Rights, the ILO 1998 Fundamental Principles on Rights at Work, and the Rio Declaration on Environment and Development. It invites MNEs to join governmental efforts, international organizations, and non-governmental organization (NGOs) to advance social and economic development. The Global Compact principles state that businesses should: support and respect the protection of internationally proclaimed human rights within their spheres of influence; make sure they are not complicit in human rights abuses; uphold freedom of association and forbid compulsory labor; eliminate racial and gender discrimination in employment and occupation; support a precautionary approach to environmental challenges; undertake initiatives to promote greater environmental responsibility; encourage the development and diffusion of environmentally friendly technologies, and work against all forms of corruption, including extortion and bribery.

Companies adhering to these principles are to send a letter from the CEO to the Secretary-General agreeing to abide by the principles and to change their culture in day-to-day operations and public communications. A company's annual report must describe the ways it is supporting the Global Compact. Progress is reported on a U.N. site. A number of companies have agreed to adhere to the Compact including British Petroleum, Daimler-Chrysler, DuPont, Shell, and others. The lack of enforcement and monitoring of compliance raises concerns about the Compact's effectiveness.[40]

In 2004, the United Nations Global Compact issued a report, "Who Cares Wins: Connecting Financial Markets to a Changing World," which examined the social, environmental, and governance issues that can have a material impact on corporate governance performance.[41] There appears to be convergence at the values level. There is an emerging paradigm of governance that perceives CSR and corporate governance to have a unified interest at the values level. It is imperative that governance have an ethical component. CSR examines the kind of product and service the company produces, how it is produced, and the social and environmental impacts of production. It includes corporate philosophy governing medium and long-term actions, and renegotiation of corporate responsibility.

International Organization for Standardization (ISO):

The ISO is a nongovernmental organization, based in Geneva, which is affiliated with national standards institutes located in 146 nation-states. The institutes are either part of a governmental structure or are compelled by governments. The organization has focused on voluntary international standards for many products and for activities in producing goods and services. It has developed some 12,000 standards to insure that products or services conform thereto. Its environmental management system was established in 1996 and is called the ISO 14,000 Series. The ISO environmental management system requires a company to establish and make publicly available an environmental policy suitable to its size and environmental impact. The system seeks to identify impacts and the management processes to reduce them. In particular, the system seeks to ascertain a process by which pollution emissions are scientifically reduced and efficiency improved.[42] Companies must comply with local laws and make a commitment to prevent pollution. They are to adopt procedures to assess and document the environmental impact of their operations; employees are to be trained in these procedures. There are no specific standards set forth but rather a management systems approach is to be used. There are provisions for internal and external audits of the process.

By December 2003, over 66,000 ISO 14,000 management system registrations have been completed worldwide. The lack of specific standards and the failure to call upon companies to adhere to treaties concerning ozone depletion, biological diversity, or hazardous wastes continue to plague the system. There is no requirement that the corporation actually release its report on adverse environmental effects nor is there a requirement for an external audit. The International Standards Organization plans to institute a proposed ISO 26,000 which would set forth social responsibility guidelines for customer assurance of ethical standards being practiced.[43]

World Bank and IMF Reports:

The World Bank and the International Monetary Fund prepare Reports on the Observance of Standards and Codes (ROSC) in order to aid countries in strengthening their corporate governance frameworks. Reports of some 35 countries have been prepared which incorporate OECD corporate governance principles and their observance by the affected countries. Included in substantial detail are the assessment, description, and policy recommendations of the rights of shareholders, the equitable treatment of shareholders, the role of stakeholders in corporate governance, disclosure and transparency, and Board responsibility.[44]

Codes focused on Specific Industries:

Industries, including the oil and the extractive and energy sectors, have been criticized for their alleged lack of environmental and social concerns. In December 2000, the Voluntary Principles on Security and Human Rights was promulgated. Companies must ensure respect for human rights and fundamental freedoms as well as maintain the safety and security of their operations. Companies are to assess a series of risk factors based on credible information from a range of perspectives, including civil society groups knowledgeable about local conditions. Companies are to use their influence with public security so as to not to use the services of individuals credibly implicated in human rights abuses; use force unless strictly necessary and to an extent proportionate to the threat; and violate the rights of individuals when they are exercising the rights of freedom association and peaceful assembly, or other related rights; Companies must follow similar procedures with respect to private security providers.[45]

Governance Practices Demonstrating CSR Principles

There are generally acceptable requirements for corporate governance systems wishing to adhere to CSR principles. These requirements include the following:

Disclosure, accountability, and transparency:

Companies need meaningful disclosure of the social, environmental, and ethical issues so that they can go beyond window-dressing. Issues of risk management and strategic advantages are to be specified. Companies must review the progress of CSR integration and examine whether internal control systems cover CSR. Incentive compensation is to given be for addressing CSR objectives. The board's CSR operations and status of the company's stakeholder's relationships are to be transparent. The company is to develop policies covering CSR issues and report on policy implementation.

Board composition and diversity:

A corporation is to move away from cronyism and towards the recruitment of independent directors with diverse skills, knowledge, backgrounds, and expertise. The board of directors shall include directors with non-traditional backgrounds who can add fresh perspectives. Diverse genders and ethnicity are to be a goal for companies.

Risk management oversight:

A key board duty is the consideration of long-term corporate risks. A critical issue is the directors' competencies. Their active efforts to take a broad view of things that affect intangible assets and their ability to assess strategies critical for effective governance and corporate performance are to be a priority.

Compensation of board, executives, and staff:

Incentives are to be given to encourage CSR performance and for a holistic approach to risk and opportunity management. There is a need to examine corporate policies from a long-term perspective.

Global Reporting initiative identification of cross-over indicators:

Directors are to be independent and possess expertise for corporate performance. Board-level processes are to be instituted for overseeing the identification and management of economic, environmental, and social risks and opportunities. Also, a linkage between executive compensation and the achievement of financial and non-financial goals is to be set forth.

Need for CSR alignment and embedment:

CSR is to be embedded throughout the organization so as to assure a company's CSR performance. Once embedded, CSR will affect corporate strategy so as to lead a company towards investments in less harmful alternatives, e.g., in matters of environmental concern. Risk management, diversity, disclosure, and compensation are to be enablers of CSR performance.[46]

Regional and Local Statutory Enactments of CSR

There has been pressure placed upon Japanese and European governments to incorporate U.S.-style principles of corporate governance. The Enron and other U.S. corporate scandals, however, have made them reluctant to bring about dramatic changes. The E.U. and its 25 member states have recommended or mandated the identification and disclosure of social and environmental risks. The E.U., France, Belgium, Germany, and the U.K. have enacted regional and local legislation requiring pension funds to disclose the extent to which they take ethical, social, and environmental information into account in constructing their portfolios.[47]

Denmark, the Netherlands, Norway, and Sweden require companies to provide expanded environmental information in their annual reports. France, in its "New Economic Regulations" (*Nouvelles Regulations Economique*), requires companies to have a "triple-bottom-line" reporting of all companies trading on the French stock exchange (the *Bourse de Paris*). Companies must disclose very detailed social[48] and economic information, including environmental, labor, community involvement, health and safety information, in their annual reports to shareholders.[49]

The E.U. has initiated a number of internal and external plans concerning CSR. The internal European Employment Strategy, E.U.-Ecolables, and the Eco-Management and Audit Scheme (EMAS) are all designed to promote CSR. The E.U.-

Ecolables voluntary initiative encourages the production of more environmentally friendly goods and services and ensures transparency to consumers. EMAS was created in order to promote "continuous improvements in the environmental performance of industrial activities by committing firms to evaluate and improve their own performance." Externally, the Cotonou Agreement with African, Caribbean, and Pacific nations seeks to promote human rights norms. The Agreement "incorporated defining human rights as a fundamental element of the agreement which serves as the basis for dialogue with a third country government on human rights." It imposes obligations upon states rather than on the corporate entities themselves.[50]

The "Communication on the E.U. role in promoting human rights and democratization in third countries" liberalizes trade under the E.U.'s Generalized Systems of Preference with countries complying with the E.U.'s minimum social and environmental standards.[51] It seeks to ensure compliance by providing sanctions in the form of preference withdrawal when countries commit serious and systematic violations of International Labor Organization core labor standards.[52] The E.U.'s Manifesto of Enterprises against Social Exclusion led to the creation of the European Business Network in 1995. The Manifesto advocated an open dialogue between the relevant actors and the exchange of best practice on CSR. In the E.U.'s Lisbon Summit of the European Council, CSR was made a major priority within the framework of sustainable development.[53]

The Goteburg Summit of June, 2001, was concerned with the role of companies within society and within the context of sustainable development strategy for Europe. It led to the publication of a "Green Paper on Corporate Social Responsibility" that sought to stimulate debate on the subject.

The Green Paper undertook to determine the role of the E.U. in the development of CSR, the role of CSR in corporate business strategies, the role of other stakeholders, the monitoring and evaluation of CSR strategies, and the mechanisms appropriate for developing CSR. It rejected the "one-size-fits-all" approach and reflected the desire to have companies self-regulate.[54]

The E.U.'s forays into CSR have had some modest success. It has harmonized financial disclosure and recognition of contractual obligations. Social and environmental responsibilities of corporations are emphasized. Its "Lisbon Strategy" of March 2000 has provided for social and governmental disclosure obligations including environmental concerns. The E.U. Commission issued a Recommendation[55] concerning the recognition, measurement, and disclosure of environmental issues in annual reports and financial accounts. The Recommendation divides the environmental issues into 39 very specific categories that are to be considered. The purpose of the information is to convey informational data to regulatory authorities, investors, financial analysts, and the public concenring the potential environmental risks and liabilities that may face a company.[56]

The 2003 Communication on Corporate Governance is prefaced by the comment that "well managed companies, with strong corporate governance records and sensitive social and environmental performance, outperforms their competitors." The E.U. Commission recognizes that the need to integrate the capital markets with an enhancement of the quality of financial reporting, the development of industrial policies to achieve sustainable economic development, and the examination of social responsibility. In its Communication for Sustainable Development, the E.U. invited companies with 500 or more employees to publish a triple bottom-line report to shareholders evaluating their performance against specified economic, environmental, and social criteria. The 2003 Modernization Directive that followed the Communication amended prior directives incorporating International Accounting Standards into E.U. companies' financial reporting.[57] Thus, commencing in 2005, companies are required to include a fair review in their financial reports of the development and performance of the company's business together with principal risks and uncertainties that they face. Companies are also to include financial and other nonfinancial key factors including environmental and employee matters.[58]

The U.S., mandates substantial reporting requirements especially after Sarbanes-Oxley. The country, nevertheless, has very limited requirements concerning the disclosure of nonfinancial information due mainly to the failure of the U.S. government to have policies favoring sustainable development. Statutory requirements are most often based on individual state laws which vary considerably from state to state. Other than operating for any lawful purpose, there are few obligations concerning stakeholders other than shareholders' compliance with local statutes and regulations especially affecting employees. Sarbanes-Oxley has only tangentially affected corporations with respect to CSR but is concerned mainly with reporting financial results accurately and with the reduction of conflicts of interest.

The few regulations concerning corporate environmental obligations include the requirement that a public reporting company disclose environmental information under Regulations S-K of federal securities law, namely the costs of complying with new environmental regulations at any governmental level. Companies are required to disclose pending environmental litigation wherever the litigation is brought by a government agency. Possible penalties for noncompliance are fines of $100,000 or more. Companies are also required to disclose their financial and operational results and to disclose any known "events, trends, or contingencies" that might have a material impact in the future.

The obligations include the disclosure of social or environmental information especially in industries that are extractive in nature especially in unstable countries or where their production might make the companies liable under the Superfund legislation. The perceived difficulty with the said Regulations is the near total lack of enforcement by the current Administration but companies should nevertheless comply with the Regulations should the position of the present Administration change or when there has been a change in leadership. Other U.S. requirements in this post-Enron era include the requirement that mutual funds and registered investment advisers disclose the policies and procedures they use to determine how to vote proxies for portfolio securities and how they actually voted.

CONCLUSION

The question remains whether social responsibility is compatible with economic success. It is clear that the U.S. economy leads the world in competitiveness. Nevertheless, it has had less than enviable success in the area of corporate social responsibility. Japan, on the other hand, together with France and Germany, have attended to the corporate social responsibility requirements but have lagged substantially behind the U.S. in economic success. Japan, for example, has until recently maintained lifetime employment for employees while the U.S. has promulgated an employment-at-will position that has displaced many thousands of employees in ensuing layoffs when companies faced economic crises. U.S. companies are permitted to go bankrupt or undergo reorganization. Japanese, French and German companies in the past were supported by bank investors and became conservative and stagnant in business practices. The financial success of the U.S. companies appears to favor the shareholder model over the stakeholder model and even to favor shareholder concerns in any possible third convergence model. U.S. companies have become enormously powerful while the Japanese and even French and German companies and their bank investors have undergone many periods of crisis. Japanese executives, in fact, are now restudying U.S. corporate governance methodologies, thereby reversing U.S. companies' attempts to emulate the successes of Japanese companies two decades ago.

It seems that economic success is the main consideration in determining the extent of corporate social responsibility. Many problems arise, however, when individuals, institutions and nation states do not insist, in some enforceable way, that local and transnational companies attend to many global concerns: consumer and employee rights, the environment, global warming, terrorism and warfare[59]. The unity of peoples brought about by transportation, communication and the media have focused global awareness: companies must attend to obligations other than making immediate profits.

ENDNOTES

[1] DAVID ROCKEFELLER, MEMOIRS 378-379 (Random House, 2002).

[2] For example, in New York State, one need only file a simple form with the Secretary of State in Albany, containing the proposed non-conflicting name, state that the corporation is to be used for lawful purposes, fix the number of initial shares to be offered (usually 200 shares no par value), name the location of the corporation, the name and address of the person

upon whom process may be served, and the signature of the incorporator. Only one person need incorporate (often the attorney's secretary), pay the appropriate filing fee, and await the formal acceptance (usually within two weeks of filing). There is no requirement that the individual be a citizen and there is no minimum capitalization requirement. In a few states, e.g., California, there is a relatively small minimum capitalization requirement. In France and Germany, the capitalization requirements are much more onerous. For example, the minimum German capitalization requirement is 100,000 deutsche marks while in France, it is 1,500,000 francs or the present equivalent in euros. France Law Digest, MARTINDALE-HUBBELL LAW DIGEST, p. FRA-3 (1998); German Law Digest, *id.* p. GER-6.

[3] "Corporate governance" has been defined in a number of ways, most of which have common characteristics. Included among the definitions are:

> [T]he top management process that manages and mediates value creation for, and value transference among, various claimants in a context that ensures accountability toward these claimants. Timothy L. Fort & Cindy A. Schipani, *Competitive Corporations with Moral Integrity: A Blended Model of Corporate Governance,* 1 ALSB INT'L BUS. L.J. 62 (2000).

> In its narrowest sense, corporate governance can be viewed as a set of arrangements internal to the corporation that define the relationships between managers and shareholders. The shareholders may be public or private, concentrated or dispersed. Magdir Iskander and Nedereh Chamlou, *Corporate Governance: A Framework for Implementation,* THE WORLD BANK GROUP (2000).

[4] THE MODERN CORPORATION AND PRIVATE PROPERTY (Macmillan Co., 1933).

[5] Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits,* N.Y. TIMES, Sept. 13, 1970 (Magazine), at 33.

[6] See, e.g., Steven R. Ratner, *Corporations and Human Rights: A Theory of Legal Responsibility*, 111 YALE L.J. 443 (Dec. 2001) and Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and*

Cognitive Style, 29 DEL. J. CORP. L. 649 (2004).

[7] The largest percentage of outstanding shares owned by the five largest shareholders in the U.S. is 25.4%, while Japan has 33.1% and Germany has 41.5%.

[8] A possible reason for the lack of contests is the well known use of "poison pills" to dissuade possible contests. They include *"preferred stock plans"* whereby the target company offers stock shareholders a dividend of preferred shares that would be convertible into large multiples of the stock of the takeover company; *"flip-over rights* which allow the holders of shares to buy stock in the acquiring firm at a low price; *"flip-in rights"* which allow holders of rights to acquire stock in the target company; " *golden parachutes"* that grant special lucrative compensation to upper management in the event of a takeover; *"white knight"* whereby the target company seeks a friendly bidder as an alternative to a hostile bidder; *"white squire"* whereby the target company places shares in the hands of a friendly firm or investor; *"pac-man defense* where the target company seeks to buy the takeover company; *"supermajority provisions"* whereby corporate charter is amended to provide for a much higher percentage of shareholder vote approval for a merger (e.g., 66 2/3rds %, 75%, or even 95%); and many other types of defenses. The takeover defenses are taken from PATRICK A. GAUGHAN, MERGERS, ACQUISITIONS, AND CORPORATE RESTRUCTURINGS (John Wiley & Sons, Inc.) (1996).

[9] Ronald C. Anderson, Richard T. Boylan, & David M. Reeb, *Paying the CEO: The Integrity Reputation Premium* (Feb. 16, 2006), www.astro.temple.edu. The figure for the United Kingdom's CEO is up to 125 times that of the worker's salary. SUNDAY GUARDIAN [UK] (April 5, 2006).

[10] For a detailed discussion, see James McConvill, *Executive Compensation and Corporate Governance: Rising Above the "Pay-for-Performance" Principle,* 43 AMERICAN BUSINESS LAW JOURNAL 413 (No. 2, 2006).

[11] "Chinese wall" is defined as "the procedures enforced within a securities firm that separate the firm's departments to restrict access to non-public, material information, in order to avoid the illegal use of inside information." www.investorwords.com/854/Chinese_Wall.html.

[12] See LARUE TONE HOSMER, THE ETHICS OF MANAGEMENT, 2d Ed. (Irwin, 1991).

[13] E.g., the top five shareholders in Daimler-Chrysler own 79% of the shares. In contrast, the top five shareholders of General Motors stock possess only 5.74% of its shares.

[14] For a discussion of German corporations, see Florian Stamm, *A Comparative Study of Monitoring of Management in German and U.S. Corporations After Sarbanes-Oxley: Where are the German Enrons, WorldComs, and Tycos?,* 32 GA. J. INT'L & COMP. L. 813 (Summer, 2004).

[15] 12 U.S.C. Section 347a.

[16] *Id.* at 821-828.

[17] A survey of institutional investors found that the percentage of such investors who said that their laws and practices require corporations to disclose sufficient information to investors ranged from a high of 84% in Britain and 82% in the U.S. vs. 53% in Germany to only 10% in Japan. *A Global Vote for U.S. Style of Corporate Openness,* NEW YORK TIMES, May 9, 1999, Sec. 3 at 4.

[18] For a discussion of French corporate governance and the rise of shareholder activism, see, Perry E. Wallace, *The Globalization of Corporate Governance: Shareholder Protection, Hostile Takeovers and the Evolving Corporate Environment in France,* 18 CONN. J. INT'L L. 1 (Fall, 2002).

