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ARTICLES

PEDAGOGY

SIGNS OF THINGS TO COME: INTER-AGENCY COORDINATION, SHARED EVIDENCE, AND WIRETAPS IN PROSECUTING WHITE-COLLAR CRIME

by

Natalie Bordeaux*

INTRODUCTION

Although wiretapping suspects and coordinated investigations by law enforcement to prosecute wrongdoers are tactics commonly used for so-called blue-collar crimes, the economic collapse of 2008 spurred a new wave of ingenuity on the part of the federal government in deterring and punishing white-collar crime, particularly fraud. It wasn't that any of the investigative techniques used were novel, as all of the methods had already existed. Rather, law enforcement's approach was fresh because its fact-gathering tools were rarely used for white-collar crime before, and never employed as successfully as in the parallel civil and criminal actions against Raj Rajaratnam and others within his circle for insider trading. Through inter-agency collaboration and wiretapping[1], the United States Department of Justice ("DOJ") and the Securities and Exchange

Commission ("SEC") prosecuted and fined perpetrators of

*Natalie Bordeaux, Adjunct Professor, Pace University

what had been described as the "largest hedge fund insider trading case in history".[2]

The "largest hedge fund insider trading case" was actually two cases: *United States v. Rajaratnam*,[3] and *SEC v. Galleon Management, LP*.[4] Both cases resulted from an organized investigation by the DOJ and the SEC that uncovered a ring of powerful, wealthy members of the financial industry engaged in insider trading.[5] Raj Rajaratnam, Manager of Galleon Management LP (hereinafter, "Galleon"), a hedge-fund advisory firm, was convicted of fourteen counts of conspiracy to commit and actual commission of insider trading.[6] In the criminal action, Rajaratnam was sentenced to 11 years in prison, ordered to forfeit $53.8 million, and was fined an additional $10 million in criminal penalties.[7] At the time, Rajaratnam's sentence was the longest ever imposed in an insider trading case.[8] In the civil action commenced by the SEC, District Court Judge Jed Rakoff imposed a civil penalty of $92,805,705 on Raj Rajaratnam.[9]

In both the criminal and civil cases, defense counsel raised numerous challenges, including the government's ability to wiretap the defendants' telephones, and utilize intercepted calls as evidence of wrongdoing. Nevertheless, the DOJ and SEC prevailed in their actions against the defendants for conspiring to engage in insider trading and committing insider trading. Their success was founded largely upon the use of wiretapped conversations between the defendants, and cooperation between the SEC and the United States Attorney's Office ("USAO")[10].

This article will provide an overview of the Rajaratnam cases, and explain key procedural and substantive issues it presented, including the fundamental requirements for lawfully obtaining wiretaps, the investigative and enforcement process

for securities violations, and the increasing communication between federal agencies regarding white-collar criminal investigations. The article concludes that the efficiencies afforded by wiretapping and the pooling of administrative resources in fact-gathering will lead to an increase in enforcement actions and penalties.

UNITED STATES V. RAJARATNAM[11] AND *SEC V. GALLEON MANAGEMENT, LP*[12]

On October 16, 2009, the USAO and the SEC filed criminal and civil complaints, respectively, against Raj Rajaratnam and other defendants[13] for insider trading.[14] The USAO unsealed criminal complaints charging Raj Rajaratnam and other defendants with conspiracy and insider trading under Section 10(b) of the Securities Exchange Act of 1934[15], and Rule 10b-5[16].

Both complaints involved the same conduct,[17] and a significant portion of evidence introduced in each case was obtained from wiretapping the communications of several defendants.[18] Members of Rajaratnam's ring included personal friends Rajiv Goel and Anil Kumar, and a former employee, Roomy Khan.[19] At the outset, many of the facts surrounding trades made by Rajaratnam on Galleon's behalf appeared remarkably fortuitous. However, upon closer inspection, the trades served as strong evidence establishing the commission of both civil and criminal violations involving the unlawful use of material, non-public information.

Rajaratnam had enlisted the aid of Roomy Khan to obtain "material, non-public information" regarding earnings, acquisitions and business agreements of numerous publicly-traded corporations, including Google, Hilton Hotels Corporation, Intel and Sprint Nextel Corporation.[20] As

Rajaratnam's criminal conduct continued, law enforcement and the SEC were able to identify a large quantity of information to corroborate suspicions surrounding Galleon's financial success. For instance, Khan (who provided Rajaratnam with confidential information regarding Polycom,[21] the sale of Kronos[22] to a private equity firm,[23] the acquisition of Hilton by the Blackstone Group, and Google's earnings reports), traded on the information herself before the information became public, and very close in time to Rajaratnam's subsequent activity on the stock, personally, and on Galleon's behalf.[24] Additionally, Rajaratnam purchased Hilton shares to capitalize on the information that Khan had provided regarding an upcoming acquisition of Hilton by the Blackstone Group[25] on behalf of the Galleon Tech Funds, an unusual investment for funds whose objective is to invest in the technology sector.[26]