[19] Literally, the "first market" on the French stock exchange (Bourse).

[20] GREENMONEY JOURNAL, www.greenmoneyjournal.com/article.mpl?newsletterid=2&articleid=19.

[21] The most cited committee report is that of the Cadbury Committee, *Report of the Committee on the Financial Aspects of Corporate Governance,* (Dec. 1, 1992). For a discussion of the report see: Brian R. Cheffins, *Current Trends in Corporate Governance: Going from London to Milan via Toronto,* Vol.1, 10 DUKE J. OF COMP. & INT'L 5

(Fall/Winter, 1999).

[22] There is substantial literature on the theory of convergence. Among the articles suggesting the convergence are: Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct,* 38 CORNELL INT'L L.J. 493 (2005); John C. Coffee, 93 NORTHWESTERN LAW REVIEW 641-708 (1999); RONALD J. GILSON, GLOBALIZING CORPORATE GOVERNANCE: CONVERGENCE OF FORM OR FUNCTION, (Columbia Law School, Working Paper, May 2000), www.law.columbia.edu/lawec/; Davis, Gerald F. & Marquis, Christopher, *The Globalization of Stock Markets and Convergence in Corporate Governance,* www.iese.edu/en/files/6_15519.pdf; Georges Ugeux, *Towards global convergence in corporate governance: An assessment of the current situation,* 1 INT'L J. OF DISCLOSURE AND GOVERNANCE (No. 4, 2004); Allison Dabbs Garrett, *Themes and Variations: The Convergence of Corporate Governance Practices in Major World Markets,* 32 DENV. J. INT'L & POL'Y 147 (Spring, 2004); JOSEPH A. MCCAHERTY, PIET MOERLAND, THEO RAAIJMAKERS, & LUC RENNEBOOG ed, CORPORATE GOVERNANCE REGIMES: CONVERGENCE AND DIVERSITY (2002) and book review of the study by John W. Cioffi, 52 AM. J. COMP. L. 770 (Summer, 2004).

[23] Ugeux *Id.*

[24] Other initiatives include the Lyons G7 meetings which concerned in major part towards the creation of a regulatory framework for global financial institutions and capital markets; the World Federation of Exchanges and the International Organization of Securities Commissions which made a number of suggestions; and the Organization of Economic Cooperation and Development (OECD) which drafted international standards of corporate governance.

[25] Timothy L. Fort and Cindy A. Schipani call the shareholder-stakeholder model approaches "contractarian-communitarian" approach. *Competitive Corporations with Moral Integrity: A Blended Model of Corporate Governance,* 1 ALSB INT'L BUS. L.J. 62 (2000).

[26] A Shleifer, and R.W. Visny, *A Survey of Corporate Governance,* 52 JOURNAL OF FINANCE 737-783 (1977), cited by Diane K. Denis and John J. McConnell *International Corporate Governance* 38 JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS 1-36 (March, 2003).

[27] The Enron debacle has led to an enormous output of articles. Some examples include: John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s,* 89 CORNELL L. REV. 269 (2004) and Geoffrey P. Miller, *Catastrophic Financial Failures: Enron and More* 89 CORNELL L. REV. 423-455 (2004).

[28] There are numerous articles concerning the misbehavior of corporations and the drive towards corporate responsibility. Included among them are: Sorcha MacLeod, *Corporate Social Responsibility Within the European Union Framework,* 23 WIS. INT'L L.J. 541 (Summer, 2005). The call for a change in corporate governance while adhering to the goal of shareholder wealth accumulation is exemplified by Kent Greenfield, *New Principles for Corporate Law,* 1 HASTINGS BUS. L.J. 89 (May, 2005). Greenfield proposes a number of principles focusing on society's well-being. They are: (1) that "the ultimate purpose of corporations should be to serve the interests of society as a whole;" (2) "corporations are distinctively able to contribute to the societal good by creating financial prosperity;" (3) corporate law should further the first two principles; (4) "a corporation's wealth should be shared fairly among those who contribute to its creation;" and (5) "participatory, democratic corporate governance is the best way to ensure the sustainable creation and equitable distribution of corporate wealth."

[29] Daniel T. Ostas, *Cooperate, Comply or Evade? A Corporate Executive's Responsibility with Respect to Law,* 41 AM. BUS. L.J. 559 (Summer, 2004).

[30] www.globalsullivanprinciples.org.

[31] www.thesullivanfoundation.org/gsp.

[32] For a listing of countries in the order of alleged degree of corruption, see www.transparency.org.

[33] For a review of various corporate codes of conduct, see WORLD BANK GROUP CORPORATE SOCIAL RESPONSIBILITY PRACTICE, COMPANY CODES OF CONDUCT AND INTERNATIONAL STANDARDS: AN ANALYTICAL COMPARISON (2003), www.worldbank.org/html/fpd/privatesector/csr/doc/Company%20Codes%20of%20Conduct.pdf.

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[34] Eric L. Zagar and Roy Jones, *European institutional investor winning corporate governance reforms in US investee companies,* http://216.239.51.104/search?q=cache:ZJQngQRw_dsJ:www.sbclasslaw.com/pr/I%26PE....

[35] *Id.*

[36] UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, THE UNITED NATIONS CODE OF CONDUCT ON TRANSNATIONAL CORPORATIONS, (Boston: Graham and Trotman, 1988). For a discussion, see William C. Frederick, *The Moral Authority of Transnational Corporate Codes,* 10 JOURNAL OF BUSINESS ETHICS 165 (March, 1991).

[37] 41 ILM 186 (2002), www.ilo.org/public/english/standards/norm/sources/mne.htm.

[38] UN ESCOR, 55th Sess., Agenda Item 4, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (13 Aug 2003). For a discussion, see David Weissbrodt and Muria Kruger, *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights,* 97 THE AMERICAN JOURNAL OF INTERNATIONAL LAW 901 (Oct. 2003).

[39] THE OECD DECLARATION AND DECISIONS ON INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES: BASIC TEXTS (2000), www.olis.oecd.org/olis/2000doc.nsf/c5ce8ffa41835d64c125685d005300b0/c125692700623b74c1256991003b5147/$FILE/0085743.PDF.

[40] In the introduction to the UN COMPACT, 2004, WHO CARES WINS: CONNECTING FINANCIAL MARKETS TO A CHANGING WORLD, it states:

> In a more globalized, interconnected and competitive world, the way that environmental, social and corporate governance issues are managed is part of companies' overall management quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets while at the same time contributing to the sustainable development of the

> societies in which they operate. Moreover these issues can have a strong impact on reputation and brands, an increasingly important part of company value.

[41] www.unglobalcompact.org/.

[42] Mallen Baker, *Standards of Corporate Responsibility*, 83 BUSINESS RESPECT (June 15, 2005), www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1446.

[43] www.iso.org/iso/en/ISOOnline.frontpage.

[44] For a summary and detailed analysis of individual countries and their observance of OECD principles, see www.worldbank.org/ifa/rosc_cg.html.

[45] www.voluntary principles.org.

[46] See, generally, BOB GARRETT, THIN ON TOP: WHY CORPORATE GOVERNANCE MATTERS AND HOW TO MEASURE AND IMPROVE BOARD PERFORMANCE, (Nicholas Brealey Publishing, 2003) 105-111; and FRED R. KAEN, A BLUEPRINT FOR CORPORATE GOVERNANCE: STRATEGY, ACCOUNTABILITY, AND THE PRESERVATION OF SHAREHOLDER VALUE 29-31 (American Management Association, 2003).

[47] RONALD J. GILSON, *The Globalization of Corporate Governance: Convergence of Form or Function,* (Columbia Law School Working Paper No. 174, May, 2000), at 31.

[48] Social information that must be disclosed include information about labor arrangements with all workers; organization of working hours and overtime; gender equity; labor relationships and collective bargaining agreements; health and safety, and other such data.

[49] Article 116 of the NOUVELLES REGULATIONS ECONOMIQUE requires that environmental information to be furnished includes the use of resources, such as water, energy, and raw materials; emissions that could cause air, water, noise, or other pollution; the company's management's efforts and systems to reduce environmental impacts; accounting reserves for environmental risks; and monetary awards paid for environmental damage.

[50] ec.europa.eu/comm./development/body/Cotonou/index_en.htm.

[51] Commission, *Promoting a European Framework for Corporate Social Responsibility,* Green Paper, europa.eu.int/comm./employment_social/soc-dial/csr/greenpaper_en.pdf.

[52] It states that "Human rights are advanced by the encouragement of businesses operating in developing states to promote human rights values in relation to workers' rights and ethical standards, particularly where their operations have an influential role in countries with a poor record in this area."

[53] www.eeb.org/activities/sustainable_development/review-sds-13-04-04.pdf.

[54] Commission *supra* note 53.

[55] 2001/453/EC.

[56] MACLEOD *supra* note 29.

[57] See Eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX :32004R0707:EN:NOT.

[58] For a discussion, see Karel Lannoo and Arman Khachaturyan, *Reform of Corporate Governance in the EU*, 5 EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 37-60 (Apr. 2004) and Ian P. Dewing and Peter O. Russell, *Accounting, Auditing and Corporate Governance of European Listed Countries: EU Policy Developments Before and After Enron,* 42 JOURNAL OF COMMON MARKET STUDIES 289 (June, 2004).

[59] For the latest extensive media discussion concerning global warming, see *Global Warming,* TIME, April 3, 2006, at 28-62.

IBP, INC. v. ALVAREZ AND *ABDELA TUM v. BARBER FOODS, INC.*—REVISITING THE LIMITATIONS OF THE PORTAL-TO-PORTAL ACT.

by

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The Portal-to-Portal Act of 1947[1] is the federal statute that places limits on the types of employee activities that are compensable under the Fair Labor Standards Act of 1938 (FLSA).[2] Although the activities covered by this law may only involve a few minutes in a worker's day, mischaracterizing whether those activities are compensable under the FLSA or noncompensable under the Portal-to-Portal Act can result in significant monetary consequences for both the employee and the employer. In 2005, the U.S. Supreme Court reconsidered the question of what constitutes compensable time in the consolidated cases of *IBP, Inc. v. Alvarez, et al.* and *Abdela Tum, et al. v. Barber Foods, Inc.*[3] The issue before the court was whether an employer is exempt under the Portal-to-Portal Act from paying for three types of employee activities: the time that an employee spends waiting to receive protective gear that must be worn at the worksite, the time that it takes to don and doff that protective gear, and the time it takes to walk between the place where the gear is donned and doffed and the production area. The court concluded that even though the statutory workday does not include the waiting time, it certainly includes the donning, doffing, and traveling time when those activities are "integral and indispensable" to the "principal activity" of the employee's work.

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Congress originally enacted the FLSA in response to a general finding that labor conditions in the 1930s were "detrimental to the maintenance of the minimum standard of living necessary for the health, efficiency, and general well-being of workers."[4] Two key provisions of the statute require employers to pay workers a minimum wage[5] and to prohibit them from employing workers in excess of 40 hours per week unless the workers receive overtime compensation at a rate not less than one and one-half times the regular rate of pay.[6] Although §203 defines many of the terms used in the FLSA, it fails to define two significant ones--"work" and "workweek." The U.S. Supreme Court made up for this omission in a series of 1940's decisions that interpreted those terms not only in the context of the standard definitions found in Webster's Dictionary but also in light of the remedial purposes of the FLSA. In the first case, *Tennessee Coal, Iron & R. Co. v. Muscoda Local No. 123,*[7] the court held that for statutory purposes "work or employment" included "physical or mental exertion (whether burdensome or not)

controlled or required by the employer and pursued necessarily and primarily for the benefit of the employer and his business."[8] Later that same year, in the case of *Armour & Co. v. Wantock et al.,*[9] the court clarified its definition of "work" by noting that "exertion" on the part of the employee is not necessary if the employer has hired the employee "to do nothing, or to do nothing but to wait until something happens."[10] Two years later, in the case of *Anderson v. Mt. Clemens Pottery Co.,*[11] the court expanded the meaning of "statutory workweek" to include "all time during which an employee is necessarily required to be on the employer's premises, on duty or at a prescribed workplace."[12] That meant that employers had to compensate employees for the time spent walking between the time clocks at the factory entrance and the employees' actual workstations as well as for time required to complete a variety of preliminary work activities.[13] The *Anderson* decision prompted a more employer-sympathetic Congress to amend the FLSA through the passage of the Portal-to-Portal Act in 1947.

Congress passed the Portal-to-Portal Act out of a concern that the Supreme Court's interpretation of the terms "work" and "workweek" superseded "long-established customs, practices, and contracts between employers and employees, thereby creating wholly unexpected liabilities, immense in amount and retroactive in operation."[14] The Portal-to-Portal Act addressed the employers' concerns by creating statutory remedies that were intended to apply retroactively as well as prospectively. Under Part II, §2 of the Act, (entitled "Relief from Existing Claims under the Fair Labor Standards Act"), an employer was no longer be liable for claims filed prior to the enactment of the statute so long as those claims arose from activities that were neither compensable under an express contract nor an established custom or practice.[15] In addition, under Part III, §4, (entitled "Relief for Certain Future Claims under the Fair Labor Standards Act"), an employer would not have to compensate employees for any time spent going to and from the actual place where the principal employment activities were performed or for any time devoted to activities that are preliminary to or postliminary to the workers' principal employment activities.[16]

Soon after Congress passed the Portal-to-Portal Act, the Department of Labor issued regulations limiting the scope of the new law. Both 29 C.F.R. §790.6(a) and §790.6(b) provided guidance on how to calculate compensable hours. According to §790.6(a), the computation of FLSA compensable hours was not changed by the terms of the Portal-to-Portal Act so long as the time claimed was "within" the workday.[17] Section 790.6(b) went on to endorse a "continuous workday rule" that measured the workday as "the period between the commencement and completion on the same workday of an employee's principal activity or activities."[18] When read together, the two regulations supported the conclusion that under the FLSA and the Portal-to-Portal Act, an activity was a compensable "workday" activity if it occurred within "the continuous workday."

The U.S. Supreme Court further restricted the impact of the Portal-to-Portal Act in its decision in the case of *Steiner v. Mitchell.*[19] The key to that case was the recognition of a distinction between employee activities that were "preliminary and postliminary" to the workday and employee activities that were "preparatory and concluding" but still within the workday. The court's ruling that the employees at the battery factory had a statutory right to be compensated for the time they spent changing their clothes at the beginning of the shift and showering at the end of the shift was based on two important factual findings. The first was that the employees worked with dangerously caustic and toxic materials. The second was that they were required, for public health and safety reasons, to change their clothes and shower before they could leave the workplace. The court noted that there was a substantial difference between employees changing and showering at the end of work under normal conditions and their changing and showering as a result of health and safety risks associated with the production of batteries. That difference meant that the latter could be classified as activities that are an "integral and indispensable part of the principal activities." The court went on to conclude "that activities performed either before or after the regular shift work, on or off the production line, are compensable under the portal-to-portal provisions of the Fair Labor Standards Act if those activities are an integral and indispensable part of the principal activities for which the covered workmen are employed and are not specifically excluded by §4(a)(1)."[20]

The *Steiner* decision acknowledged that the Portal-to-Portal Act was the consequence of a negative Congressional reaction to the *Anderson* case. The court also admitted that it had experienced difficulty in trying to understand some of the provisions of the new act. While the purpose of §2 was clearly to limit an employer's liability for unexpected wages based on activities occurring before 1947, the purpose of other sections was much less obvious. The court found it necessary to review the legislative history—and especially that of the Senate—in order to untangle the statutory ambiguity. Much of the court's inquiry was directed at understanding the meaning of the phrase "principal activity or activities" as it was used in §4.[21] In the end, the court concluded that "while Congress intended to outlaw claims prior to 1947 for wages based on all employee activities unless provided for by contract or custom of the industry, including, of course, activities performed before or after regular hours of work, it did not intend to deprive employees of benefits of the Fair Labor Standards Act where they are an integral part of and indispensable to their principal activities."[22] Consequently, whether an employer had to compensate an employee for work that had been performed before or after the regular work shift and on or off the production line depended on whether those activities were an "integral and indispensable part of the principal activities for which the person was employed" as opposed to being "preliminary to or postliminary to said principal activity or activities."

Nearly fifty years after *Steiner*, the Supreme Court agreed to reconsider the question of the FLSA compensability in two new donning and doffing cases. The primary difference between the *Steiner* case and the consolidated cases of *IBP* and

Barber Foods was that the issue was no longer whether donning and doffing of mandatory protective gear was compensable. The new focus was on the issue of whether two employee activities--the time spent waiting to collect the protective gear and the time spent either walking to a work site after donning the gear or walking from the work site to the area where the gear is doffed--are integral and indispensable to the employee's work and, therefore, compensable.

II.

The *IBP* and *Barber Foods* cases both involved FLSA claims by workers employed in the food processing industry. IBP, Inc., the world's largest producer of fresh beef, pork, and related products, operates a "kill and processing plant" in Pasco, Washington. At the time of the lawsuit, the employees at the Pasco plant included approximately 178 workers in the slaughter division and 800 line workers in the processing division. All of the production workers in both divisions were required to wear sanitary outer garments, hardhats, hairnets, earplugs, gloves, sleeves, aprons, leggings, and boots. Others, including those who worked with knives, also had to wear protective equipment including chain link metal aprons, vests, plexiglass armguards, and special gloves. When the protective gear was not being use, it had to be stored in locker rooms at the plant.[23]

The production line workers at the Pasco plant were covered by a collective bargaining agreement that required them to be at their workstations and prepared to work from the moment the first piece of meat came across the production line. Prior to arriving at their workstations, the employers had to gather their assigned equipment, don that equipment in the locker rooms, and prepare work-related tools. It was only when these tasks were completed that the employees could walk to the slaughter or processing floors. If employees needed to visit the cafeteria or restrooms during their unpaid thirty-minute meal break, they were required to remove the outer garments, protective gear, gloves, scabbards, and chains. (It was the company's policy that any time needed to doff and don the equipment had to be completed during the break time.) Finally, at the end of each workday, the workers were required to clean, restore, and return their equipment to the appropriate on site storage area.[24]

Although the IBP workers were required to use a computerized "swipe card" system when they arrived at and left the plant, they were not paid based on the data from their individual swipe cards. Pay was based, instead, on a "gang time pay" model. Under such a plan, workers only received compensation for the actual time that all of the employees were actually cutting and bagging meat. Compensable time began with the processing of the first piece of meat and ended with the processing of the last piece of meat. As a result, workers were not paid for the time it took to don and doff the protective gear or for the time needed to walk between the locker rooms and production floor at the beginning and end of the work shifts.[25]

The second of the two consolidated cases involved a claim, which was filed against Barber Foods, Inc., by some of the 300 hourly wageworkers at its Portland, Maine plant. The employees, who were divided between two shifts with six production lines each, worked in the secondary processing of poultry-based products. The poultry products, which were assembled on three specialty production lines, were pouched, packed, and palletized on three pack-out production lines. The production workers included the rotating associates (who rotated to different positions every few hours), the set-up operators (who maintained the various machines on the lines), the meat room associates (who blended the raw products with the ingredients), the shipping and receiving associates, the maintenance workers, and the sanitation workers.[26] All of the production workers were required to wear certain kinds of protective gear that had to be donned before the workers punched in and doffed after they punched out. The required gear included lab coats, hairnets, and earplugs for the rotating associates;[27] lab coats, hairnets, earplugs, safety glasses, steel-toed boots, bump hats, back belts, and lock-out/tag out equipment for the set-up operators; lab coats, hairnets, earplugs, safety glasses, steel-toed boots, and back belts for meatroom associates;[28] and steel-toed boots, hard hats, and back belts for shipping and receiving associates.[29]

Barber Foods provided the mandatory equipment to the employees. Some items, such as the bump hats, back belts, safety glasses, steel-toed boots, and reusable earplugs that were given to the workers on a one-time basis and replaced only as needed, could be stored either in the workers' lockers or at their homes. The rest of the items had to be picked up and returned to a variety of locations in the plant by the employees each day.[30] It was only after the workers have waited for, collected, and donned their equipment that they were allowed to punch in at their designated computerized time clocks.[31] Employees were paid from the moment that they punched in until the moment that they punched out. In addition, the company had a twelve minute "swing time" that allowed an employee to punch in up to six minutes early and get paid for that time or punch out up to six minutes late without being charged with an attendance violation.

III.

The *IBP* and *Barber Foods* cases, which were both filed in federal courts, presented similar, though not identical, claims under the FLSA. Both sets of plaintiffs asserted that their employers had violated the FLSA when they failed to compensate the workers for the time spent donning and doffing the protective gear and for the time spent walking between the locker rooms and the production floors of the processing facilities. In addition, the employees in *Barber Foods* claimed compensation for the time they had spent waiting to receive their protective gear.

a. *Alvarez v. IBP.*

The *IBP* class action case was originally filed in the U.S. District Court for the Eastern District of Washington.[32] After a twenty-day bench trial, Judge Robert H. Whaley concluded that the employer were obliged, under the terms of the FLSA, to compensate the workers for the time they spent donning and doffing protective gear that was unique to a particular job since that time was integral and indispensable to the work of the employees. In addition, employees, who were required to don and doff unique protective gear, had to be paid for the time it took them to walk between the locker room and the production area since those activities occurred during the continuous workday. On the other hand, employees were not be entitled to be paid for the time they had spent in ordinary clothes changing and washing or for the donning and doffing of a hard hat, ear plugs, safety glasses, boots, or a hairnet.

The *IBP* case was appealed to a three-judge panel of the U.S. Court of Appeals for the Ninth Circuit.[33] In response to the threshold question of whether the donning and doffing and waiting and walking constituted "work" under the FLSA," the appellate court answered in the affirmative.[34] The court then considered whether the activities, which were preliminary and postliminary to the principal activity of the job, were, if fact, "an integral and indispensable part of the principal activities" and, therefore, not covered by §4(a) of the Portal-to-Portal Act. Noting that the Supreme Court had adopted a context-specific approach in deciding whether an activity was integral and indispensable to a principal activity, the Ninth Circuit evaluated the activities in question to determine if they were both necessary to the principal work performed and done for the benefit of IBP.[35] Since federal law (including the sanitation standards of the Department of Agriculture and the industry standards of the Occupational Safety and Health), IBP's own internal rules, and the nature of the work all required the plaintiffs to don and doff specific gear, the appellate court concluded that the activities were "necessary" to the "principal" work performed. The fact that the workers had to use the protective gear in order to prevent unnecessary workplace injury and contamination (which would impede work on the production line) also supported the trial court's conclusion that the donning, doffing, and cleaning activities were for the benefit of the employer.[36]

The Court of Appeals distinguished between the donning, doffing, and cleaning of unique protective gear (such as Kevlar gloves) and non-unique gear (such as hard-hats and safety glasses). While the court concluded that both types of gear were necessary for the performance of the principal work (and as such could fall under the *Steiner* exception), it denied compensation for the time spent donning and doffing the non-unique gear on the grounds that that time was *de minimis* as a matter of law.[37]

IBP had also argued that 29 U.S.C. §203(o), (hereinafter referred to as §3(o)), provided a statutory basis for denying compensation to workers for the time spent donning and doffing their gear. Section 3(o) of the FLSA excluded from compensable time "any time spent in changing clothes or washing at the beginning and end of each workday which was excluded from measuring working time during the week involved by the express terms of or by custom or practice under a bona fide collective-bargaining agreement applicable to the particular employee." The Circuit Court rejected IBP's expansive understanding of the phrase "changing clothes." It reasoned that since there was no statutory clarification, legislative history, or case law to help explain the meaning of the phrase, it had no choice but to give the words their "ordinary, contemporary, common meaning."[38] That meant that the protective gear that had been worn by IBP's workers and that certainly had been different from typical clothing, did not "plainly and unmistakably" fit within the statute's meaning of word "clothing". This conclusion was supported by reference to an OSHA regulation that had made a similar analytical distinction between "general work clothes" and "personal protective equipment."[39] Consequently, the court held that the §3(o) exemption did not apply in this instance.[40]

The employer was equally unsuccessful in its assertion that the District Court erred in its determination of what constituted a compensable workday. IBP suggested that §4(a)(1) of the Portal-to-Portal Act was a "stand alone" provision that had to be read to exclude compensation for any and all "walking, riding, or traveling to and from the actual place of performance of the principal activity."[41] As such, IBP argued that even if it had to pay its employees for the time spent donning and doffing the protective gear, it certainly did not have to compensate them for the time spent walking between the locker rooms and their workstations. According to IBP, the compensable workday was made up of the sum of a number of discrete periods—the time spent donning and doffing of the gear and the time spent at the workstation—but not the time spent walking to the worksite or the principal activity. The Court of Appeals rejected IBP's arguments and affirmed the trial judge's view that the compensable workday began with the first act of compensable work and did not end until the last act of compensable work was completed. Since the trial court had determined that the first act of compensable work had been the preliminary donning of the protective gear and that the last act had been the returning to the changing areas and doffing the gear and since it had also determined that both activities were "integral and indispensable" to the principal work activities, the court did not err in holding that the workday included the reasonable time spent walking between the locker rooms and the workstations.

b. *Abdela Tum, et al. v. Barber Foods, Inc.*

The *Barber Foods* case, which was filed in the federal court in Maine,[42] was originally presented to a federal magistrate, who recommended a partial summary judgment in favor of the defendant. In the first of two critical rulings, the magistrate held that the time spent donning and doffing clothing and equipment was compensable (and not excluded as preliminary and postliminary activities under the Portal-to-Portal Act) if the activities had been mandated by the employer or by the government. Employees, on the other hand, were not entitled to compensation for the time it took them to don and doff clothing and equipment that they were not required to use.[43] The second ruling rejected the claim that the employer had to pay workers for the time they had spent waiting to obtain mandated gear since these activities could not reasonably be construed to be an integral part of the employees' work activities.[44] The magistrate concluded by recommending that a summary judgment be entered denying the claims relating to the time each employee spent walking from the entrance of the plant to the employee's workstation, locker, time clock or site where the required clothing and equipment were distributed and for claims based on the time spent waiting to punch in or out for that clothing and equipment.[45] What the magistrate did not consider was the applicability of §4 of the Portal-to-Portal Act to the time spent walking between the place of donning and doffing and the production line.[46]

When the case was presented to the trial court, Judge Gene Carter followed the recommendation of the magistrate and granted the partial summary judgment in favor of Barber Foods. The only unresolved issue involved Barber Foods' alleged liability for the time its employees spent donning and doffing various gear. Prior to submitting the case to the jury, the parties stipulated that four categories of workers (the rotating, set-up, meatroom, and shipping and receiving associates) had been required to don and doff protective gear at the beginning and end of their shifts. The instructions to the jury asked for a specific set of factual findings. The first required the jury to determine how much time was reasonably needed to don and doff the gear. The second asked whether that time had been *de minimis* and, consequently, noncompensable. The jury ultimately concluded that in each case the time had in fact been *de minimis* and noncompensable.[47]

Both parties appealed the decisions of the lower court to a three-judge panel of the U.S. Court of Appeals for the First Circuit.[48] The employees claimed that the lower court had erred when it granted the partial summary judgment in favor of the defendants and when it instructed the jury. The employer, in a cross-appeal, objected to the lower court's ruling that the donning and doffing of required clothing and equipment had been an integral part of the employees' work and, as such, had not qualified as noncompensable preliminary and postliminiary activities under the Portal-to-Portal Act.

The appellate court's *de novo re*view of the lower court's granting of a partial summary judgment focused on two issues. The first was whether the trial court had erred in denying the employers compensatioin for the time spent going from place to place to collect different pieces of required clothing and gear, for the time spent walking from where those items were received to the time clocks, and for the time spent doffing and disposing of the items at the end of the day. The second issue was whether the court had erred in denying the employees compensation for the time they had spent waiting in line to collect the required gear and to punch in at the time clocks.

The three-judge panel affirmed the trial court's denial of compensation for walking time. It found support for the lower court's decision in 29 C.F.R. §790.7(g) n.49, which provided that even though the changing of clothes may in "certain situations be so directly related to the specific work the employee is employed to perform that it would be regarded as an integral part of the employee's 'principal activity[,]' this does not necessarily mean, however, that travel between the washroom or clothes-changing place and the actual place of performance of the specific work the employee is employed to perform, would be excluded from the type of travel to which the section 4(a) [Portal-to-Portal Act] refers."[49] The appellate court further stated that even if it had assumed, for the sake of argument, that employees had been engaged in an integral and indispensable part of their principal employee activities when they donned and doffed mandated gear, their walking time would still be noncompensable under the Portal-to-Portal Act.[50] Just because the traditional understanding of a primary activity had been stretched to cover donning and doffing in a very limited number of cases did not mean that Congress intended to create an avenue to circumvent the Portal-to-Portal Act's exemption of preliminary and postliminary activities.[51] The panel then referred to 29 C.F.R. §790.7 to determine whether the walking in this case had merely been a "preliminary or postliminary" activity. After differentiating the facts in this case from the examples listed in the federal regulation, the court found that the time that had been spent walking from place to place to gather ordinary safety gear and to punch in "[fell] outside of the narrow category of walking that [was} "not segreable from the simultaneous performance of [their] assigned work.""[52]

The appellate court also rejected both of the employees' claims that they should have been compensated for the time that they spent waiting to punch in and waiting to collect the required clothing or gear. The panel found no persuasive argument to depart from the general rule, articulated in 29 C.F.R §790.8 (c) n. 67, that states that even when changing clothes has been considered to be a principal activity, "activities such as checking in and out and waiting in line to do so would not ordinarily be regarded as integral parts of the principal activity or activities."[53] The panel similarly rejected the employees' claim that they should have been compensated for the time they had spent waiting to collect the required gear after noting that 29 C.F.R. §790.8 states that a reasonable amount of time was intended to be preliminary and postliminary—and noncompensable.[54]

The Court of Appeals granted the plaintiffs' request for a rehearing and reaffirmed the decision of the district court and the three-judge panel.[55] The court began by agreeing that the donning and doffing of gear was only an integral and indispensable part of an employee's principal activities when the employer or government had mandated the use of the gear. It went on to reject the employees' claims that they should have been compensated for any walking time that occurred between when the employees picked up their first piece of required gear and when they returned the gear at the end of the shift. This conclusion was based on the court's understanding of 29 C.F.R. § 790.7(g) n. 49 and a narrower understanding of the term "workday".[56] The issue of whether employees should be compensated for waiting in line to receive mandated gear and to punch in at the time clocks was also decided in favor of the employer. The court characterized this as a classic FLSA case of "waiting to be engaged" and not as a case of "engaged to wait." It went on to note that even if the waiting time qualified as "engaged to wait" time, it would not be compensable since it also constitutes a preliminary or postliminary activity that is noncompensable under the Portal-to-Portal Act.[57] Finally, the court rejected both the employer's cross-appeal (on the grounds that a party cannot appeal a favorable judgment merely to obtain the review of a finding it deems erroneous) and the employee's objection to the jury instructions (on the grounds that the instructions were correct and did not confuse or mislead the jury.)[58]

IV.

The U.S. Supreme Court granted *certiorari* to the consolidated cases of *IBP* and *Barber Foods* in order to resolve the differences between the lower courts on two questions. The first question was whether the FLSA required the employer to pay an employee for postdonning and predoffing walking time. The second question, which had only been raised in the *Barber Foods* case, was whether the FLSA also required the employer to compensate an employee for the time spent waiting to collect the protective gear. The court's opinion, which was delivered by Justice John Paul Stevens, held that an employer was required to compensate employees for the time they spent walking between changing and production areas when the donning and doffing of required gear was "integral and indispensable" to the workers' "principal activities." Under the continuous workday rule, the workday began when the required gear was donned and continued uninterrupted until the gear was finally doffed. Since the time spent waiting to receive and don the first piece of gear was more properly characterized as a "preliminary" activity, it was not compensable under the terms of the Portal-to-Portal Act.

The court's unanimous decision began with a summary of the legislative history of the FLSA and the Portal-to-Portal Act and with a review of the judicial interpretation of the statutes. Particular attention was paid to §4(a) of the law, which had narrowed the scope of future FLSA claims. The court conceded that §4(a) had nullified previous judicial decisions that had allowed compensation to employees both for the time spent on the employer's premises walking to and from the actual place where the employees' principal activities were performed and for the time spent performing activities that were "preliminary or postliminary" to the employees' principal activities.[59] On the other hand, the court found that, except for those two types of activities, the Portal-to-Portal Act had not altered the judicial interpretation of the terms "work" and "workday" nor had it provided an alternative definition for the term "workday."[60] It also noted that the regulations issued by the Secretary of Labor after the passage of the legislation indicated that the statute had had no effect on the computation of hours worked within the 'workday' proper (29 C.F.R. §790.6(a))[61] and that it had not changed the continuous workday regulation that defined the workday as the "period of time between the commencement and completion on the same workday of an employee's principal activity or activities" (29 C.F.R. §790.6(b).[62] The court concluded the first part of its decision by reaffirming its holding in *Steiner* that the time spent in activities such as the donning and doffing of specialized protective gear was compensable if the activities were an "integral and indispensable part of the principal activities."[63]

IBP*'s* appeal was based on its belief that §4(a)(1) of the Portal-to-Portal Act excluded FLSA compensation for the time spent walking between the locker rooms and the production areas. IBP did not challenge the lower court's finding that the donning and doffing of protective gear were compensable activities under §4.[64] It tried instead to differentiate between the category of "integral and indispensable" activities that might be compensible because they are not merely preliminary or postliminary within the meaning of §4(a)(2)" and the category of actual "principal activities" which the employee was "employed to perform" within the meaning of §4(a)(1). Activities that were "integral and indispensable" to the "principal activities" of the employee were covered by the FLSA and not excluded by §4(a)(2). That did not, however, mean that the "integral and indispensable" activities were themselves "principal activities" as defined by §4(a)(1). The significance of this distinction was that while "integral and indispensable" activities might be compensable, only "principle activities" could trigger the beginning of the compensable workday.

IBP's attempt to claim two different meanings for the phrase "principal activities" under §4(a)(1) and §4(a)(2) of the Portal-to-Portal Act was rejected by the Supreme Court. Justice Stevens, referring to the *Steiner* case, noted that when activities were "integral and indispensable" to "principal activities," they were not excluded from FLSA coverage by §4 of the Portal-to-Portal Act precisely because they were themselves "principal activities."[65] Although the court acknowledged that *Steiner* decision had only been concerned with the meaning of "principal activity or activities" under §4(a)(2), it presented two reasons why that meaning was also applicable to §4(a)(1). The first was a matter of normal statutory interpretation—identical words used in different parts of the same statute are generally presumed to have the same meaning.[66] The second was that the "*said* principal activity or activities" referred to in §4(a)(2) was an explicit reference to the use of the same term in §4(a)(1).[67] The court also rejected IBP's assertion that some activities may be sufficiently "principal" to be compensable, but not sufficiently "principal" to commence the workday. It concluded instead that while walking to the locker room to don special safety gear would be noncompensable time under §4(a)(1), walking from the locker room after donning the special safety gear would be compensable §4(a)(1) since the locker room had become the relevant "place of performance" of the principal activity that the employee was employed to perform.[68]

In addition to presenting arguments based on the text of the Portal-to-Portal Act, IBP also suggested that the court should construe the statute in a way that would effectuate the real purpose for which it was enacted. IBP claimed that there was a proximate cause connection between Supreme Court's decision in the *Anderson* case (in which the court granted compensation for the time employees spent walking from the punch in clock to the actual workstation) and the passage of the Portal-to-Portal Act (in which Congress excluded from compensation the time spent walking to and from the actual place of performance of the principal activity or activities which the employees had been employed to perform). The court rejected this line of reasoning on the grounds that there was a crucial difference between the walking in the *Anderson* case and the walking in the *IBP* case. In the former, the walking occurred before the workday began whereas, in the latter, the walking did not occur until the workday had already begun.[69]

The court also considered the impact of a number of regulations, which had been adopted by the Secretary of Labor shortly after the enactment of the Portal-to-Portal Act. The regulations not only supported the employees' view that the donning and doffing of protective gear were compensable activities but they also defined the outer limits of the workday. Both 29 C.F.R. §790.7(c) and §785.38 suggested that the time spent walking between a locker room and a production area was similar to the compensable time spent walking between different workplaces on the disassembly line.[70] The court noted that while 29 C.F.R. §790.6, measured the limits of most workdays as "roughly the period 'from whistle to whistle,'" 29 C.F.R. §790.6(b) stated that the term "workday" had also been used in the Portal-to-Portal Act to mean, "in general, the period between the commencement and completion on the same workday of an employee's principal activity or activities."[71] Finally, the court agreed with IBP's claim that, under 29 C.F.R. §790.7(g), n. 49, the postchanging walking time was not "necessarily" excluded from the scope of §4(a)(1).[72] That, however, did not help IBP's case since the fact that the activity was not "necessarily" excluded did not mean that it was *always* excluded and since the ambiguity in the regulation's note did not overcome the meaning of the statute, as it had been resolved in the *Steiner* decision.[73] Justice Stevens summarized the court's holding in the *IBP* case by stating that if an employee's activity was "integral and indispensable" to a "principal activity," it was itself a "principal activity" under §4(a) of the Portal-to-Portal Act.

b. *Barber Foods, Inc.*

It was only after resolving the issues in the *IBP* case that the Supreme Court considered the one unique issue in the *Barber Foods* case: whether the time that had been spent waiting to obtain mandatory clothing and equipment was compensable.[74]

The employees claimed that the waiting time was ""integral and indispensable" to the "principal activity" of donning, and was therefore itself a principal activity."[75] The employer, on the other hand, took the position that the waiting time qualified as a "preliminary or postliminary activity" that was explicitly covered by §4(a)(2) of the Portal-to-Portal Act. The court based its decision in favor of the employer on the distinction it drew between the time spent donning mandatory gear, "which was *always* essential if the worker is to do his job," and the time spent waiting to receive the gear, which "may or may not be necessary in particular situations or for every employee."[76] Although the waiting time was certainly a "preliminary" activity, it was not an activity that was "integral and indispensable" to a "principal activity." The conclusion that there was a difference between preshift activities that were "necessary" to a principal activity and preshift activities that were "integral and indispensable" to a principal activity was based on an understanding that the waiting time was analogous to the kind of walking time, which the court had found to be compensable in the *Anderson* case and which Congress had repudiated in the Portal-to-Portal Act.[77]

The court also rejected a claim that had been presented by the government in an *amicus* brief filed on behalf of the employees. The government claimed that, under 29 C.F.R. §790.7(h), when an employee "is required by his employer to report at a particular hour at his workbench or other place where he performs his principal activity, if the employee is there at that hour ready and willing to work but for some reason beyond his control there is no work for him to perform until some time has elapsed, waiting for the work would be an integral part of the employee's principal activities." The problem with trying to apply this waiting to work regulation to the *Barber Foods* case was that there had never been any allegation or finding that the protective gear had been unavailable to the employees when they finally arrived at the front of the waiting line.[78] Although the court rejected the applicability of §790.7(h), it did find §790.7(g) to be pertinent. Under this section, the Secretary of Labor characterized as "preliminary," and noncompensable, the time that an employee waited to check in or to receive a paycheck. The court concluded that these kinds of collateral activities, which are similar to the collateral activity of waiting to collect required gear, are only compensable if they are covered by an agreement of the parties or by the custom or practice of a particular industry.