Yet there was still more information to establish Rajaratnam's illegal activities. After Rajiv Goel provided Rajaratnam with insider information concerning Intel's earnings, and a business endeavor involving Sprint Nextel Corporation and Clearwire Corporation,[27] Rajaratnam rewarded Goel by trading on Goel's account, using insider information concerning the imminent Hilton takeover, and other companies' information.[28]

Danielle Chiesi, portfolio manager at New Castle, used several tips she received to trade on New Castle's behalf, and shared the information with other individuals, including Rajaratnam.[29] Chiesi traded on material nonpublic information obtained from an Akamai Technologies, Inc. executive, and shared this information with Mark Kurland, and Rajaratnam, who traded on behalf of himself and Galleon using this information.[30]

Chiesi also received several tips from Robert Moffat, a senior executive of IBM, which she used in trading on behalf of New Castle. Moffat provided Chiesi with material nonpublic information regarding the earnings of IBM and Sun Microsystems, Inc., along with negotiations between AMD[31] and two companies based in Abu Dhabi.[32]

Additionally, communications between several of the defendants were ongoing, and/or extremely close in time with changes in investments. For instance, Rajaratnam contacted Goel on January 8, 2007, about one week before Intel's earnings information regarding the fourth quarter of 2006 was to be released.[33] On January 9, 2007, Rajaratnam began buying Intel shares on his own behalf and that of Galleon.[34] Over the course of the Martin Luther King Day weekend, Rajaratnam and Goel were in repeated communication.[35] When the markets reopened on Tuesday, January 16, 2007, both defendants suddenly altered their investment strategies regarding Intel, with Galleon selling its entire long position in Intel.[36] In its complaint, the SEC cites numerous examples of continued communication coinciding with very pointed changes in investing by defendants Rajaratnam, Galleon, Chiesi, Kurland, New Castle, and Goel.[37]

AUTHORIZATION OF WIRETAPS PURSUANT TO TITLE III OF THE OMNIBUS CRIME CONTROL AND SAFE STREETS ACT OF 1968

An Overview on the Use of Wiretaps

Today, the term "wiretapping" refers to electronic or mechanical eavesdropping[38], a sweeping description that includes the surveillance of voice, e-mail, fax, and internet communications.[39] Other than certain enumerated exceptions

described below, wiretapping is illegal and yields inadmissible evidence.

In 1967, the Supreme Court issued two landmark decisions regarding law enforcement's use of wiretapped conversations. Although several earlier cases had ruled upon the permissibility of intercepted conversations,[40] the Supreme Court's decisions in *Berger v. New York*[41] and *Katz v. United States*[42] confirmed that the Fourth Amendment protection against unreasonable search and seizures[43] applied to intercepted communications in places where an individual has a reasonable expectation of privacy.[44]

In *Berger*, the petitioner's conviction for conspiring to bribe the Chairman of the New York State Liquor Authority was based solely on recorded conversations using a planted "bug" in the office of an attorney allegedly involved in the bribery scheme.[45] The Court held that law enforcement must abide by the Fourth Amendment requirement of a warrant based upon probable cause before recording conversations in an individual's home or office.[46]

The holding in *Katz* went a step further than *Berger*, extending Fourth Amendment protection to any location where an individual may "justifiably" expect to have a private conversation.[47] In *Katz*, the petitioner's conviction for interstate gambling by wire communication was based, in part, upon evidence submitted by the Government of the petitioner's portion of conversations recorded using a device attached to the outside of the public telephone booth where the petitioner had placed his bets. The Supreme Court confirmed that the determination as to the admissibility of oral evidence required the same analysis as conducted for physical evidence.[48] Additionally, the Court dismissed the notion that physical intrusion of a recording device was required for resulting

recordings to be in violation of the Fourth Amendment.[49] After *Berger* and *Katz*, law enforcement needed rules for permissible electronic surveillance.

Added Guidance: Title III of the Omnibus Crime Control and Safe Streets Act of 1968[50]

In response to these holdings, Congress undertook its own efforts to define a clearer standard for law enforcement. Congressional research found that unauthorized and nonconsensual wiretapped communications were being used as evidence in courts and administrative agencies by both governmental and private parties, in violation of individuals' privacy rights. [51]

As a result of these findings, Congress enacted Title III of the Omnibus Crime Control and Safe Streets Act of 1968, also known as the "Wiretap Act".[52] At its inception, the Wiretap Act sought to balance the privacy interests of private persons with the needs of law enforcement in intercepting communications to prosecute individuals engaged in criminal activity.[53] This legislation made unauthorized or nonconsensual interceptions of wire or oral communications illegal.[54] Additionally, it delineated specific requirements for government officials to satisfy to obtain wiretap authorizations, and regulated the use of such interceptions.

Statutory Requirements for Lawful Wiretapping

Permissible use of wiretaps by government agents is comparable to any other governmental search and seizure under the Fourth Amendment, as law enforcement must obtain authorization to intercept communications in places where an individual has a reasonable expectation of privacy.[55]

There are several ways in which law enforcement may legally intercept wire, oral or electronic communications. For instance, a "person acting under color of law" may utilize a wiretap if a party to the communication or where prior consent has been given by one of the parties engaged in the communication.[56]

The Wiretap Act also permits application by both federal and state law enforcement agencies to the appropriate judges for authorization of a wiretap.[57] Such application requires great detail in order to avoid granting unfettered discretion to law enforcement in its use of wiretaps. Supporting information required for any wiretap authorization is similar to that of a regular warrant application in that the application must be made under oath,[58] with a specific description of the facts and circumstances upon which the applicant relies[59] as showing probable cause to believe that specific offenses have or are being committed.[60] The application must describe the type of communication which authorities seek to intercept,[61] and the identity of the person, when known, whose communications are to be wiretapped.[62]

However, the applicant must also provide a "a full and complete statement as to whether or not other investigative procedures have been tried and failed or why they reasonably appear to be unlikely to succeed if tried or to be too dangerous".[63] As any wiretapping authorization is to be as narrow in scope as possible, authorizations must describe the type of communications to be intercepted,[64] the location where the authority to intercept is given,[65] the agency possessing the authority to conduct such interceptions,[66] and the period of time for which interception is permissible by the order.[67] Additionally, the order must include a provision requiring the interception to "be conducted in such a way as to minimize the

interception of communications not otherwise subject to interception" pursuant to the Wiretap Act.[68]

Despite the utmost precision with which wiretapping authority is given, and a lengthy list of offenses for which interception is authorized, the Wiretap Act enables law enforcement to use information obtained from otherwise lawful intercepts regarding offenses for which authorization was not granted or those offenses that are not specifically listed in the Wiretap Act as lawful grounds upon which wiretapping is permissible.[69] As will be discussed below, the United States Attorneys' Office procured a lawful intercept for an investigation of wire fraud (an enumerated offense in the Wiretap Act), and obtained admissible evidence establishing charges of insider trading in the *Rajaratnam* case.

Furthermore, the Wiretap Act permits law enforcement to share the information obtained from authorized interceptions with other members of law enforcement.[70] Cooperation is now increasingly likely between several federal enforcement agencies, including the United States Department of the Treasury, the DOJ and the United States Department of Housing and Urban Development, as will be discussed below.

Issues Presented by the Rajaratnam Cases

Unlisted Offenses:

In the criminal action brought against Raj Rajaratnam and others, Rajaratnam and Danielle Chiesi moved to suppress the recorded conversations obtained by the DOJ pursuant to Title III on several grounds. First, Rajaratnam and Chiesi sought exclusion of the wiretapped calls from evidence because insider trading was not an offense enumerated in Title III for which a wiretap was permissible.[71] In its application, the

government requested wiretap authorization for investigation of wire fraud, an enumerated offense for which recording conversations is authorized.[72] District Court Judge Richard Holwell rejected this contention, noting that although Title III only authorizes the use of wiretaps for offenses listed in 18 U.S.C. § 2516, it does not bar evidence obtained during the course of a lawful wiretap for unlisted offenses, so long as wiretap applications were obtained in good faith and "not as a subterfuge for gathering evidence of other offenses."[73] Judge Holwell found the DOJ's applications to be very transparent, detailing the insider trading plot, and setting forth the evidence they had obtained that established probable cause to believe that wire fraud and money laundering had been committed.[74] Thus, the government's investigation was conducted in good faith, and evidence obtained by the wiretapped conversations which established securities fraud was a "by-product" of lawfully procuring evidence of wire fraud.[75]

Probable Cause:

Rajaratnam and Chiesi also argued that the government's applications and supporting affidavits failed to show probable cause as to the necessity of the wiretaps.[76] Rajaratnam argued that the wiretap application and supporting documentation falsely characterized co-defendant Roomy Khan as a credible source, and misconstrued other evidence in the application.[77] Judge Holwell rejected this challenge, noting that the government's application provided information that corroborated Ms. Khan's allegations that she had given Rajaratnam insider information on Polycom, Hilton, Google and Kronos.[78] Specifically, Khan's claims were validated by Rajaratnam's own statements to Khan in conversations she had recorded at the request of the FBI.[79]

Full Statement of Other Attempted Investigative Procedures:

Rajaratnam and Chiesi both sought suppression of the recordings on the grounds that the wiretap applications did not comply with Title III's requirement of a "full and complete statement as to whether or not other investigative procedures have been tried and failed or why they reasonably appear to be unlikely to succeed if tried or to be too dangerous."[80] This argument also failed, as Judge Holwell noted that the requirement was not one of exhaustion of all other investigative methods, but rather, communication with the authorizing judge about the investigation's progress and difficulties corresponding with employing regular law enforcement tactics.[81] Where an application shows that less invasive methods are unlikely to succeed or are impractical, such facts will satisfy the requirements of Section 2518(1)(c).[82]