V.

The Supreme Court's decision in the consolidated *IBP* and *Barber Foods* case was the not one of the big decisions of the first year of the new Roberts' court. Nor was it a landmark employment law case. Instead, the unanimous decision demonstrated an affirmation by the court of key understandings of the FLSA and the Portal-to-Portal Act. There were no conceptual changes to the meaning of the words "work," "workweek," and "continuous workday." "Preliminary and postliminary" activities were still found to be distinct from "preparatory and concluding" activities. The characterization of preparatory and concluding activities as "integral and indispensable" to the principal activity still resulted in increasing the length of the compensable day. Walking time was found to be compensable while waiting time was not. In each instance, the court balanced the statutes, the administrative agency regulations, and past judicial decisions in order to arrive at a decision that was balanced.

ENDNOTES

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[1] 29 U.S.C. §§ 251-262.

[2] 29 U.S.C. §§ 201-219.

[3] 546 U.S. 21; 126 S.Ct. 514 (2005).

[4] 29 U.S.C. § 202 (a).

[5] 29 U.S.C. §206(a)(1).

[6] 29 U.S.C. §207(a)(1).

[7] 321 U.S. 590; 64 S.Ct. 698 (1944). The Court held that iron ore miners were entitled to compensation for the time spent underground as they traveled to and from the "working face of the mines." Although the travel time might have been considered non-productive in the strict sense, the Court concluded that it constituted a "process or occupation necessary . . . to production" within the meaning of the FLSA.

[8] *Id.* at 598.

[9] 323 U.S. 126; 65 S.Ct. 165 (1944). In this case, auxiliary fire fighters claimed compensation for the time that they were required to remain in the fire hall at the end of their regular day-shift in order to respond to fire-alarms, make any temporary repairs of fire equipment, and take care of the sprinkler system if it was defective or set off by mistake. In fact, much of that time was idle time. The Court held that the idle time could be compensable if it was spent predominately for the employer's benefit and not for the employee's. Such a determination could only be made after a review of all the circumstances of the case.

[10] *Id.* at 133.

[11] 328 U.S. 680; 66 S.Ct. 1187 (1946). The employees in this case worked in a pottery plant. At the beginning and end of each day, they were required to punch time clocks that were located at the entrance of the plant. Workers could punch in during a 14 minute period of time before the regular starting time for productive work and could punch out during another 14 minute period of time at quitting time. Since 200 employees were punching in and out at the same time, a minimum of eight minutes was usually needed to get

by the time clock. The estimated walking time between the time clocks and work places would range between 30 seconds and three minutes. *Id.* at 683.

The employees' compensation was not based on the actual times that they punched in or out but from the next even quarter hour after punching in until the next even quarter hour prior to punching out. That meant that an employee, who punched in for work at 6:46 a.m., punched out and in for lunch at 12:14 p.m. and 12:46, and finally punched out for the day at 4:14 p.m., would be paid for an eight hour day even though the worker's actual time on the work site would include 56 additional minutes. *Id.* at 683-684.

[12] *Id.* at 690-691.

[13] These activities included putting on aprons and overalls, removing shirts, taping or greasing arms, putting on finger cots, preparing the equipment for productive work, turning on switches for lights and machinery, opening windows, and assembling and sharpening tools. The Court also held that compensation could be denied, under the *de minimus* rule, for work that involved insubstantial or insignificant periods of time.

[14] 29 U.S.C. §251(a).

[15] Section 2 (codified at 29 U.S.C. §252), (hereinafter referred to as §2), states that:

"(a) No employer shall be subject to any liability or punishment under the Fair Labor Act of 1938, as amended, the Walsh-Healey Act, or the Bacon-Davis Act (in any action or proceeding commenced prior to or on or after the date of the enactment of this Act [May 14, 1947], on account of the failure of such employer to pay an employee minimum wages, or to pay an employee overtime compensation, for or on account of any activity of an employee engaged in prior to the date of the enactment of this Act, except an activity which was compensable by either—

"(1) an express provision of a written or nonwritten contract in effect, at the time of such activity, between such employee, his agent, or collective-bargaining representative and his employer; or

"(2) a custom, practice in effect, at the time of such activity, at the establishment or other place where such employee was employed, covering such activity, not inconsistent with a written or nonwritten contract, in effect at the time of such activity, between such employer, his agent, or collective-bargaining representative and his employer."

[16] Section 4 (codified at 29 U.S.C. §254), (and hereinafter referred to as §4) states that:

"(a) Except as provided in subsection (b), no employer shall be subject to any liability or punishment under the Fair Labor Standards Act of 1938, as amended, the Walsh-Healey Act, or the Bacon-Davis Act, on account of the failure of such employer to pay an employee minimum wages, or to pay an employee overtime compensation, for or on account of any of the following activities of such employee engaged in on or after the date of the enactment of this Act—

"(1) walking, riding, or traveling to and from the actual place of performance of the principal activity or activities which such employee is employed to perform, and

"(2) activities which are preliminary to or postliminary to said principal activity or activities, which occur either prior to the time on any particular workday at which such employee commences, or subsequent to the time on any particular workday at which he ceases, such principal activity or activities.

"(b) Notwithstanding the provisions of subsection (a) which relieve an employer from liability and punishment with respect to an activity, the employer shall not be so relieved if such activity is compensable by either—

"(1) an express provision of a written or nonwritten contract in effect, at the time of such activity, between such employee, his agent, or collective-bargaining representative and his employer; or

"(2) a custom or practice in effect, at the time of such activity, at the establishment or other place where such employee is employed, covering such activity, ot inconsistent with a written or nonwritten contract, in effect at the time of such activity, between such employee, his agent, or collective-bargaining representative and his employer."

[17] 29 C.F.R. §790.6(a) provides that: "Section 4 of the Portal Act does not affect the computation of hours worked within the 'workday' proper,

roughly described as the period 'from whistle to whistle,' and its provisions have nothing to do with the compensability under the Fair Labor Standards Act of any activities engaged in by the employee during that period. Under the provisions of section 4, one of the conditions that must be present before 'preliminary' or 'postliminary' activities are excluded from hours worked is that they 'occur either prior to the time on any particular workday at which the employee commences, or subsequent to the time on any particular workday at which he ceases' the principal activity or activities which he is employed to perform. Accordingly, to the extent that activities engaged in by an employee occur after the employee commences to perform the first principal activity on a particular workday and before he ceases the performance of the last principal activity on a particular workday, the provisions of that section have no application. Periods of time between the commencement of the employee's first principal activity and the completion of his last principal activity on any workday must be included in the computation of hours worked to the same extent as would be required if the Portal Act had not been enacted. The principles for determining hours worked within the 'workday' proper will continue to be those established under the Fair Labor Standards Act without reference to the Portal Act, which is concerned with this question only as it relates to time spent outside the 'workday' in activities of the kind described in section 4."

[18] 29 C.F.R. § 790.6(b).

[19] 350 U.S. 247, 76 S.Ct. 330 (1956).

[20] *Id.* at 256.

[21] The Court found the following interchange between Senators Cooper and McGarth to be particularly significant on the question of prospective liability:

SENATOR McGRATH: "I think that at this point we might very definitely make contribution to the legislative history of what we are doing here. Am I correct in understanding the Senator to say that what the majority of the committee proposes is that any activity of a worker shall be considered a part of his principal activity if the doing of that act is indispensable to the performance of the rest of his day's work?"

SENATOR COOPER: "I can read the language used in the report, and I think that language should be used in this connection, because the words and phrases it employs were adopted by the committee. On page 48 of the report, in the definition of 'principal activity,' we find these words:

"'It will be observed that the particular time at which the employee commences his principal activity or activities and ceases his principal activity or activities marked the beginning and the end of his workday. The term "principal activity or activities" includes all activities which are an integral part thereof as illustrated by the following examples:

"'1. In connection with the operation of a lathe an employee will frequently at the commencement of his workday oil, grease, or clean his machine, or install a new cutting tool. Such activities are an integral part of the principal activity, and are included within such term.

"'2. In the case of a garment worker in a textile mill, who is required to report 30 minutes before other employees report to commence their principal activities, and who during such 30 minutes distributes clothing or parts of clothing at the workbenches of other employees and gets machines in readiness for operation by other employees, such activities are among the principal activities of such employee.'"

"We believe that our bill provides that the employee must receive compensation for such activities."

SENATOR McGRATH: "Then we can clear that point up by reiterating that what the committee means is that any amount of time spent in the performance of the type of activity expressed in examples 1 and 2 is to be hereafter regarded as compensable time."

SENATOR COOPER: "I should certainly say so, as a part of the principal activity."

SENATOR McGRATH: "There are innumerable instances of operations which have to be performed that are not covered in these particular examples. I think of one at the moment. In certain of our chemical plants workers are required to put on special clothing and to take off their clothing at the end of the workday, and in some of the plants they are required to take shower baths before they leave. Does the Senator regard such activity as that as coming within the compensable workday?"

SENATOR COOPER: "I am very happy that the Senator has asked the question, because I believe it gives the opportunity of drawing a fine distinction between the type of activity which we consider compensable and the type which should not be compensable. In accordance with our intention as to the definition of 'principal activity,' if the employee could not perform his activity without putting on certain clothes, then the time used in changing into those clothes would be compensable as part of his principal activity. One the other hand, if changing clothes were merely a convenience to the employee and not directly related to the specific work, it would not be considered a part of his principal activity, and it follows that such time would not be compensable." (93 Cong. Rec. 2297-2298.) *Id.* at 257-258; 336-337.

[22] *Id.* at 255.

[23] *Supra,* n. 3, at 521-522.

[24] *Alvarez v. IBP,* 339 F.3d 894, 898 (9th Cir., 2003).

[25] *Id.* at 899-900.

[26] *Abbela Tum, et al.,* v. *Barber Foods, Inc.,* 331 F.3d 1, 2-3 (1st Cir., 2003).

[27] The rotating associates were also required to wear safety glasses. The glasses and other non-mandatory items such as gloves, aprons, and sleeve covers could be donned and doffed after punching in and before punching out. *Id.* at 3.

[28] The meatroom associates were also required to wear vinyl gloves, and aprons. These and other non-mandatory items such as sleeve covers could be donned and doffed after punching in and before punching out. *Id.* at 4.

[29] *Id.* at 3-4.

[30] Lab coats and cotton glove liners could be found on hanger racks and in tubs in the hallway between the entranceway and the equipment cage. Hairnets and earplugs aprons had to be obtained at the window of the equipment cage. Vinyl gloves, sleeve covers, and aprons were available at the window of the equipment cage or from tubs on the production floor. *Id.* at 4-5.

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[31] Rotating associates, set-up operators, and meatroom employees punched in at a clock near where they work and punched out on clocks next to the two primary exits. Maintenance workers punched in on a clock in the maintenance room. Shipping-and-receiving workers used a clock next to the shipping-and-receiving office to punch in and out. Sanitation workers punched in on the cafeteria clock and out on the plant office clock. *Id.* at 5-6.

[32] *Alvarez v. IBP, Inc.,* 2001 U.S. Dist. LEXIS 25344 (E.D. Wash., Sept. 14, 2001).

[33] *Alvarez v. IBP, Inc,* 339 F.3d 894 (9th Cir., 2003). The opinion of the court was delivered by Judge Sidney R. Thomas.

[34] The Circuit Court applied the Supreme Court's definition of "work" in the *Muscoda* case and held that since the donning and doffing had been "pursued necessarily and primarily for the benefit of the employer," it constituted work. *Id.* at 902 (citing , *supra,* note 7, at 598.)

[35] *Id.* at 902-903.

[36] *Id.* at 903.

[37] *Id.* at 903. The Circuit Court cited Supreme Court's decision in *Anderson:* "When the matter in issue concerns only a few seconds or minutes of work beyond the scheduled working hours, such trifles may be disregarded. Split-second absurdities are not justified by the actualities or working conditions or by the policy of the [FLSA]." *Supra,* n. 11, at 692.

[38] *Supra,* n. 33, at 904.

[39] 29 C.F.R. §1910.1030(b) states that: "Personal protective equipment is specialized clothing or equipment worn by an employee for protection against a hazard. General work clothes (e.g. uniforms, pants, shirts or blouses) not intended to function as protection against a hazard are not considered to be personal protective equipment."

[40] *Supra,* n. 33, at 905.

[41] *Id.* at 906.

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[42] *Abdela Tum, et al., v. Barber Foods, Inc.,* 2002 U.S. Dist. LEXIS 1064 (D.Me., Jan. 23, 2002).

[43] *Supra,* n. 3, at 526 (citing App. to Pet. for Cert. in 04-66, pp. 36a-40a.).

[44] *Id.* at 526 (citing App. to Pet. for Cert. at 33a.)

[45] *Id.* at 526 (citing App. to Pet. for Cert. at 33a-34a.)

[46] *Id.* at 526.

[47] The jury found that the combined donning and doffing time for rotating associates had been 1 minute, for set-up operators 2 minutes 16 seconds, for meatroom associates 1 minute 53 seconds, for shipping and receiving associates 2 minutes 8 seconds, and for maintenance and sanitation workers no minutes since they had not been required to don and doff clothing before punching in and punching out.

[48] 331 F.3d 1 (1st Cir, 2003).

[49] *Id.* at 6.

[50] *Id.* at 6.

[51] *Id.* at 6. The court found it nonsensical that the employees had conceded that the time needed to walk to the place where first piece of mandatory gear had been collected was not compensable and still have claimed that they should be compensated for the time it took them to pick up their gear from two bins instead of one bin.

[52] *Id.* at 7 (citing 29 C.F.R. §790.7(d)).

[53] *Id.* at 7.

[54] The Code would have allowed compensation for preliminary activities such as the time loggers spend taking carry heavy equipment out to a logging site and the time butchers spend sharpening knives. The court, however, found that there was a significant difference between those types of activities and the waiting time claimed by the Barber employees. It concluded that it had to draw a line in this case "otherwise an almost

endless number of activities that precipitate the employee's essential tasks would be compensable." *Id.* at 7-8.

[55] 360 F.3d 274 (1st Cir., 2004). Judge Torruella, the author of the original three-judge panel's opinion, presented the opinion of the appellate court after the rehearing.

[56] The court rejected the Labor Secretary's suggestion that the ordinary "workday" rule should be expanded "in favor of a broader, automatic rule that any activity that satisfies the "integral and indispensable" test itself starts the workday, regardless of context." *Id.* at 280.

[57] *Id.* at 281-282

[58] In a concurring opinion, Judge Boudin found in favor of the employer both with regard to the *de minimis* time spent donning and doffing required gear and the more extensive time spent in walking and waiting. He reached this similar conclusion after examining the history and underlying tensions that were presented in the legislative history of the FLSA and the Portal-to-Portal Act, in the U.S. Supreme Court's precedents in the area, and in contractions between the regulations of the Labor Department and contradictory recommendations of the Labor Secretary.

[59] *Supra,* n. 3, at 520.

[60] *Id.* at 520.

[61] *Id.* at 520. 29 C.F.R. §790.6(a) states that: "That to the extent that activities engaged in by the employee occur after the employee commences to perform the first principal activity on a particular workday and before he ceases the performance of the last principal activity on a particular workday, the provisions of [§4] have no application."

[62] *Id.* at 520-521.

[63] *Id.* at 521.

[64] Even if IBP had entertained hopes that the decision in *Steiner* might be overruled, it became clear during oral arguments that that was not going to occur. Justice Stevens confirmed that belief in his opinion when he wrote "considerations of *stare decisis* are particularly forceful in the area of

statutory construction, especially when a unanimous interpretation of a statute has been accepted as settled law for several decades." *Id.* at 523.

[65] Id. at 523, citing *Steiner, supra*, note 19, at 253.

[66] *Id.* at 523, citing *Sullivan v. Stroop*, 496 U.S. 478, 484 (1990).

[67] *Id.* at 523-524. .

[68] *Id.* at 524.

[69] *Id.* at 524.

[70] §790.7(c) states that the Portal-to-Portal Act does not affect the compensabiltiy of time spent traveling from the place of performance of one principle activity to that of another. §785.38 states that "where an employee is required to report at a meeting place to receive instructions or to perform other work there, or to pick up and to carry tools, the travel from the designated place to the work place is part of the day's work and must be counted as hours worked [under the FLSA.]"

[71] *Id.* at 524.

[72] Footnote 49 states that: "Washing up after work, like the changing of clothes, may in certain situations be so directly related to the specific work the employee is employed to perform that it would be regarded as an integral part of the employee's 'principal activity.' This *does not necessarily mean*, however, that travel between the washroom or clothes-changing place and the actual place of performance of the specific work the employee is employed to perform, would be excluded from the type of travel to which section 4(a) refers." (Emphasis added.)

[73] *Supra,* n. 3, at 525.

[74] The Supreme Court noted that since it had already addressed the issue of the compensability for the time spent walking between the location where the gear was donned and doffed in favor of the employees, it only needed to consider the compensability for the pre-donning waiting time. *Supra,* n. 3, at 527.

[75] *Id.* at 527.

[76] *Id.* at 527.