Minimization Requirement:

Both Rajaratnam and Chiesi also challenged the introduction of several wiretaps, arguing that the government failed to minimize conversations that were not relevant to the investigation, as required by 18 U.S.C. § 2518(5).[83] Judge Holwell noted that the wiretap authorizations properly included the minimization order, and that the law enforcement agents worked to reasonably minimize the interception of irrelevant conversations.[84] Furthermore, the Court recognized that an investigation involving a large-scale conspiracy requiring "more extensive surveillance may be justified in an attempt to determine the precise scope of the enterprise."[85]

Rajaratnam's Motions for Acquittal:

Subsequent to these challenges, Rajaratnam sought acquittal on all 14 charges against him at three different points in the trial: (1) at the close of the prosecution's case; (2) after all evidence had been presented; and (3) after a jury verdict

found him guilty of all 14 charges (five counts of conspiracy to commit securities fraud, and nine counts of securities fraud).[86] Amidst multiple arguments submitted regarding Rajaratnam's conviction, Rajaratnam's attorneys contended that his conviction on several conspiracy counts was based solely upon indirect evidence from the wiretapped conversations and that such conversations were inadmissible hearsay evidence.[87] Both arguments were rejected. Pursuant to the Federal Rules of Evidence, a co-conspirator's statements made "during the course and in furtherance of the conspiracy" are not considered hearsay.[88] Furthermore, the government was able to provide additional evidence corroborating statements made, notably, changes in Rajaratnam's investment positions within very short time periods subsequent to calls made and information he obtained therefrom.[89]

The SEC's Discovery Demands for Wiretapped Conversations from Rajaratnam and Chiesi:

In the course of the criminal proceedings commenced against the defendants, the USAO had given Rajaratnam and Chiesi the wiretap recordings that they intended to use at trial; however, the prosecutors had not shared these recordings with the SEC.[90] Since certain recordings were in the possession of Rajaratnam and Chiesi, the SEC sought to obtain production of the recordings through discovery demands, which both Rajaratnam and Chiesi opposed.[91] Although there was no dispute that such recordings would normally be discoverable, Rajaratnam and Chiesi challenged the requests. They claimed that they were unable to provide the SEC with the recordings because Title III prohibited disclosure of interceptions not explicitly permitted by statute, stemming from Congress' privacy concerns in enacting Title III.[92]

Judge Rakoff of the Southern District of New York noted that 18 U.S.C. § 2517 had been amended in 1970 to enable anyone who had lawfully obtained wiretap recordings to disclose the contents of such recordings "while giving testimony in any proceeding held under the authority of the United States or of any State or political subdivision thereof."[93] In granting the SEC's demand for production of the recordings, Judge Rakoff observed:

> [T]he notion that only one party to a litigation should have access to some of the most important non-privileged evidence bearing directly on the case runs counter to basic principles of civil discovery in an adversary system and therefore should not readily be inferred, at least not when the party otherwise left in ignorance is a government agency charged with civilly enforcing the very same provisions that are the subject of the parallel criminal cases arising from the same transactions.[94]

Privacy concerns were addressed by the court's issuance of a protective order barring disclosure of the recordings to any non-party to the case until a court of competent jurisdiction ruled on a suppression motion regarding such disclosure.[95]

INTER-AGENCY COORDINATION OF INVESTIGATIVE AND ENFORCEMENT EFFORTS IN WHITE-COLLAR CRIME CASES

The SEC is authorized to investigate potential securities violations using administrative, civil, and/or criminal remedies.[96] The SEC may employ civil and/or administrative actions to enforce the relevant federal laws.[97] However, only the DOJ may pursue a criminal action for these violations.[98]

The investigation surrounding Rajaratnam and his co-defendants showed that the ultimate success in prosecuting Rajaratnam and others resulted from the complimentary investigative approaches of the SEC and DOJ. The SEC had employed conventional investigational tools to expose Rajaratnam's insider trading circle and was unable to unearth the scheme to its fullest extent because the suspects had carried out their violations by telephone.[99] It was through the DOJ's efforts that wiretaps were authorized,[100] and resulting recorded conversations served as key evidence against the defendants.[101]

The Authority of the SEC

The Securities Exchange Acts of 1933 and 1934 prohibit a number of securities-related activities.[102] Congress has given the SEC the authority to promulgate rules and regulations pertaining to such activities.[103]

After monitoring suspicious market activity, receiving a complaint, or a referral from other SEC divisions or other sources, the SEC's Enforcement Division may commence an informal investigation of possible securities violations.[104] Upon completion of the initial review and identifying violations, the Enforcement Division prepares a "formal investigative order", which requires only a non-adherence to securities laws.[105] The Enforcement Division is able to issue subpoenas, and order production of documents.[106] At the conclusion of the Enforcement Division's investigative presentation, the Commission may authorize the Enforcement Division to file a claim in federal district court or seek administrative action.[107]

Administrative proceedings are conducted before an Administrative Law Judge or the SEC.[108] Where a successful showing of securities violations is made by a preponderance of

the evidence, the SEC may seek to enjoin wrongdoers from continuing to engage in wrongful conduct,[109] impose fines,[110] and/or order disgorgement.[111]

The Role of the United States Attorney's Office in Securities-Based Crimes

As mentioned above, the SEC lacks the authority to impose criminal sanctions on violators. Such proceedings must be commenced by the United States Attorney's Office within the Department of Justice.[112] The SEC rules enable the USAO to access its investigation files, preventing bureaucratic inefficiency from hampering an investigation.[113]

A securities-based criminal action has stronger investigative techniques at its disposal, including the use of search warrants,[114] and the USAO's ability to determine the scope of discovery, without interference of the defendants.[115] Although the USAO's actions are generally initiated after a referral from the SEC,[116] the DOJ is not bound by, or reliant solely upon, information from the SEC.[117] Thus, the USAO may commence criminal actions in situations where the SEC has either declined to pursue civil or administrative remedies, or where violations, while related to securities, are not within the purview of the SEC's enforcement efforts.[118]

The Financial Fraud Enforcement Task Force

On the heels of the cooperation between the SEC and the DOJ in investigating Rajaratnam and numerous others allegedly involved in his insider trading ring, the government sent a strong message to would-be violators that joint investigative and enforcement efforts were the new normal. By Executive Order dated November 17, 2009, President Barack Obama established the Financial Fraud Enforcement Task

Force (the "Task Force").[119] The Task Force, led by the Department of Justice, includes senior-level members of numerous federal agencies, and departments, including the SEC, the Department of Treasury, the Criminal Investigation Division of the IRS, the Federal Deposit Insurance Corporation ("FDIC"), and the Department of Housing and Urban Development ("HUD").[120]

The Task Force's main purpose is to advise the Attorney General on investigating and prosecuting a variety of fraud cases.[121] Additionally, the Task Force is expected to "coordinate law enforcement operations" with state and local law enforcement.[122] As SEC Chairman Mary Schapiro explained, "Many financial frauds are complicated puzzles that require painstaking efforts to piece together. By formally coordinating our efforts, we will be able to better identify the pieces, assemble the puzzle, and put an end to the fraud."[123]

CONCLUSION

The accomplishments of the SEC and DOJ in unraveling Raj Rajaratnam's insider trading ring sounded a loud and clear warning to white-collar criminals – federal agencies are now working together, sharing their information, and using new investigative methods to build and bolster their cases. While some may characterize the use of recorded conversations in the Rajaratnam cases as historically insignificant, it is clear that neither the DOJ nor the SEC would have triumphed in the actions commenced against Rajaratnam and others without those communications. Given the number of defendants that were fined and/or sentenced because of the admissible wiretapped evidence, it is highly probable that enforcement agencies will seek to intercept communications in future investigations. If anything, the decisions in the Rajaratnam

cases have refined the wiretapping standards propounded by Title III.

The SEC's and DOJ's combined resources and pooled efforts in the Rajaratnam cases are also significant. The agencies' coordination in these cases exemplified the aims of the Financial Fraud Enforcement Task Force – to aggressively and efficiently prosecute white-collar crime. The image presented by the Task Force is that of a unified movement to protect the public, and punish fraud. If this Task Force succeeds, this is the dawn of a new era, one with strong enforcement, and without red tape.

ENDNOTES

[1] Before the Rajaratnam investigation, wiretapping was a rarity in white-collar criminal investigations. However, this tool had been used before. In United States v. Zolp, 659 F.Supp. 692 (D.N.J.) (1987), a case alleging conspiracy to defraud, and actual securities fraud committed by some of the defendants, the United States Attorney's Office obtained authorizations to intercept calls in various locations, including a defendant's home, and corporate offices.

[2] Press Release, United States Attorney's Office, Manhattan U.S. Attorney Charges Hedge Fund Managers, Fortune 500 Executives, and Management Consulting Director in $20 Million Insider Trading Case (Oct. 16, 2009) (available at http://www.fbi.gov/newyork/press-releases/2009/nyfo101609.htm); United States v. Rajaratnam, No. 09 Cr. 1184 (RJH), 2010 U.S. Dist. LEXIS 70385, *5 (S.D.N.Y. 2010).

[3] United States v. Rajaratnam, No. 09 Cr. 1184 (RJH) (S.D.N.Y. Oct. 16, 2009).

[4] SEC v. Galleon Mgmt., LP., No. 09 Civ. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009).