[77] In this case, the waiting time was two steps removed from the productive activity on the assembly line and is therefore not "integral and indispensable" to a "principal activity."

[78] *Id.* at 527.

FIRST AMENDMENT RIGHTS OF FACULTY AND STUDENTS: A PERSPECTIVE

by

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INTRODUCTION

Assume a faculty member at a public college is reprimanded by her department chair for the following reasons: she is told that her explanations to her students are unclear. In a recent class she taught, she gave 13 incompletes. When students approach her about making up the incomplete, she does not explain how to successfully complete the course. The students complain to her chair and she is given a reprimand and eventually not re-hired.

The faculty member sues the college. She alleges infringement of her rights to free speech and academic freedom "in retaliation for her refusal to comply with a request that she communicate more clearly to her students what was required to complete the coursework in a class she taught in the fall of 2000."[1]

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Is this the sort of issue that the framers of the Constitution envisioned when they approved the Bill of Rights? Faculty members often assert that they "have First Amendment rights" yet few agree on exactly what those rights are. While there is a consistently held belief that discussions in the classroom are protected, do those rights encompass the "right *not to explain* class material;" or the "right to have personal discussions"? And what of the students' rights? Does the First Amendment mean that students can "say anything they want" in the name of academic freedom? And do faculty have a right to remove a student from a classroom if they find the students' speech disturbing or upsetting?

The purpose of this paper is to examine issues of free speech as they apply in the classroom. It will examine these issues both as they pertain to statements by faculty in the classroom, for which they receive some form of "punishment" as well as statements or actions by students.

PART I. FACULTY FREE SPEECH AT PUBLIC COLLEGES AND UNIVERSITIES

Historically, courts have held that at a public college or university, "faculty may not be terminated for the content of their classroom speech, so long as it is consistent with the purpose of the course."[2] The rationale is that an institution cannot limit a public faculty member's right to speech, or terminate a faculty appointment for speech expressed in the context of the citizen role or about a public issue."[3] Language, however, is not protected if, "taken in context, it constitute[s] a deliberate, superfluous attack on a 'captive audience' with no academic purpose or justification."[4] The First Amendment does not protect public college faculty in vulgar and profane speech where the words are not "germane to the subject matter" or in violation of the college's sexual harassment policy.[5]

In the seminal case of *Pickering v. Board of Education*,[6] the Supreme Court ruled that school board officials in Will County, Illinois, violated the First Amendment rights of a public high school teacher when they fired him for writing a letter to the editor of the local newspaper criticizing the board of education for its allocation of school funds between athletics and education. The Court ruled that "[i]n determining a public employee's rights of free speech, the problem is to arrive "at a balance between the interests of the [employee], as a citizen, in commenting on matters of public concern and the interest of the State, as an employer, in promoting the efficiency of the public services it performs through its employees."[7] "Whether a public employee's speech addresses a matter of public concern," so as to protect an employee from termination for expressing those views "must be determined by content, form and the context of a given statement."[8]

There are deeply ingrained societal reasons for protecting faculty speech. Justice Brennan noted in *Keyishian v. Board of Regents*, [9] "Our nation is deeply committed to safeguarding academic freedom, which is of transcendent value to all of us and not merely to the teachers concerned. That freedom is therefore a special concern of the First Amendment, which does not tolerate laws that cast a pall of orthodoxy over the classroom. The classroom is peculiarly the 'marketplace of ideas.'" [10] He warned how dangerous it would be to "impose any strait jacket upon the intellectual leaders in our colleges and universities."[11] "The nation's future depends upon leaders trained through wide exposure to the robust exchange of ideas which discovers truth 'out of a multitude of tongues, [rather] than through any kind of authoritative selection.'"[12]

Free speech in the classroom is not unfettered. Like any public employee, the courts analyzing the dismissal of faculty at public colleges and universities employ a four part test in determining whether that dismissal is protected speech.

> "The first step is to determine whether the speech is protected, i.e., on a matter of public concern. If so, the second step is to balance the employee's interest in commenting on matters of public concern against the government employer's interest in promoting efficient government services. If that balance is struck in favor of the employee's interest, the third step requires the employee to demonstrate that his speech was a substantial or motivating factor in the adverse employment action. If the employee so demonstrates, the fourth step considers whether the government employer has proven that it would have taken the same adverse employment action, even in the absence of the protected speech. The first two steps are legal questions which the court resolves to determine whether the speech is constitutionally protected. The second two steps concern causation and involve questions of fact."[13]

Is the speech a matter of public concern?

The courts differentiate between speech that is personal in nature, and thus unprotected, versus speech that is a matter of public concern and thus protected.[14] What constitutes a matter of public concern is generally related to a "political, social or other matter of community concern,"[15] as enunciated in *Connick v. Meyers*.[16] Here, the respondent, an Assistant

District Attorney, was informed that she would be transferred to a different section of the criminal court to prosecute cases. She strongly opposed the transfer and distributed a questionnaire around the District Attorney's office. She was terminated for refusing to accept the transfer and told that the distribution of the questionnaire was an act of insubordination. The court found that this was not a matter of public concern. "Myers did not seek to inform the public that the District Attorney's office was not discharging its governmental responsibilities in the investigation and prosecution of criminal cases. Nor did Myers seek to bring to light actual or potential wrongdoing or breach of public trust on the part of *Connick* and others. Indeed, the questionnaire, if released to the public, would convey no information at all other than the fact that a single employee is upset with the status quo.[17] The Court recognized that an assistant district attorney's speech related to official pressure to work on a campaign was a matter of public concern because it was "a matter of interest to the community upon which it is essential that public employees be able to speak out freely without fear of retaliatory dismissal."[18] Speech, however, that deals with 'individual personnel disputes and grievances' and that would be of 'no relevance to the public's evaluation of the performance of governmental agencies' is generally not of 'public concern'."[19]

Other protected speech can be characterized as that which serves a purpose, such as speech which "discloses any evidence of corruption, impropriety, or other malfeasance on the part of [state] officials, in terms of content, clearly concerns matters of public import "[20] in comparison to speech that is "calculated to redress personal grievances."[21]

Hulen v. Yates[22] involved a dysfunctional accounting department at Colorado State University (CSU). The department was fraught with in-fighting and accusations of unethical behavior. The plaintiff "cooperated with other members of the Accounting Department in seeking to revoke the tenure of a colleague (Dr. William Mister) on grounds of plagiarism and copyright violations, emotional abuse of students, abuse and harassment of staff, misuse of state funds, receipt of kickbacks from a publisher in return for adopting textbooks, and other charges"[23]. Hulen "attempted to bring his concerns to the CSU Administration. He wrote memos to the provost about the lack of an investigation, and made statements about unethical behavior that he perceived going on in the department.[24] In one memorandum, he wrote, "Yet the very cornerstone of our profession of accounting involves ethical behavior and integrity. We cannot successfully teach ethics if it is not practiced at CSU."[25] The administration asked Dr. Hulen to stop its investigation of Dr. Mister. When he refused, Dr. Hulen was removed from the accounting department and placed in the management department, in which he was not qualified to teach any courses, "thereby resulting in a diminished ability to attract research funds, publish scholarship, receive salary increases, teach summer tax classes, and obtain reimbursement for professional dues and journal subscriptions."[26]

The court found that this was exactly the type of speech worth protecting. "The speech in this case fairly relates to charges at a public university that plainly would be of interest to the public. "[T]eachers whose speech directly affects the public's perception of the quality of education in a given academic system find their speech protected [under the First Amendment]."[27]

Many times the action of the professor is mixed with some protected and some non-protected activities. For example, in *Blum v. Schlegel*,[28] a law school professor wrote letters to his fellow faculty members relating to his quest for tenure and promotion, and a letter making suggestions about school policy and curriculum. The letters regarding the professor's particular status for tenure and promotion were held not to "relate in any way to any political, social or other matter of community concern....Moreover, many of these letters make clear that plaintiff was writing merely as a disgruntled employee complaining of a personal employment dispute."[29]

In *Hudson v Craven*,[30] an economics professor at Clark College encouraged her students, as part of a class assignment, to attend the World Trade Organization (WTO) meetings/protests in Seattle. These protests were highly publicized in the area and attracted international attention. When the college learned of her plans to take the students to a potentially dangerous event, the college admonished her that she could not do so. She sued, claiming that her First Amendment rights were violated, but the court disagreed. "While Hudson's freedom to participate in discussion about the WTO surely implicates core political speech, the actual curtailment of her First Amendment rights was minimal. Hudson was free to attend the anti-WTO rally on her own. She was free to communicate her views on the WTO to her students or to anyone else. She was free to associate with her students in the classroom on this matter. The only claimed abridgement of her First Amendment rights was that she was not permitted, under the de facto auspices of the College, to associate with a handful of students during a discrete event for a limited duration."[31]

This case is an excellent example of when the "legitimate administrative interests of Clark College" strongly outweighed the professor's associational interests. The court also espoused language helpful in determining when faculty's first amendment rights can be legitimately curtailed. These include:

> (1) risks to students, particularly an underage group, and potential liability for the college, because of the reports of potential for violence;
> (2) students who were not able to attend would not have the benefit of access and networking with teachers;
> (3) mixing one's politics with one's professional responsibility in the classroom, which is a special trust; [and] (4) marginal benefit from participating in the demonstration.[32]

The court found that, "This litany boils down to two reasons: student safety and pedagogical oversight. While some of these justifications are more significant than others, on balance the legitimate interests of Clark College as an employer and educational institution outweigh those of Hudson to participate in the de facto field trip with her students."[33] Clark College met its burden by demonstrating that its legitimate interests outweighed Hudson's interest in attending the anti-WTO rally with her students.

Was the speech a substantial or motivating factor?

The plaintiff's second hurdle is proving that the speech was a "substantial or motivating factor" in the employment decision. In *de Llano v. Berglund*,[34] a faculty member criticized numerous administrative decisions including rising salaries of administrators and poor spending policies of administrators. The plaintiff met the first requirement, that the issue be one of public concern, but he failed to satisfy the second requirement. He could not prove that his speech is what caused his dismissal. The court stated that, "We are unable to ascertain any evidence that he was terminated because of the letters he wrote to the various venues. The dismissal notice given to de Llano outlines a number of reasons for his termination and those reasons were substantiated in two separate hearings. Not one of the reasons stated for his termination related to de Llano's letters. The fact that de Llano publicly criticized college administrators, and that some of the criticism is constitutionally protected, is insufficient to carry his burden of establishing that the letters were a substantial factor in the termination decision."[35] The unfortunate reality of this case is that the review boards or administrators hearing these types of complaints can choose their words carefully. By not stating that any of the reasons for dismissal are due to the exercise of speech, the plaintiff will have a difficult time prevailing on the issue of causation.

Since the *Pickering* decision, the Supreme Court has significantly modified its analysis of first amendment rights of civil or public employees which are applicable, therefore, to faculty employed at public institutions. In *Waters v. Churchill,*[36] the plaintiff, a nurse, complained to others in the hospital about co-workers as well as the running of the hospital. Ultimately, she was fired and she sued claiming her speech was both protected and non-disruptive. Here, the court stated that the right to speak is also limited if it *may cause disruption, not if it actually did.* "Whittled to its core, *Waters* permits a government employer to fire an employee for speaking on a matter of public concern if: (1) the employer's prediction of disruption is reasonable; (2) the potential disruptiveness is enough to outweigh the value of the speech; and (3) the employer took action against the employee based on this disruption and not in retaliation for the speech. [37] In addition, when weighing the value of the employee's speech against the interference with government operations, the *Waters* plurality also indicated that a government employer need only show that the speech is *likely to be disruptive* before the speaker may be punished.[38]

In *Jeffries v. Harleston* [39] one of the few cases to interpret *Waters*, the plaintiff, was the chairman of the Black Studies department at CUNY. In delivering a speech he made derogatory statements about the public school curriculum, Jews and the history of black oppression. As a result, the CUNY Board of Trustees voted to reduce his chairmanship from three to one year. Jeffries sued, claiming that his demotion was based on the speech, and thus protected.

But the court, applying the criteria set forth in *Waters*, disagreed. The court held that the defendants did not violate Jeffries' free speech rights if: (1) it was reasonable for them to believe that the Albany speech would disrupt CUNY operations; (2) the potential interference with CUNY operations outweighed the First Amendment value of the Albany speech; and (3) they demoted Jeffries because they feared the ramifications for CUNY, or, at least, for reasons wholly unrelated to the Albany speech. [40] Because there was a potential for disruption, the court found, that, as a matter of law, this potential disruptiveness was enough to outweigh whatever First Amendment value the Albany speech might have had.

There is also a clear line of cases involving faculty members engaged in inappropriate language and/or behavior as unprotected activity. For example, suppose that a professor uses profanity in the classroom. In spite of warnings from the dean, the instructor continued to make derogatory statements towards his students about their attitude in his class, some of which included the words "hell," "damn," "bullshit," and "sucks."[41] After two students filed written complaints concerning the professor's speech, the dean initiated action, approved by the board of trustees, to terminate the appellant.

The appellant argued that his language was not obscene, and that he had been exercising his First Amendment right to use profane language. Furthermore, he argued that his First Amendment right to "academic freedom" permitted such language. The Supreme Court affirmed the district court's decision that a publicly employed college teacher is not constitutionally protected in the offensive use of profanity in the classroom. In fact, the court found that professors hold a unique position. "We view the role of higher education as no less pivotal to our national interest. It carries on the process of instilling in our citizens necessary democratic virtues, among which are civility and moderation. It is necessary to the nurture of knowledge and resourcefulness that undergird our economic and political system. Repeated failure by a member of the educational staff of Midland College to exhibit professionalism degrades his important mission and detracts from the subjects he is trying to teach."[42]

Furthermore, "there was no doubt that the appellant's outbursts did not address a matter of public concern."[43] As previously stated, the indecent language appellant used described his attitude toward his students, "hardly a matter that....would occasion public discussion." The Court ruled that the "appellant has not argued that his profanity was for any purpose other than cussing out his students as an expression of frustration with their progress—to 'motivate' them—and has thereby impliedly conceded his case under *Connick*."[44]

In *Bonnell v. Lorenzo*, [45] the plaintiff was suspended for his use of vulgar and profane language in his literature class. He filed a suit against the president of Macomb Community College alleging, among other things, that his freedom of speech was violated. College officials met with the plaintiff who defended his use of the language by stating that it was used to highlight the "'chauvinistic degrading attitudes in society that depict women as sexual objects, as compared to certain words to describe male genitalia, which are not taboo or considered to be deliberately intended to degrade.'"[46]After the meeting, the College gave the plaintiff a written warning that stated in part:

> Unless germane to discussion of appropriate course materials and thus a constitutionally protect act of academic freedom, your utterance in the classroom of such words as 'f**k,' 'c**t' and 'p***y' may serve as a reasonable basis for concluding as a matter of law that you are fostering a learning environment hostile to women."[47]

After subsequent complaints of vulgar and profane language in class, the College reprimanded and then suspended the plaintiff for a period of time. The Court concluded that the plaintiff had no constitutionally protected right to use vulgar and profane language in his English composition class because it was "not germane to the subject matter." [48] The court stated that "Plaintiff may have a constitutional right to use words such as "p***y," "c**t," and "f**k," but he does not have a constitutional right to use them in a classroom setting where they are not germane to the subject matter, in contravention of the College's sexual harassment policy."[49] The Court remarked that, "[w]hile a professor's right to academic freedom and freedom of expression are paramount in the academic setting, they are not absolute to the point of compromising a student's right to learn in a hostile-free environment."[50]

In a subsequent case, the plaintiff's gratuitous use of in-class vulgarity was distinguished from speech that, while offensive to some, was germane to the course material and therefore protected by the First Amendment.[51] The instructor had given a lecture about language and social constructivism in order to show students the way in which language is used to marginalize minorities and other oppressed groups of society.[52] The students were then engaged in a classroom discussion analyzing the effect of oppressive and demeaning words such as "n*****r" and "b***h."[53] Subsequently, one of the instructor's African-American students complained to her minister, a local civil-rights activist, who, in turn threatened the school with a decline in African-American enrollment if the dispute was not resolved in the student's favor. The President and Dean obliged, and the instructor's teaching contract was not renewed.

The court held that the use of "socially controversial words," along with "racial and gender epithets in an academic context designed to analyze the impact of these words upon societal relations, touched upon a matter of public concern and thus fell within the First Amendment's protection."[54] Furthermore, the court ruled that "speech on public issues occupies the highest rung of the hierarchy of First Amendment values, and is entitled to special protection." [55] In addition, the teacher's actions did not have an impact on the governance or operation of the school, thus satisfying the balancing tests other prong.

What about a faculty member who makes off color jokes; uses sexual innuendo around students and makes comments such as "he wanted to "get his hands" on one graduate student and "get naked" or "drink some good beer" with another? These statements by a non-tenured probationary faculty member were held to be in the faculty member's personal interest. "The statements were simply parts of a calculated type of speech designed to further Trejo's private interests in attempting to solicit female companionship and, at the same time, possibly to irritate the other graduate students to whom he was speaking." [56] As such they were completely unprotected by the First Amendment and the actions taken against him by the administration were upheld.

PART II. STUDENT FIRST AMENDMENT RIGHTS.

The rights of students in the classroom was enunciated in the seminal case *Tinker v. Des Moines Independent Community School Dist.* [57] Set during the political turmoil of the 1960's, Tinker involved high school students suspended from school for wearing black arm bands. The court set out a balancing test to be employed in instances when First Amendment rights clash with the need to maintain order in schools. In the now famous pronouncement, the court stated, "It can hardly be argued that either students or teachers shed their constitutional rights to freedom of speech or expression at the schoolhouse gate. This has been the unmistakable holding of this Court for almost 50 years."[58]

On the other hand, it is equally important for schools to maintain order in the schools if for no other reason than the safety of the students. Therefore, the courts also acknowledge the need to allow schools "to prescribe and control conduct in the schools." [59]

A classic example of the court's reasoning is evidenced in *Salehpour v. University of Tennessee* [60] Here, a dental student refused to follow the professor's classroom rule 'barring first-year dental students from sitting in the last row of their classrooms.' On one particular day, the professor asked the student to move in the presence of a guest lecturer. "Plaintiff replied that he was comfortable where he was sitting and did not wish to move. Dr. Fletcher informed Plaintiff that if he did not move to another seat, he would have to leave the class." [61] The lawsuit that ensued included allegations "that he was discriminated against because of his national origin, physical disability, and protest against the classroom rule prohibiting first-year dental students from sitting in the last row of certain classes." [62]

Citing *Tinker*, the court noted that, "conduct by the student, in class or out of it, which for any reason--whether it stems from time, place, or type of behavior--materially disrupts class work or involves substantial disorder or invasion of the rights of others is, of course, not immunized by the constitutional guarantee of freedom of speech." As such, we find that, here, Plaintiff's claim fails at the inception where his alleged speech, i.e., his conduct of disrupting the classroom milieu for the sole purpose of advancing and pursuing his admitted "power struggle" with the University, was not protected activity.[63]

It is interesting to note that few cases exist that examine the tension between faculty and students in the classroom. In *Brown v. Li*, [64]however, the court acknowledged that neither the courts or the parties had found any Supreme Court case discussing the appropriate standard for reviewing a university's regulation of students' *curricular* speech

As a general rule, however, the court found that United States Supreme Court sentiment that "the curriculum of a public educational institution is one means by which the institution itself expresses its policy, a policy with which others do not have a constitutional right to interfere."[65] Therefore, when the student submitted his thesis and attached to it a "Disacknowledgment" which began "I would like to offer special *F*** You's* to the following degenerates for being an ever-present hindrance during my graduate career····" It then identified the Dean and staff of the graduate school, the managers of Davidson Library, former California Governor

Wilson, the Regents of the University of California, and "Science" as having been particularly obstructive to Plaintiff's progress toward his graduate degree. The dean then wrote a letter to Plaintiff, informing him that his degree would be conferred upon the approval of his thesis. The letter further noted that approval would be forthcoming as soon as Plaintiff removed his "Disacknowledgements."[66]

The court found that no First Amendment violation existed but rather this was a clear pedagogical decision by the university and the university set the standard.