[5] According to SEC Enforcement Director Robert Khuzami, "[Rajaratnam] cultivated a network of high-ranking corporate executives and insiders, and then tapped into this ring to obtain confidential details about quarterly earnings and takeover activity." Press Release, SEC (Oct. 16, 2009) (available at http://www.sec.gov/news/press/2009/2009-221.htm).

[6] *See* United States v. Rajaratnam, 802 F.Supp.2d 491 (S.D.N.Y. Aug. 16, 2011) (referring to May 11, 2011 jury verdict that found Rajaratnam guilty of five counts of conspiracy to commit insider trading, and nine counts of engaging in insider trading).

[7] United States v. Rajaratnam, No. 09 Cr. 1184 (RJH) (S.D.N.Y. Oct. 16, 2009). According to evidence proffered by the DOJ, Rajaratnam was believed to have amassed unlawful gains totaling $72,071,219, resulting from insider trading activities. United States v. Rajaratnam, No. 09 Cr. 1184 (RJH), 2012 U.S. Dist. LEXIS 14961, at *3-4 (S.D.N.Y. Feb. 6, 2012).

[8] Aaron Smith, *Raj Rajaratnam Checks into Prison*, CNN MONEY (Dec. 5, 2011), http://money.cnn.com/2011/12/05/news/companies/rajaratnam_prison/index.htm.

[9] Before reaching this determination, the parties asked Judge Rakoff to review excerpts from the Pre-Sentence Report in the corresponding criminal case. In describing the criminal penalties imposed, he observed that such penalties were far less than Rajaratnam's net worth. SEC v. Rajaratnam, 822 F.Supp.2d 432, 434 (S.D.N.Y. 2011).

"When to this is added the huge and brazen nature of Rajaratnam's insider trading scheme, which, even by his own estimate, netted tens of millions of dollars and continued for years, this case cries out for the kind of civil penalty that will deprive this defendant of a material part of his fortune." *Id*.

[10] "Our law enforcement agencies are together much more than the sum of our parts. That is why coordination, of which today's actions are a prime example, is critically important to the goal of rooting out fraud and misconduct in our markets. The investing public deserves no less, and we will deliver." Robert Khuzami, Remarks at Press Conference Regarding Rajaratnam Case (Oct. 16, 2009) (available at http://www.sec.gov/news/speech/2009/spch101609rk.htm).

[11] United States v. Rajaratnam, No. 09 Cr. 1184 (RJH) (S.D.N.Y. Oct. 16, 2009).

[12] SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009).

[13] The other defendants in these cases were: (1) Galleon Management, LP (the hedge fund management firm that was managed by Rajaratnam); (2) Rajiv Goel (Rajaratnam's friend, and Managing Director at Intel Corp.); (3) Anil Kumar (Rajaratnam's friend, investor in several Galleon funds, and a director at McKinsey & Co.); (4) Danielle Chiesi (a portfolio manager at New Castle Funds LLC); (5) Mark Kurland (Senior Managing Director and General Partner at New Castle Funds, LLC); (6) Robert Moffat (a senior executive at IBM); (7) New Castle Funds, LLC (an investment adviser to hedge funds which was previously a part of Bear Stearns Asset Management); (8) Roomy Khan (a hedge fund consultant); (9) Deep Shah (a former Moody's analyst); (10) Ali Hariri (Vice President of Broadband Carrier Networking at Atheros, a "developer of semiconductor systems for network communication products"); (11) Schottenfeld Group LLC (a New York-based registered broker-dealer); (12) Zvi Goffer (a registered representative and proprietary trader at Schottenfeld during the period investigated); (13) David Plate (a registered representative and proprietary trader at Schottenfeld); (14) Gautham Shankar (registered representative and proprietary trader at Schottenfeld); (15) S2 Capital Management, LP (a New York-based unregistered hedge fund investment adviser); (16) Steven Fortuna (principal and founder of S2 Capital Management, LP); (17) Ali T. Far (Managing Member of Spherix Capital and Far & Lee, LLC, and previously worked for Galleon as a Managing Director, portfolio manager, and analyst).; (18) Choo-Beng Lee (Managing Member of Far & Lee, LLC., and co-founder of Spherix Capital) (19) Spherix Capital (a California-based, unregistered hedge-fund investment adviser established by Far and Lee); and (20) Far & Lee (trading entity created by Lee and Far before establishing Spherix Capital, LLC. SEC Complaint, SEC v. Galleon Mgmt., LP (No. 09-CV-0811-JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010). Excluding Rajaratnam and Galleon Management, LP, all of the defendants served as sources of material, non-public information to Rajaratnam who, in turn, traded on behalf of Galleon based upon such information. *Id*. All named individuals were defendants in criminal actions commenced by the USAO. *See, e.g.,* United States v. Rajaratnam, No. 09 Cr. 1184 (RJH) (S.D.N.Y. Oct. 16, 2009); United States v. Moffat, No. 10 Cr. 270 (DAB) (S.D.N.Y. Oct. 16, 2009); United States v. Goel, No. 10 Cr. 90 (BSJ) (S.D.N.Y. Oct. 16, 2009); United States v. Hariri, No. 09

MAG. 2436 (S.D.N.Y. Nov. 4, 2009); and United States v. Goffer, No. 100 Cr. 56 (RJS) (S.D.N.Y. Nov. 5, 2009).

[14] The USAO also indicted other defendants in a separate criminal action, as a result of information they obtained during the Rajaratnam investigation. SEC v. Rajaratnam, 622 F.3d 159, 164-65 (2d Cir. Sep 29. 2010). *See also* United States v. Goffer, 756 F.Supp.2d 588 (S.D.N.Y. 2011). The SEC filed a civil complaint against Rajaratnam and Rajat Gupta on October 26, 2011, separate from the complaint filed against Rajaratnam described above. This case was also based upon evidence obtained from wiretapped conversations, corroborated by investment changes. SEC v. Gupta, No. 11 Cv. 7566 (JSR) (S.D.N.Y. Oct. 26, 2011).

[15] Pursuant to Section 10(b), it is "unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange – (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange…any manipulative device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Securities Exchange Act of 1934 § 10(b) (2012), 15 U.S.C. § 78j(b) (2012).

[16] Codified at 17 C.F.R. § 240.10b-5(a) (2012), which prohibits "any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme or artifice to defraud…" Aside from insiders possessing a fiduciary duty, insider trading restrictions also apply to recipients of insider information from such insiders. United States v. Rajaratnam, 802 F.Supp.2d 491, 497-98 (S.D.N.Y. 2011) (citing SEC v. Ballesteros Franco, 253 F. Supp.2d 720, 726 (S.D.N.Y. 2003)).

[17] Although both the civil and criminal complaints alleged violations of Section 10(b) of the Securities Exchange Act of 1934(15 U.S.C. § 78j(b) (2012)), and Rule 10b-5 (codified at 17 C.F.R. § 240.10b-5(a) (2012)), the criminal complaint also alleged that the defendants had conspired to commit insider trading. United States v. Rajaratnam, No. 09 Cr. 1184 (RJH) (S.D.N.Y. Oct. 16, 2009).

[18] SEC Complaint, SEC v. Galleon Mgmt., LP (No. 09-CV-0811-JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5,

2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010); United States v. Rajaratnam, No. 09 Cr. 1184 (RJH) (S.D.N.Y. Oct. 16, 2009).

[19] SEC Complaint, SEC v. Galleon Mgmt., LP (No. 09-CV-0811-JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).

[20] SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).

[21] Polycom is a corporation that "produces applications for voice, video and data networking". SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).

[22] Kronos is a "workforce management software company" that sells time tracking and payroll software to businesses. ABOUT KRONOS, http://www.kronos.com/about/about-kronos.aspx (last visited January 9, 2013); SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).

[23] SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).

[24] SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010). Khan also compensated Deep Shah, the Moody's analyst who had provided this information, with $10,000. Shah was reviewing Hilton's creditworthiness in furtherance of the takeover. *Id*.

[25] As described by Shah, the contemplated Hilton takeover by the Blackstone Group would remove Hilton's stock from the New York Stock Exchange, resulting in it becoming a private company. This tip was accurate. The Blackstone Group bought back all of Hilton's stock at a premium. *Id*.

[26] SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).

[27] Clearwire constructs and operates wireless and broadband networks worldwide. SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).
[28] SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).
[29] *Id*.
[30] *Id*.
[31] "AMD is a global semiconductor company offering microprocessor, embedded processor, chipset and graphics products." SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).
[32] *Id*.
[33] SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).
[34] *Id*.
[35] *Id*.
[36] SEC Complaint, SEC v. Galleon Mgmt., LP, No. 09 Cv. 8811 (JSR) (S.D.N.Y. Oct. 16, 2009), amended by First Amended Complaint (S.D.N.Y. Nov. 5, 2009), amended by Second Amended Complaint (S.D.N.Y. Jan. 29, 2010).
[37] The SEC filed a civil complaint against Rajaratnam and Rajat Gupta on October 26, 2011, separate from the complaint filed against Rajaratnam described above. This case was also based upon evidence obtained from wiretapped conversations, corroborated by investment changes. Gupta, a former Board Member of Procter & Gamble, and Goldman Sachs, as well as a former Director of McKinsey, was found to have provided Rajaratnam with material nonpublic information concerning Goldman Sachs and Procter & Gamble. SEC v. Gupta, No. 11 Cv. 7566 (JSR) (S.D.N.Y. Oct. 26, 2011). Gupta was found guilty of insider trading in the criminal action commenced by the USAO, and sentenced to 24 months' imprisonment, and fined $5 million. United States v. Gupta, No. 11 Cr. 907 (JSR), 2012 U.S. Dist. LEXIS 45610 (S.D.N.Y. March 26, 2012), *sentence imposed by* United States v. Gupta, No. 11 Cr. 907 (JSR), 2012 U.S. Dist. LEXIS 154226 (S.D.N.Y. 0ct. 24, 2012).