> … Plaintiff's thesis was subject to a reviewing committee's reasonable regulation. Plaintiff was given reasonable standards for that assignment, including a pedagogically appropriate requirement that the thesis comply with professional standards governing his discipline. He was instructed that he should consult a standard style manual, or talk with members of his committee, about those requirements…Plaintiff's committee members acted well within their discretion, and in conformity with the First Amendment, when they declined to approve the noncompliant section. Their decision was reasonably related to a legitimate pedagogical objective: teaching Plaintiff the proper format for a scientific paper.

With few cases to rely upon to answer questions regarding classroom behavior at the college and university level, this case contains especially helpful language.

What if the student's first amendment rights are infringed by an in-classroom activity? In *Axson-Flynn v. Johnson* [67] a student in the University of Utah's actor training program and a devout Mormon argued that making her say the "F" word as part of a script violated her religious beliefs. As a result, she dropped out of the program and then sued for deprivation of her civil rights.

The court found that as long as there was a relationship between the pedagogy and the goals of the course, then the language was justified. "The school's methodology may not be *necessary* to the achievement of its goals and it may not even be the most effective means of teaching, but it can still be "reasonably related" to pedagogical concerns. A more stringent standard would effectively give each student veto power over curricular requirements, subjecting the curricular decisions of teachers to the whims of what a particular student does or does not feel like learning on a given day. This we decline to do."[68]

Nevertheless, the court wondered if the use of such language was in fact a pretext to discriminate against her on the basis of religion, or an 'anti- Mormon sentiment.' "Viewing the evidence in a light most favorable to Axson-Flynn, we find that there is a genuine issue of material fact as to whether Defendants' justification for the script adherence requirement was truly pedagogical or whether it was a pretext for religious discrimination"[69] thereby reversing and remanding the decision for further deliberation.

CONCLUSION

The foregoing review of the case law on faculty and student first amendment rights in the classroom provides some comforting safe havens and guidelines, but it also indicates a disconcerting undercurrent of subjectivity that may undermine free speech in academia. It seems reasonable that both faculty and students have no right to engage in gratuitous profanity in the classroom, that a modicum of decorum should be maintained. Nor should faculty *require* students to participate in potentially dangerous demonstrations in furtherance of their own political viewpoints. But some faculty, particularly those not tenured, may abridge their speech for fear of reprisals. After *Hudson,* would a professor be at risk is she encouraged her students to become informed citizens and to engage in participatory democracy by checking out the campus sit-in? And after *Bonnell*, should speech, media, language, and English professors refrain from the study of inflammatory Literature for fear that some may take offense? Perhaps most disturbing is the courts willingness in *Axson-Flynn* to allow a jury to review a script to determine if the use of a swear word was actually a pretext for religious discrimination. If the university is to remain Justice Brennan's ideal "marketplace of ideas", it cannot be pre-sanitized.

ENDNOTES

1 *Johnson-Kurek v. Abu-Absi*, 423 F.3d 590 (6th Cir. 2005)

2 Cameron, C., Meyers, L., and Olswang, S., Academic Bills of Rights: Conflict in the Classroom, 31 Journal of College and University Law 243, 251. (2005)

3 *Id.*

4 Martin v. Parris, 805 F.2d 583, 584 (5th Cir. 1986).

5 Eisenstein, K., *First Amendment Protected Speech in an Academic Environment*, 80 University of Detroit Mercy Law Review 275, 277 (Winter 2003).

6 391 U.S. 563, 88 S.Ct. 1731, 1 IER Cases 8, 20 L.Ed.2d 811 (1968)

7 *Id.* at 568

8 *Id.*

9 385 U.S. 589, 87 S.Ct. 675, 17 L.Ed.2d 629 (1967)

10 385 U.S. at 603

11 *Id.*

12 *Id.*

13 *Id.* at 1202

14 "[T]o assess the extent to which a state may regulate the speech of its employees, courts must balance 'the interests of the employee, as a citizen, in commenting upon matters of public concern and the interest of the State, as an employer, in promoting the efficiency of the public services it performs through its employees.' " Morris v. Lindau, 196 F.3d 102, 109-110 (2d Cir.1999) (quoting Pickering v. Board of Educ., 391 U.S. 563, 568, 88 S.Ct. 1731, 20 L.Ed.2d 811 (1968)). "Before this balancing test is reached," a court must first assess whether the plaintiff has "initially demonstrate[d] by a preponderance of the evidence that: (1)[her] speech was constitutionally protected, (2)[s]he suffered an adverse employment decision, and (3) a causal connection exists between [her] speech and the adverse employment determination against [her], so that it can be said that [her] speech was a motivating factor in the determination." Id. at 110 (citing Mount Healthy City Sch. Dist. Bd. of

Educ. v. Doyle, 429 U.S. 274, 283-87, 97 S.Ct. 568, 50 L.Ed.2d 471 (1977)). Once this burden is met, "the defendant has an opportunity to show by a preponderance of the evidence that it would have taken the same adverse employment action 'even in the absence of the protected conduct.' "

15 *Blum v. Schlegel*, 830 F.Supp. 712, 85 Ed. Law Rep. 1109, (W.D.N.Y.1993).

16 461 U.S. 138, 103 S.Ct. 1684, 75 L.Ed.2d 708 (1983))

17 *Id* at 1691

18 *Id.* at 1684.

19 *McKinley v. City of Eloy*, 705 F.2d 1110, 1114 (9th Cir.1983)

20 *Conaway v. Smith*, 853 F.2d 789, 796 (10th Cir.1988)

21 *Gardetto v. Mason*, 100 F.3d 803, 812 (10th Cir.1996).

22 *Hulen v. Yates*, 322 F.3d. 1229 (Tenth Cir. 2003).

23 *Id.*

24 *Id.* at 1238.

25 *Id.*

26 *Id.* at 1233.

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27 *Id* at 1238.

28 830 F.Supp. 712 (W.D.N.Y.1993)

29 *Id* at 731.

30 403 F.3d 691 (Ninth Cir. 2005).

31 *Id.* at 700

32 *Id.*

33 *Id.*

34 282 F. 3d. 1031 (8th Cir. 2002)

35 *Id.* at 1037

36 *Waters v. Churchill,* 511 U.S. 661, 114 S.Ct. 1878 (1994).

37 *Id.* at 674.

38 114 S.Ct. at 1887, 1890.

39 52 F.3d 9 (2nd Cir. 1995.)

40 *Id.* at 11.

41 *Id.*

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42 *Id.* at 585.

43 *Id.*

44"There is no doubt that Martin's epithets did not address a matter of public concern. One student described Martin's June 19, 1984, castigation of the class as an explosion, an unprovoked, extremely offensive, downgrading of the entire class. In highly derogatory and indecent terms, Martin implied that the students were inferior because they were accustomed to taking courses from inferior, part-time instructors at Midland College. The profanity described Martin's attitude toward his students, hardly a matter that, but for this lawsuit, would occasion public discussion. Appellant has not argued that his profanity was for any purpose other than cussing out his students as an expression of frustration with their progress-to "motivate" them-and has thereby impliedly conceded his case under Connick. Id.

45 241 F.3d 800, 2001 Fed.App. 0057P, 151 Ed. Law Rep. 387, 142 Lab.Cas. P 59,159 (2001)

46 *Id.* at 803.

47 *Id.*

48 *Id.* at 811.

49 *Id.*

50 *Id.* at 825.

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51 *Hardy v. Jefferson Community College*, 260 F.3d 671, 17 IER Cases 1523, 156 Ed. Law Rep. 415, 2001 Fed.App. 0267P, 144 Lab.Cas. P 59, 418 (6th Cir. 2001)

52 *Id.* at 674.

53 *Id.*

54 *Id.*

55 *Id.* citing Connick v. Myers, 461 U.S. 138, 103 S.Ct. 1684, 75 L.Ed.2d 708 (1983)

56 *Trejo v. Shoben*, 319 F.3d 878 (7th Cir. 2003)

57 393 U.S. 503, 89 S.Ct. 733, 49 O.O.2d 222, 21 L.Ed.2d 731 (1969)

58 *Id.* at 735

59 *Id.* at 737.

60 159 F.3d 199 (6th Cir. 1998)

61 *Id.* at 201-202.

62 *Id.* at 203.

63 *Id.* at 206.

64 308 F.3d 939 (2002)

65 *Id.* at 951

66 *Brown v. Li*, 308 F.3d 939 (9th Cir. 2002).

67 356 F..3d 1277 (10th Cir. 2004)

68 *Id.* at 1290.

69 *Id.*

THEY EAT HORSES, DON'T THEY? THE AMERICAN HORSE SLAUGHTER PREVENTION ACT

by

Donna Sims*

"The measure of a society is how well it treats its animals."[1]
Barbara Righton

I. INTRODUCTION

Congress has historically exhibited a significant interest in the welfare of the nation's horses. The recent debate over attempts to end the slaughtering of horses in the United States that are exported for consumption to Europe and Japan has ended at least temporarily, in a modern coup d'e'tat pitting Congress and numerous animal welfare groups, against the United States Department of Agriculture (USDA)[2]. The losers unfortunately, in this ongoing battle of wills are the 80,000 horses slated for slaughter at three U.S. slaughterhouses which continue in operation despite the clear intent of Congress.

II. BACKGROUND

The horse has a long and intimate history with mankind in general and in particular with the development of the Americas. The Western Hemisphere had not seen horses since the end of the Ice Age (circa 10,000 B.C.). Christopher

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Columbus brought horses to the New World in 1492, followed by Hernando deSoto and Francisco Vasquez deCoronado in 1540. Those horses and other escaped horses of early settlers formed the foundation of wild horses that roamed the western plains in the centuries to follow.[3]

That the horse has occupied a significant role in the history and development of United States is irrefutable.[4] Horses were used as the principal means of transportation until the arrival of the steam train in the mid 1800's. They served as riding mounts, pulled wagons and carts, and even provided the power for the first railed, trolley cars in many eastern cities. Known as the "Horse Railroad", early statutory regulations provided the foundation for later regulation of the steam rail system.[5] The horse was an essential component of the settlement and expansion of the western territories. Covered wagon trains not only moved families west but also evolved into the central means for transportation of goods across the country. They were a major business before the railroad tracks were laid and thousands of wagons, usually drawn by six horses each, pulled loads of up to eight tons. Even the short-lived "Pony Express" has contributed to the romantic saga of the American horse and its rider.[6]

Horses proved their value to the early settlers and to farmers well into the twentieth century, as a tool of agriculture. It was not until after World War II that the horse was almost entirely replaced by equipment driven by internal combustion engines. James Watt, better known for his association with the electric measurement associated with his name, invented the term "horsepower" in 1782.[7]

III. HORSE INDUSTRY TODAY

The advent of the industrial age and the age of technology have not diminished the American enthusiasm for horse ownership.[8]The American Horse Council[9] is a national organization representing horse business interests and the promotion of associated horse industries. Its not-for-profit arm, The American Horse Council Foundation has conducted numerous studies designed to recognize the value of the horse industry in the United States. Its most recent report[10], researched and prepared by Deloitte & Touche USA LLP[11] estimated that the horse industry annually generates approximately $102 billion for the United States economy. With approximately 9.2 million horses in the U.S. and almost 2 million people owning horses, equines are big business.[12]

IV. REGULATORY HISTORY

Since the initial passage of the Wild Horse Annie Act[13] in 1959, Congress has made it clear that the protection of the nation's horses is a high priority. A single individual, Velma Johnston (who later came to be referred to as Wild Horse Annie) launched a campaign alerting the American public to the plight of wild horses. At that time it was a common practice for ranchers and hunters to round up and capture horses and burros on public lands through the use of both motor vehicles and helicopters. Public Law 86-234 which became law on September 8, 1959 prohibited these practices. Congress continued to respond to objections to the treatment of horses with the adoption of the Horse Protection Act[14] in 1970. In fact, the initial focus of the act under Congress's enumerated powers, limited the transportation in interstate and foreign commerce of horses that were "sored" for show purposes. "Soring" was a practice common to the showing of gaited horses. Trainers apply caustic materials to the inside of the hoof; causing burns which make the "sore" horse raise the front feet in order to get away from the pain. Other methods include the placement of nails, screw or ball bearings into the sensitive part of the hoof and hoof wall: again causing the horse to exhibit a high lift in the front. When the Senate Committee on Commerce, Science and Transportation met in 1973 in an oversight hearing, considerable testimony was offered regarding the deficiencies and inadequacy of USDA enforcement of the Act in light of the continuing widespread practice of soring. The discussion recommended provisions for horse examination and enforcement procedures.[15] The Horse Protection Act was amended in 1976 with support from both the House H.R. 6155 and Senate S.811, providing for more effective enforcement, by imposing criminal sanctions and increasing the funding for enforcement.[16]

Subsequent to the Horse Protection Act Congress passed the Wild Free-Roaming Horses and Burros Act in 1971.[17]The impetus behind this piece of legislation was the growing public awareness and concern over widespread slaughter of wild horses and burros for use as pet food, which reduced their numbers to a few thousand. Responsibility for oversight and maintenance of the wild herds was placed with the Bureau of Land Management (BLM).

The Bureau of Land Management has come under scrutiny because of problems with its horse sale and adoption program. In April 2005 BLM officials discovered that six wild horses that had sold for $50 a head to "an Oklahoma man posing as a minister and promising to provide humane care for the horses, resold the animals less than a week later to meatpacker Cavel International in Dekalb, Illinois."[18]Another thirty-five horses were slaughtered at Cavel after the Rosebud Sioux tribe of South Dakota sold fifty-one horses to a horse broker. "Tribal officials said they did not realize the broker would sell the horses to slaughter".[19] Although the terms prohibit sale for slaughter with both a maximum fine of $20,000 and/ or five years in prison, BLM found itself unprepared to monitor the future well being of horses once sold, and suspended sales after the discovery.

V. THE U.S. HORSE MEAT INDUSTRY

Although federal law does not ban[20] eating horse meat in the United States, the meat is no longer sold for human consumption.[21] During World War II, New Jersey legalized the sale of horse meat for that purpose, presumably because of the low supply and high price of beef; but it was again outlawed at the war's end. Horse meat has not been used in the production of pet food since the early 1980's, because the common wormer used for horses, Ivermectin, caused deaths in many breeds of dogs. [22] Ivermectin and other equally lethal worming products and medications are used today as a part of regular horse care: some even on a daily basis. Even if the American public had a taste for horse meat, it would not pass current FDA standards. If horse meat is not fit for human or dog consumption in the United States, why is it shipped out of the country for human consumption elsewhere? Proponents of the ban on horse slaughter have raised this issue with regulatory agencies and lawmakers to no avail.[23]

Statistics from the USDA show that over 3.3 million horses have been slaughtered domestically since 1985, with peak years of 1986 to 1992. The following table excludes live horses that were exported to Mexico, Canada or Japan for slaughter. Figures for 2006 through June 24 show that 47,654 horses have been slaughtered to that date.

Table 1.

Year	***Head***	***Year***	***Head***	***Year***	***Head***
1985	128,300	1992	246,400	1999	62,813
1986	202,100	1993	167,310	2000	47,134
1987	275,700	1994	107,029	2001	56,332
1988	331,000	1995	109,225	2002	42,312
1989	348,400	1996	103,687	2003	50,564
1990	345,700	1997	87,154	2004	65,986
1991	276,900	1998	72,120	2005	94,011

The three horse slaughterhouses in the U.S. are Cavel International located in Dekalb, Illinois, Beltex of Fort Worth, Texas and Dallas Crown of Kaufman, Texas. All three plants are Belgian owned and it is reported that all three generate $29 million in annual foreign sales.[24] The two plants in Texas employ about 150 local employees and spend at least $6 million yearly in refrigerated shipping expenses through the Dallas/Fort Worth Airport.[25]

VI. CURRENT LEGISLATION

Beginning in 2002 Congress has attempted to address the ongoing and increasingly disturbing issue of horse slaughter in the U.S.[26] The proposed legislation was sponsored by Representative Constance Morella.[27] Although the bill was unsuccessful in the 2002 session, it was reintroduced again in 2003 as 108 H.R. 857, and in the Senate in 2004 as 108 S. 2352. Congress again considered the current versions, S. 1915 and H.R. 503 for passage in 2006.

In June 2005 the U.S. House voted 269 to 158 and in September the Senate voted 69 to 28 to pass an amendment to the 2006 Agricultural Appropriations bill that removes funding for the USDA for one year to conduct inspections at the three U.S. horse slaughterhouses and for border inspections of slaughter bound horses.[28] Both of the provisions referred to in this amendment deal with the inspection of horses before slaughter, which is delineated as ante-mortem inspection in the Federal Meat Inspection Act (FMIA)[29] and the Federal Agricultural Improvement and Reform Act (FAIR)[30]. Each of these provisions recognizes that horses, like cattle are slaughtered for human consumption and are subject to before or pre slaughter inspections. Although both pre and post mortem inspections are permitted under the FMIA, it seems clear that Congress' failure to address the funding of post mortem inspections is reasonable since removal of funding for ante-mortem inspections should have brought horse slaughter to an end. Congressional intent was to put a stop to the slaughter of American horses.

While Congress and humane organizations were celebrating the success of the temporary halt to the slaughter, lobbyists for the three slaughterhouses quietly requested that the USDA establish a "fee for service" inspection program for horse slaughter in lieu of Congressional funding. The USDA proposed a plan to accommodate the slaughterhouses by using the Agricultural Marketing Act,[31] which permits a fee for ante and post mortem inspection of exotic animals such as bison, elk, and antelope. The USDA proposed new rules that would include horses in this program and allow the slaughterhouses to pay for the inspection services. Ignoring the notice and hearing procedures of the Administrative Procedure Act, the USDA went forward with the final rule claiming that "good cause" required it. An example of previous decisions of what constitutes "good cause" occurred in December 2003 when the USDA issued an emergency ruling banning the slaughter and sale of downer cows after the first confirmed case of mad cow disease.

Some members of Congress were outraged. In January 2006 Representative John E. Sweeney, (D-N.Y.) and thirty-nine members of Congress sent a letter to the Secretary of Agriculture Michael Johanns[32] expressing their intent for defunding the inspections, was for the purpose of stopping horse slaughter.

> "...We were shocked and deeply upset to learn that the agency has apparently decided it need not carry out Congress' clearly expressed intent to halt horse slaughter for human consumption in FY 2006, but rather, intends to engage in a complex regulatory maneuver to willfully circumvent legislation that was passed by an overwhelming majority of both the House and the Senate. ....Instead of deferring to Congress' intent, the agency appears poised to continue horse slaughter inspections under a different law. This action is in direct defiance of Congressional intent. ...As required by the 2006 Amendment, the agency must cease inspection of horses for slaughter. Failure to do so constitutes willful disregard of clear Congressional intent on the part of USDA. The agency has absolutely no authority to circumvent a Congressional mandate and effectively rewrite an unambiguous law at the request of the horse slaughter industry."[33]

While the USDA moved forward with its plan to implement the fee for service, the Humane Society of the United States and other animal welfare organizations, which included residents living near the three U.S. slaughterhouses, filed a lawsuit[34] to enjoin the USDA inspections under the fee for service plan. The same day the USDA filed an opposition to the group's request. The foundation for the claims filed by the plaintiffs (Humane Society of the United States and others) is that the USDA violated the Administrative Procedure Act[35] by expediting the notice and public comment period; abused its discretion and acted arbitrarily and capriciously in acting against Congressional intent[36] and it violated the National Environmental Policy Act[37] by not conducting an environmental assessment prior to creating the fee for service program. The court dismissed the claims relating to the expedited notice period and abuse of discretion on the grounds that the plaintiffs lacked standing to bring those claims.[38] The court found that the plaintiffs APA claims relating to Congress' defunding of ante-mortem inspections, "effectuates only a change in federal funding which does not in itself invoke the environmental, aesthetic, informational, or economic interests raised by any of the Plaintiffs in the instant case."[39] Although the court determined that the plaintiffs had standing to bring a claim under NEPA, it denied the motion for a temporary restraining order, preliminary injunction and hearing citing failure to satisfy the burden to show a substantial likelihood of victory on the merits.[40] The court further opined that the plaintiffs failed to demonstrate tangible, irreparable injury required for the issuance of a preliminary injunction. As a result of the decision, horse slaughter has continued without interruption.

VII. SUBSEQUENT ACTION

Debate continued in the House and Senate on H.R. 503 and S.1915 during the first six months of 2006. In July the U.S. House Energy and Commerce Subcommittee on Commerce, Trade and Consumer Protection held a legislative hearing that drew such a large crowd that the location was moved in order to accommodate the participants. Witnesses speaking against the bill raised the issue that slaughter provides horse owners with a humane means of disposing of unwanted horses which might otherwise face neglect and mistreatment.[41] After hearing additional testimony the House Agricultural Sub-committee voted 37-3 to "discharge the bill with disfavor and recommended that the House vote against it.[42] Despite this negative recommendation, the House passed H.R. 503 by a vote of 263-146 in September 2006. The Senate version, S.1915 languished without a vote as the second session of the 109th Congress ended. Two new bills, H.R. 503 and S. 311 were introduced in January 2007 at the opening of the 110th Congressional Session.

VIII. CONCLUSION

Clearly, the position taken by the USDA is one in conflict with the intent of Congress. Representative John Sweeney's January 2006 letter to the Secretary of Agriculture outlined the following conclusions:

> "Accordingly, we can only conclude that the USDA has special, and as of yet undisclosed, reasons for attempting to circumvent this particular de-funding mandate. We therefore request that you immediately provide our offices with copies of all agency documents with industry representatives – so that we can ensure that USDA is carrying out its duly assigned role of *implementing* congressional policy, rather than attempting to *determine or circumvent* such policy for itself." [43]

Representative Sweeney contends that congressional intentions are clear by pointing out that Congress on numerous occasions has used its ability to remove funding to "effectuate congressional policy on a number of subjects."[44] In a letter to the Committee on Agriculture Secretary Johanns made clear the USDA position, "Fourth, we do not believe that the Horse Protection Act, a law to prevent soring of horses in the United States, should be amended to prohibit a completely different type of activity."[45] While the court's dicta in *Humane Society* of *the United States v. Johanns* relates almost exclusively to procedural matters, in summarizing public interest arguments states, "Congress, which has taken a half-step to eliminate the existing programs."[46] It seems probable from these representations that should S.1915 be successfully adopted, the USDA would participate in, if not initiate action, to prevent its implementation.

ENDNOTES

[1] Barbara Righton, *All the Sad Horses,* Maclean's, Toronto, February 10, 2003, Vol. 116, No 6, at 38. "Unlike cats and dogs, who are cradled by their lifelong owners as they die on a vet's table and are then buried under the rose bushes, horses often live their lives from pillar to post. Horse-trading has always had a bad reputation because unsavory characters gull the uninitiated. Fair enough for the buyers, who ought to know better, but what about the dumb animals?"

[2] U.S.C. Title 7

[3] Gale Encyclopedia of U.S. Economic History, Eds. Thomas Carson and Mary Bonk, Vol1, Detroit, (1999).

[4] Webb Garrison, *Civil War Curiosities,* Famous Horses of the Civil War, www.civilwarhome.com/horses.htm, (2002). The military horse's rich history is infused within our nation's development. The relationship between a cavalryman and his horse was so important that part of the surrender terms at Appomattox in 1865 allowed each confederate cavalryman to take his horse home with him. General Robert E. Lee's favorite mount "Traveller" was a Morgan horse, a breed considered by many to be the second exclusive breed developed in the United States. Traveller is buried outside of the Lee Chapel at Washington and Lee University in Lexington, Virginia. A well known U.S. Army Recruiting Office slogan was, "The Horse Is Man's Noblest Companion – Join the Cavalry And Have A Courageous Friend."

[5] *New York, New Haven and Hartford Railroad Company v. City of New London,* 80 Conn. 623 (1908).

[6]Frank S. Popplwell, *The Spirit of the Pony Express,* www.ponyexpress.org/history.htm. The founders of the Pony Express were Russell, Majors and Waddell. The company, Central Overland California and Pike's Peak Express Company which operated from April 3, 1860 to October 1861 was a financial failure and was sold at auction in March 1862. "From the days of ancient Persia to dawn of modern history, horse and rider served to bind together the provinces of monarchy, empire and republic. In rain and in snow, in sleet and in hail over moonlit prairie, down tortuous mountain path...pounding pony feet knitted together the ragged edges of a rising nation."

[7]H.W. Dickenson, *James Watt – Craftsman and Engineer,* Cambridge University Press, 1936, at 145. Watt intended to market a steam engine that he had developed and was looking for a measurement tool that others would easily understand.[7] His unintentional legacy lives on in the automobile industry and engine power calculations from lawn mowers to vacuum cleaners.

[8]Jackson Turner Main, *Society and Economy in Colonial Connecticut,* Princeton University Press, (1983) at 177. Horse owners in Connecticut often quip "There are more horses here today than there were in colonial times." That statement may not be far off the mark. Comparing the 52,000 horses estimated to exist in the state today, historian Jackson Turner Main estimates that in the year 1730 the colony of Connecticut had a population of about 38,000. Since it is most probably not likely that each person owned a horse, but also possible that some part of the population owned multiple horses for agricultural and transportation purposes, an estimate of 38,000 colonial horses is not beyond reason.

[9] The organization's mission is to represent and promote the equine industry. It was founded in 1969 and today includes 195 member organizations and over 1,800 individuals.

[10] American Horse Council Foundation, *The Economic Impact of the Horse Industry on the United States,* (July 2005).

[11] Deloitte & Touche USA LLP is the U.S. member firm of Deloitte Touche Tohmatsu. In the U.S., services are provided by the subsidiaries of Deloitte & Touche USA LLP (Deloitte & Touche LLP, Deloitte Consulting LLP, Deloitte Financial Advisory Services LLP, Deloitte Tax LLP, and their subsidiaries), and not by Deloitte & Touche USA LLP.

[12] The study breaks down usage into the following categories; 844,500 used in racing, 2,719,000 used in showing, 3,906,900 used in recreation and 1,752,440 used in other activities. It further ranks horse numbers by state with Texas, California, Florida, Oklahoma and Kentucky respectively, coming in as the top five nationally

[13] Wild Horse Annie Act, §18 U.S.C. §47 (1959).

[14] 15 U.S.C. § 1821 et seq.(Dec.9, 1970). The initial purpose of the Horse Protection Act was to prohibit the transportation or showing of horses that were injured through "soring" to alter the gait for show purposes.

[15] Legislative History of P.L. 91-540, 74 C.I.S. S261 27, (1973).

[16] *Id.* at 76 C.I.S. H. 501 16 (1975).

[17] 16 U.S.C. §1331 et seq. (1971). "Congress finds and declares that wild free-roaming horses and burros are living symbols of the historic and pioneer spirit of the west; that they contribute to the diversity of life forms within the Nation and enrich the lives of the American people; and that these horses and burros are fast disappearing form the American scene. It is the policy of congress that wild free-roaming horses and burros shall be protected from capture, branding harassment, or death; and to accomplish this they are to be considered in the area where presently found, as an integral part of the natural system of public lands." (Public Law 92-195, Dec. 15 1971, 85 Stat. 649).

[18] Samantha Young, *BLM Sale Program: 427 Wild Horses Seeking Homes, Potential Buyers back out after Agency Imposes Fines for Selling Animals to Slaughter,* Las Vegas Review-Journal, October 31, 2005, at 2.

[19] *Id.*

[20] Marsha A. Levine, *Eating Horses: The Evolutionary Significance of Hippophagy,* Antiquity Publications, Ltd., March 1, 1998. This is the quintessential oxymoron: we do not eat horses in the United States. In fact many would consider it downright un-American. The foundation for our widespread abhorrence to horse eating may have its roots in early Christianity. In 732 Pope Gregory, in an effort to stop the pagan practice of animal sacrifice, and the subsequent eating of the sacrificed animal, forbid

the eating of horseflesh. While these early taboos may contribute to the evolution of our present "distaste" for horse flesh, there is a widespread consensus that the horse is treasured by the American public for its contributions to our nation's growth and history. The Equine Protection Network, a horse slaughter awareness group that publishes opinion polls on horse slaughter, reports that overwhelmingly the American public is opposed to horse slaughter for food and in many cases is not even aware that horses are being slaughtered in the U.S. for export overseas.

[21] Mary Jacoby, *Why Belgians Shoot Horses in Texas for Dining in Europe; Grass-Fed Meat is Superior, But Slaughterhouses Draw Growing Criticism in U.S.,* Wall Street Journal, September 21, 2005, at A.1.

[22] Reader Mail, The American Spectator, March 31, 2006 at 1.

[23] It should be noted that not all horse meat is shipped out of the country. A small percentage of meat is sold to U.S. zoos for their big cat population and other carnivores because of its high protein content.

[24] Barry Shlachter, *Horse plants to pay for inspections,* Fort Worth Star-Telegram, March 10, 2006, at 1.

[25] Shlachter, *supra* note 24 at 1.

[26] 107 H.R. 3781, (2002). Synopsis: A bill to prevent the slaughter of horses in and from the United States for human consumption by prohibiting the slaughter of horses for human consumption and by prohibiting the trade and transport of horseflesh and live horses intended for human consumption, and for other purposes.

[27] Representative Constance Morella,(R- M.D.) "Mr. Speaker, today I join my colleagues, Mr. Gilman, Mr. Chris Smith, Mr. Jones, Mr. Pallone, and Mr. Lantos to introduce the American Horse Slaughter Prevention Act. This bill will prevent the cruel and senseless slaughter of American horses simply to satisfy the culinary desires of consumers in Canada, Europe, Japan and elsewhere. According to the U.S. Department of Agriculture, 55,776 horses were slaughtered in the United States last year for their meat, which was then sent overseas for human consumption. Thousands more were shipped live across the borders to Canada and Mexico for slaughter there.

The American public is largely unaware that our horses are slaughtered for human consumption, and the three foreign- owned slaughterhouses operating on U.S. soil would like to keep it that way. As Canadian slaughterhouse operator Claude Bouvry said, "People in the horse-meat industry don't like talking about slaughtering horses for food because of the horse's almost mythical place in Western culture."

.... While the transport of horses to slaughter is itself horrific, callous handling at the slaughterhouse often results in additional suffering. Improper use of stunning equipment, designed to render the animal unconscious, means that horses sometime endure repeated blows to the head, and remain conscious through the last stages of slaughter, including throat slitting.

There are human health reasons to be concerned about horse slaughter, too. Because they are not raised for food or fiber, the flesh of many horses going to slaughter is likely to be contaminated with medications and other substances unfit for human consumption.

Americans do not eat horses. We do not raise them for food. The vast majority of Americans, when told that our horses are being slaughtered for dinner in Europe, are horrified. In fact, a recent survey indicated that the American public would overwhelmingly support a ban on the slaughter of horses for human consumption.

The American Horse Slaughter Prevention Act is a strong bill, which will end the slaughter of our horses for human consumption for good, rather than simply sending the practice over the border. This bill has the support of the American public, the animal protection community, horse owners and prominent members of the horse industry. Mr. Speaker, as we enter the Year of the Horse I urge my colleagues to join me in supporting this important and long-overdue legislation."

[28] Agriculture Appropriations Act, FY 2006. "Effective 120 days after the date of enactment of this Act, none of the funds made available in this Act may be used to pay the salaries or expenses of personnel to inspect horses under section 3 of the Federal Meat Inspection Act (21 USC §603) or under the guidelines issued under section 903 of the Federal Agricultural Improvement and Reform Act of 1996."

[29] Federal Meat Inspection Act, 21 U.S.C § 603.

[30] Federal Agricultural Improvement and Reform Act, 9 C.F.R. § 309 et seq, 1996.

[31] Agricultural Marketing Act, 7 U.S.C. § 1621.

[32] Michael Owen Johanns grew up in an Iowa family of dairy farmers. A practicing attorney, he began his Republican political career in 1983 in Lincoln, Nebraska and served two terms as Nebraska's governor from 1999 to 2005, until his nomination by President George W. Bush for U.S. Secretary of Agriculture in 2005.

[33] Letter from John E. Sweeney, Member House of Representatives, to Michael Johanns, Secretary United States Department of Agriculture (January 17, 2006).

[34] *The Humane Society of the United States v. Johanns,*
No. 06-265, U.S. Dist. DC, (Memorandum Opinion March 14, 2006).

[35] Administrative Procedure Act, 5 U.S.C. § 553 (2000).

[36] *Id.* at 5 U.S.C. § 706.

[37] National Environmental Policy Act of 1969 , 42 U.S.C. § 4321 (1970).

[39] *Humane Society of the United States,* at 8.

[40] *Id.* at 20.

[41] Amanda Duckworth, *Federal Hearing on Horse Slaughter Draws Large Crowd,* The Blood Horse, July 2006, at 13.

[42] Chad Mendell, *Agriculture Subcommittee Strongly Disapproves of Slaughter Bill,* The Blood Horse, July 2006, at 19.

[43] Sweeney, *supra* note 33 at 13.

[44] *Id.*

[45] Letter from Michael Johanns, Secretary United States Department of Agriculture, to Bob Goodlatte, (R-VA) Chairman, Committee on Agriculture House of Representatives, (Sep. 6, 2006).

[46] *The Humane Society of the United States v. Johanns,*
No. 06-265, U.S. Dist. DC, (Memorandum Opinion March 14, 2006).

FINANCIAL ACCOUNTING STANDARDS BOARD STATEMENT 123 (R): THE EXPENSING OF OPTIONS

By

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Introduction

In the 1980's Nelson Pelz benefited greatly from Michael Milken's junk bond financing. Pelz successfully bought and sold Triangle Industries. He then turned his attention to obtaining control of Triarc Companies, owner of Arby's, R.C. Cola and other brands. At the time of acquisition the market priced Triarc at $18 per share. Pelz immediately granted himself options on 600,000 shares at that price exercisable over the following decade. Under Pelz's leadership the price of the stock dropped to half its former value leaving

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Pelz's options under water. Pelz then announced that his salary would be $1 per year but took an additional 75,000 options at the new price level. As the stock struggled along at the new price, Pelz took monthly options grants that eventually totaled almost three million shares. The stock eventually recovered a portion of its original price and Pelz was able to exercise his options and gain a seven million dollar personal profit[1]. Pelz had managed to reward himself well for what can be referred to at best as mediocre executive performance. Pelz's case is only one of many that took place before the stock market crash of 2000.

The Financial Accounting Standards Board (FASB) now requires that stock options be reported as an expense on the corporation's income statement. However, it is the authors' contention that this treatment is not theoretically sound. Stock options are, in fact, a redistribution of equity from existing shareholders to option recipients. The proper way to record these options would be similar to the method in which stock dividends are recorded, i.e. as a decrease in retained earnings and an increase in paid-in-capital.

An option may be defined as the right (but not the obligation) to buy a set number of shares of stock at a specific, fixed price by a specific date in the future[2]. This is known as a call option. A put option gives the holder the right to sell a set number of shares of stock at a specific, fixed price by a specific date in the future[3]. Options have been used since the days of Benjamin Graham, mentor at Columbia University to Warren Buffett. Graham believed a grant of options would offer a small financial incentive to executives when good management performance was reflected in increased stock price. Most options grants in the earlier days resulted in an additional $10,000 to $15,000 to successful executives.

By the 1980's the options landscape had changed considerably. Founders of high technology companies were usually short on funds to lure talent away from larger companies such as IBM or Hewlett Packard. As an added incentive, new hires were given an ability to grow with the new companies through grants of options. Many young engineers and computer scientists became millionaires in a few short years through the exercise of these grants during the stock market increases of the 1980's and 1990's. CEO's, especially in Silicon Valley, were almost uniformly given tens of thousands of options grants annually. The companies were attempting to align the performance of the executives with the interests of the stockholders[4]. Not surprisingly, accounting rules were often bent and stretched to maximize earnings and inflate stock prices. Even after the sharp decline in stock values after March 31, 2000, Silicon Valley industries have remained the staunchest proponent of both options grants (even at lower re-pricing) and as against expensing their cost on the earnings reports.

Accounting for Stock Options

The October 1972 Accounting Principals Board Opinion No. 25 (APB 25) became the first accounting standard written specifically for stock options[5]. A measurement date concept determined the value of options. Using the intrinsic value method to calculate this amount, the "charge to earnings was equal to the excess of the fair market value of the stock at that date over the amount payable by the employee, if any", the amount being determined on the measurement date, or "the first date on which both the number of shares and the price to be paid...are fixed"[6] . But companies used fixed options to find ways around recording stock option expenses. This was accomplished by setting the exercise price equal to the fair market value on the date of grant.

Two different forms of options, incentive stock options and nonqualified stock options, offer varying advantages and drawbacks. Incentive stock options are "qualified" stock options because they qualify to receive special tax treatment. The employee can defer income tax on the qualified options, past the grant and exercise dates, to the date of sale. The difference between the exercise (strike) price and the sale price is then taxed at the capital gains tax rate if the sale occurs after completion of the holding period.[7] However, if the sale occurs before the completion of the holding period, the difference between the exercise price and the fair market value of the stock at the time of option exercise is taxed at the employee's ordinary income tax rate. Since the employee receives special tax treatment for the incentive option, the company is not allowed to receive a tax deduction for the value of the option. Employers offering incentive stock options are able to attract and keep talented employees without the cash drain from paying higher salaries.

Several different conditions must be met for an option to qualify as an incentive stock option. Section 422 of the Internal Revenue Code requires that the options:

- Be granted to employees only;
- Be exercised by any employee during employment or prior to three months from termination of employment;
- Be for the issuing company, its parent company, or any of its subsidiaries.
- Be under a written plan, which must be approved by the stockholders within 12 months before or after plan adoption;
- Be granted within 10 years of the earlier of adoption or shareholder approval, and...exercisable only within 10 years of grant;
- Be of equal or higher value than the fair market value of the underlying stock at the time of grant;
- Not be issued to any employee owning stock with greater than 10% of the voting power of all stock outstanding...unless the option exercise price is at least 110% of the fair market value and the option is

not exercisable more than five years from the time of the grant;

- Not be transferable by the option holder other than by will or by the laws of descent and that the option cannot be exercised by anyone other than the option holder;
- Not have an aggregate fair market value exceeding $100,000 in a calendar year. [8]

Stock options that do not meet these conditions are nonqualified stock options. These options have little tax benefit for employees, but are tax deductible for the employer. As indicated above the employee must pay income tax on the spread between the grant price and the stock's market value [9] on the date of exercise; this same amount can then be deducted from the employer's taxes. A distinct disadvantage of nonqualified stock options results from the employee having to report income even if, as he or she holds the stock, the market crashes and the stocks lose value. In this case the employee cannot offset the income previously reported.

Since they did not have to worry about the expense associated with fixed options, companies disbursed large amounts of options to employees. Executives received nearly their entire compensation in the form of options. Executive had an incentive to increase the value of the stock within the vesting period in order to sell them at a later date. Since stock options were the basis of most accounting frauds during this period, the Financial Accounting Standards Board (FASB) implemented Statement No. 123 [10]in order to influence employers to report the impact of options on the corporations' financial statements.

FASB 123

As early as 1984, the FASB searched for ways to update APB 25 to fit the needs of the modern corporation and its investors. In 1995, they attempted to implement Statement 123, which required companies to expense the value of all employee stock options granted. The value of the options was calculated using the Black-Scholes valuation method and then amortized...over the expected period of benefit, which is usually the period from the date of the grant to the date of vesting [11].

The impact on the financial statements can be understood by an illustration. Assume 1,000 options are granted with a two-year vesting period, a $5 exercise price, and that the options are exercised in the third year after the grant when the market value of the stock is $16 per share. Assume also that the fair value of the options using the Black-Scholes model is $15 per share. The net impact on the income statement and the balance sheet after the three-year period will be a reduction in net income of $15,000-the fair value of the options, and an increase in paid-in capital of $20,000-the $16 per share market value at the date of the exercise plus $4 per share- the difference between the $15 fair value per share deducted from the difference between the $16 market value and the $5 cash received upon exercise

*The fall of FASB 123*s

After the attempted implementation of Statement 123, the FASB received harsh criticism from companies and members of Congress. The new regulation would greatly reduce earnings and high-tech executives, led by John Doerr, the venture capitalist...engineered a public rally to demonstrate the supposedly grassroots support for stock options.[12] The outcry continued as members of Congress slowly began pressuring the Board to change their position on stock options. Since the FASB feared it would lose its private-sector, standards-setting authority, [13] they relented and made Statement 123 voluntary. Companies could comply with Statement 123 or use APB 25; however, with APB 25, companies still hade to make pro forma footnote disclosures stating what the financial statements (in particular, net income and earnings per share) would be using Statement 123 and how many options were unexercised.

Legislative Attempts

In order to further weaken the FASB's authority high tech companies lobbied members of Congress to bypass the FASB by passing options legislation. The House of Representatives on July 20, 2004, passed HR-3574, the Stock Option Reform Bill by a vote of 312-111.[14] The legislation required expensing only the five largest individual option grants, presumably received by the top executives. Stock option grants to other employees were subject only to a footnote in the annual report. The bill further reduced the price volatility assumption underlying the "fair value" method of expensing option to zero, which meant that the price of any of the stock involved was not presumed to fluctuate.

This bill was harshly criticized by the public at large. The most common complaint was that expensing some options and not others would give an even more distorted financial picture of the corporation. The Chairman of the Senate Banking Committee, Sen. Shelby of Alabama, voiced his immediate opposition to the House bill and the bill never made it out of committee in the Senate.

The FASB's inability to require Statement 123 led to extensive debate between the supporters and opponents of expensing stock options. Slowly the Board gained the support of the investment industry which emboldened them to reconsider the statement. They issued Statement 123(R) which required companies to expense stock options for reporting periods beginning after June 15, 2005.

Effects of FASB 123(R)

Corporations, and particularly high tech corporations, took several steps in anticipation of the new rule. Many accelerated the vesting period for option grants so they would not be expensed.[15] Some corporations began to phase out stock options for new employees. Microsoft for example, discontinued stock option grants and replaced them with outright grants of restricted stock. The use of option grants in hiring declined, which would suggest that now it is more difficult to hire new, talented employees.

Ironically, grants to higher management have increased rather than decreased[16]. This has become evident due to the visibility of options in quarterly financial statements.[17] Expensing stock options reduces reported earnings and as a result, opponents expected the value of corporate stock to decline. However, expensing stock options has not resulted in a decline in the stock market nor damaged the economy. To the contrary in the first quarter of 2006, the S & P 500 Index rose nearly five percent.

Conclusion

It is our position that employee stock options should not be reported as an expense on the corporate income statement. In support of this Statement of Financial Accounting Concepts 5 states that "expenses and losses are generally recognized when an entity's economic benefits are used up in delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations or when previously recognized assets are expected to provide reduced or no further benefits"[18] . Utilizing this explanation, opponents of expensing argue that stock options do not fit under the requirements to be classified as an expense; they are not part of the operations of the company, not the main business activities that generate revenues or use assets.

Also, expenses are sometimes described as costs relating to transactions with third parties. Since the stock options in question are given to employees, technically the two parties involved are both part of the same entity. In this situation neither corporate assets nor corporate liabilities have changed, total equity remains unchanged…but total equity has been redistributed[19]. Expenses normally result in use of an asset or a creation of a liability. Stock options do not produce either of these results, and therefore should not be classified as expenses. An additional criticism is that expensing employee options results in an income statement equation which is inconsistent with generally accepted accounting principles, i.e., Revenues – Expenses – Stock = Net Income. The normal equation is that Revenues – Expenses= Net Income.

Stock options should be reported in the same way as stock dividends, i.e. as a redistribution of retained earnings. The impact on the financial statements can be understood using the same data as in our earlier example. Under our proposal, at the end of the third year after the option grant date, the income statement would be unchanged. Recall that under Statement 123(R) net income was lower by $15,000. Under our proposal paid-in capital on the balance sheet would increase by $20,000 and retained earnings would decrease by $15,000, the same as Statement 123 (R). The difference is that under our proposal the $15,000 reduction in retained earnings does not appear on the income statement as an expense; it is a direct reduction in retained earnings. The net income reflects the results of operations and not the redistribution of equity by means of a stock option. This provides a more representative income measure which better serves the investment community.

ENDNOTES

[1] Origins of the Crash; The Great Bubble and its Undoing, Roger Lowenstein, The Penguin Press, New York, NY, 2004, pp.37-38.

[2] Getting Started in Options, Michael C. Thomsett, John Wiley and Sons, New York, NY, 3rd Ed, 1997, p. 12.

[3] Id at pp. 13-14.

[4] Infra, footnote 1 at pp. 15-34.

[5] APB Opinion No. 25 Accounting for Stock Issued to Employees, Financial Accounting Standards Board Original Pronouncements, John Wiley and Sons, Inc, New York, NY, 1995-96.

[6] Id p. 286.

[7] Id

[8] Id

[9]Id

[10] FASB No 123 Accounting for Stock Based Compensation, Financial Accounting Standards Board, Norwalk, CT. 1995.

[11] Financial Accounting: An Introduction to Concepts, Methods, and Uses, Clyde P.Stickney, Roman L. Weil, 11th Ed., Willard, Ohio. 2005, pp. 536-538.
[12] Infra, footnote 1 at p. 44.

[13] "Stock Option Accounting: Defying the Usual Answers," Gregory J.Baviers, and Larry M.Walther, The CPA Journal, April 2004, pp. 36-39.

[14] Accounting for Employee Stock Options, Douglas Holtz-Eakin, Congressional Budget Office, pp.5534-37.

[15] "Tech Companies Give Stock-Options Value, and Actually Survive," Lee Gomes, The Wall Street Journal, March 22, 2006, p. B1.

[16] Id

[17] Id

[18] Statement of Financial Accounting Concepts No. 5 Recognition and Measurement in Financial Statements of Business Enterprises, Financial Accounting Standards Board, Norwalk, CT. 1984, p.31.

[19] Infra footnote 14 at p.37.

USING "THE LETTER" AS A DEVICE TO TEACH ETHICAL PRINCIPLES IN A LAW CLASS

by

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INTRODUCTION

In teaching courses in the Legal Environment of Business or other law courses, one popular assignment is to assign a movie with legal themes as a writing project. Students are provided with a list of movies containing legal issues and each chooses a film about which to write a five to seven page paper due at the end of the semester.

Students often ask what they should be looking for when they view the film. They are instructed to provide a brief discussion of the characters and plot (no more than a paragraph or two) but that the main focus of the assignment is their ability to recognize the legal and ethical dilemmas presented and to relate them to specific topics covered in the class.

To aid the students in their work on this project, I show a movie called The Letter[1] in class. The movie is based on a novel written by Somerset Maugham concerning the murder of one Jeff Hammond at the hands of Leslie Crosby, played by Bette Davis. The latter is married to Robert Crosby played by Herbert Marshall.

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The Plot

The setting of the story is a rubber plantation in Singapore.

The story opens with a quiet moonlit night punctured by three shots fired by Leslie. She reports "There has been an accident and Mr. Hammond is dead."

Her claim is that Hammond tried to make love to her against her will so she shot him.

The focus of the lesson to be learned from this film is the behavior of lawyer Howard Joyce, played by James Stephenson.

Leslie told the following story to her husband and Joyce. She was surprised to see Hammond because her husband Robert was not at home. Leslie said that Hammond told her that she had pretty eyes and that she was the prettiest thing he had ever seen. She claimed Hammond tried to take one of her hands saying, "Don't you know I am terribly in love with you." Leslie suspected Hammond was drunk and said, "If you don't leave immediately I'll call one of the boys to throw you out". According to her account he then grabbed her arms and kissed her. Then he picked her up and tried to carry her away. She then grabbed her husband's revolver, which he left in the house whenever he was away.

Attorney Joyce advised Leslie and Robert that she should go to the Attorney General and tell him her story. Joyce told her that only possible charge was murder and that bail could not be obtained.

Detective Withers was impressed with Leslie's story but admitted that Hammond was likable. Joyce was skeptical. He questioned whether Hammond was the type to make the advances that Leslie had claimed and questioned her about the fact that some of the shots were clearly fired while Hammond was lying on the ground, an issue that he warned her was sure to come up later.

The Ethical Dilemma

Joyce was a principal in the Singapore law firm of Joyce and Spencer Counselors at Law. Joyce had a clerk named Ong, an Asian who notified the lawyer of the existence of a letter written by Leslie to Hammond, on the day of the murder.

While Leslie had stated that she had no contact with Hammond for several weeks, the letter indicated otherwise. Ong suggested that the letter might be of interest to the prosecution. Joyce brought a copy of the letter to the prison where Leslie was incarcerated pending trial.

Joyce reminded Leslie that every time she told her story, she told it exactly the same way. Either she had an excellent memory or she was telling the unvarnished truth, Joyce opined. She said she had a poor memory.

Joyce told her that there was a letter in her handwriting asking Hammond to come to see her as "Robert is going to be away."

Leslie swore she did not write the letter but as the lawyer was about to leave, she admitted it. She claimed that she wrote Hammond asking him to order a gun for her husband's birthday. The contents of the letter however undermined her story:

> "Robert will be away for the night. I absolutely must see you. I am desperate and if you don't come, I won't answer for the consequences". Don't drive up."

Joyce said that her told Robert he was sure of an acquittal and that it was the duty of counsel to defend his client, not to convict her, even in his own mind. "I don't want to tell anything but what's needed to save your neck." He warned her what would happen if the jury did not believe that she acted in self-defense.

Leslie suggested that Joyce could get the letter but Joyce told her that he could not do what she asked because a lawyer has a duty to his profession and to himself. He said it would be suborning a witness.

Vowing to do what he could to save her life, Joyce told her that the letter would cost money to obtain.

Joyce and Ong discussed what it would cost to obtain the letter. Ong said $10,000 because Robert Crosby had $10,452 in a bank in Singapore. Ong admitted that he was getting $2000 out of the deal as well as "the great satisfaction of being of service to you (Joyce) and our client."

Joyce informed Robert that Leslie wrote to Hammond asking him to come to her house regarding a gift for his birthday and that Hammond's widow had the letter and Joyce wanted to obtain it. Robert said he would do whatever Joyce thought was right. Joyce stated that he did not think that it was right but that it was expedient. "It might alter things in the minds of the jury if they find out Leslie invited Hammond to the bungalow. Juries can be stupid and it's better not to bother them with more evidence that they can deal with it," he told Robert.

Joyce was clearly uncomfortable with the notion of suppressing evidence. "Maybe it's my own sense of guilt. I have a feeling I'm going to be made to pay the piper for what I'm doing (buying the letter) and I have rely on your discretion," he told Leslie.

After Leslie was released into her lawyer's custody, Joyce and Leslie went to the Chinese quarter to meet Hammond's widow bringing the $10,000 to pay for the incriminating letter. In a gesture of contempt, the Eurasian woman threw the letter on the floor to make Leslie bend over to retrieve it.

With the letter safely in the hands of the defense, the trial began the next day. Joyce gave the summation in which he admitted Leslie killed Hammond but said that any self respecting woman in her shoes would have done the same.

Joyce noted that the prosecution produced no evidence to contradict Leslie's story and that there were no complicating motives or premeditation.

He said there was no need to extol her character. He told the jury falsely that, there was no evidence that existed to contradict the truth of Leslie's story.

Joyce was clearly shaken and distressed during and after the summation. When the "not guilty" verdict was announced, he sat mute without a reaction. When Ong congratulated him, he stared at him without acknowledgement.

After the acquittal Joyce faced the unpleasant talk of telling Robert Crosby that he had purchased the letter. Crosby asked if it was a criminal offense. Joyce admitted that it was and that he could be disbarred for having obtained it.

Leslie later admitted to her husband that was having a long term affair with Hammond and that she shot him out of jealousy and not in self-defense.[2]

Having viewed the film up to this point, the students need not to be shown the conclusion (although they usually want to see it). The discussion should focus on the following issues:

1. What is the duty of a lawyer to his client?
2. How do the duties to a client conflict with one's duties as an officer of the court?
3. Since Joyce was dubious about the truth of Leslie's story, should he have withdrawn from the case at the beginning?
4. Since the penalty for conviction on a murder charge was hanging, was Joyce justified in doing whatever he had to do "to get his client off."?
5. Does the duty of a lawyer to tell the truth supersede his obligation to his client?

6. Should Joyce have taken a chance, not purchased the letter, allowed it to be given to the prosecutor and tried to explain away Leslie's behavior as a crime of passion?
7. Should Joyce have tried to claim that the language of the letter was ambiguous?
8. Should Joyce have examined Leslie on the witness stand, urged her to tell the truth, and let the jury decide her fate?
9. Joyce was very conflicted as to how to handle the letter. Initially he told Leslie he would not purchase it but after Leslie made an impassioned plea based on how a guilty verdict would affect her husband, he reconsidered. Should Joyce's sympathy for her husband have influenced his decision to purchase the letter?
10. What about the role of Ong as Joyce's law clerk and intermediary in obtaining the letter? Should his role in this incident bar him from becoming a lawyer?
11. Since Hammond, was a partner in an interracial marriage to a Eurasian woman, would an all white male jury have been more sympathetic to Leslie in light of that fact?
    Should Joyce have explained that fact in an effort to gain sympathy for his client?
12. During his closing argument to the jury Joyce paused for a long time, provoking a buzz in the courtroom, as he discussed the issues of truth and justice. Had he blurted out the truth at that point, would he have violated his confidential relationship with his client?
13. Did Joyce really know what happened between his client and the victim before the trial ended?
14. As a result of his behavior, should Joyce resign from the bar?

15. Discuss the difference between doing what is right and what is expedient?
16. Did the fact that Joyce was working for no fee (pro bono) on the case as a favor to a friend affect his judgement as a lawyer?

There are many thought provoking legal and ethical issues presented in the letter that students will enjoy discussing. The movie can be used to best advantage by stopping it at various intervals and asking students what they think of Joyce and how he should proceed at the various junctures in the case.

Students can also be asked to play the role of a Grievance Committee to which a complaint has been made about Joyce's ethical conduct. Given a range of punishment from reprimand to disbarment what sanctions should the panel impose? Another point of discussion is the fact that Singapore was a British colony with a common law system. Students should note the courtroom scenes and their similarity to English proceedings with the court principals wearing robes and wigs.

CONCLUSION

Business and individuals face numerous ethical dilemmas every day. "The Letter" poses many issues of behavior that conflict with the conscience that can be a springboard for class discussion and a catalyst for the question "What would I do if I were confronted with such a dilemma"? Expediency? Rectitude? Or a middle road?

ENDNOTES

[1] Produced by Hal B. Wallis for Warner Bros and directed by William Wyler, "The Letter" was released in 1940. (BW Running time 97 minutes Available VHS, DVD) The Letter was nominated for seven Academy Awards including Best Picture, Best Actress, Best Director and Best Supporting Actor for James Stephenson as the conflicted defense attorney.

[2] Since "The Letter" was made in Hollywood after the Hayes Code was in effect, the ending of the book in which the murderer resumed her life with her husband was unacceptable. In the movie version Leslie Crosby received her punishment.