[38] BLACK'S LAW DICTIONARY 769 (9th ed. 2009).
[39] 18 U.S.C. §§ 2510 (1), (2), (5), (12), (14), & (17) (2012).
[40] *See, e.g*. Wong Sun v. United States, 371 U.S. 471 (1963) (holding that oral evidence obtained from an unwarranted intrusion may be inadmissible as the result of an impermissible search).
[41] Berger v. New York, 388 U.S. 41 (1967).
[42] Katz v. United States, 389 U.S. 374 (1967).
[43] "The right of the people to be secure . . . against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched, and the person or things to be seized." U.S. CONST. amend. IV.
[44] Berger v. New York, 388 U.S. 41 (1967); Katz v. United States, 389 U.S. 347 (1967).
[45] Berger v. New York, 388 U.S. 41, 44-45 (1967).
[46] Berger v. New York, 388 U.S. 63-64 (1967).
[47] Katz v. United States, 389 U.S. 347, 353 (1967).
[48] Katz v. United States, 389 U.S. 347, 353 (1967).
[49] Katz v. United States, 389 U.S. 347, 352 (1967) (noting "[W]hat [petitioner] sought to exclude when he entered the booth was not the intruding eye – it was the uninvited ear").
[50] Title III of the Omnibus Crime Control and Safe Streets Act of 1968, 18 U.S.C. §§ 2510-22, Pub. L. 90-351 (1968), as amended by Electronic Communications Privacy Act, Pub. L. 99-508 (1986), Communications Assistance to Law Enforcement Act, Pub. L. 103-414 (1994), Antiterrorism and Effective Death Penalty Act of 1996, Pub. L. 104-132 (1996), USA PATRIOT Act, Pub. L. 107-56 (2001), USA PATRIOT Additional Reauthorization Amendments Act of 2006, Pub. L. 109-178 (2006), Foreign Intelligence Surveillance Act ("FISA") Amendments Act of 2008, Pub. L.110-261 (2008), FISA Sunsets Extension Act, Pub. L. 112-3 (2011), PATRIOT Sunsets Extension Act of 2011, Pub. L. 112-14 (2011).
[51] Pub. L. 90-351 (1968).
[52] *Id*.
[53] *Id*.
[54] The Electronic Communications Privacy Act, enacted in 1986, amended the Wiretap Act to include interception of electronic communications. Pub. L. 99-508 (1986).

[55] Notwithstanding the overall similarities between wiretap authorizations and conventional warrants, the Supreme Court in Katz v. United States noted that "a conventional warrant ordinarily serves to notify the suspect of an intended search" and that advance notice to a suspect of governmental intent to record his conversations would render such recordings useless. Katz v. United States, 389 U.S. 347, 355 (1967).
[56] 18 U.S.C. § 2511(2)(c) (2012).
[57] 18 U.S.C. § 2516 (2012).
[58] 18 U.S.C. § 2518(1) (2012).
[59] 18 U.S.C. § 2518(1)(b) (2012).
[60] 18 U.S.C. § 2518(1)(d); 18 U.S.C. § 2518(3).
[61] 18 U.S.C. § 2518(1)(b)(iii).
[62] 18 U.S.C. § 2518(1)(a).
[63] 18 U.S.C. § 2518(1)(c).
[64] 18 U.S.C. § 2518(4)(c) (2012).
[65] 18 U.S.C. § 2518(4)(b).
[66] 18 U.S.C. § 2518(4)(d).
[67] 18 U.S.C. § 2518(4)(e).
[68] 18 U.S.C. § 2518(5) (2012).
[69] 18 U.S.C. § 2517(5) (2012).
[70] 18 U.S.C. § 2517(1) (2012).
[71] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *1-2 (S.D.N.Y. Nov. 29, 2010).
[72] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *8-23 (S.D.N.Y. Nov. 29, 2010); 18 U.S.C. § 2516(c) (2012).
[73] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *9-11 (S.D.N.Y. Nov. 29, 2010).
[74] *Id*. at *11-19.
[75] *Id*. at *17-19.
[76] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *23 (S.D.N.Y. Nov. 29, 2010).
[77] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *27-28 (S.D.N.Y. Nov. 29, 2010).
[78] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *35 (S.D.N.Y. Nov. 29, 2010).
[79] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *35 (S.D.N.Y. Nov. 29, 2010). Since the government established probable cause in furtherance of its wiretap application to wiretap Chiesi solely on recorded

conversations from the Rajaratnam wiretap, Chiesi's challenge that the wiretap authorization lacked probable cause failed. *Id*. at *52-53.

[80] 18 U.S.C. § 2518(1)(c) (2012); United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *52-53 (S.D.N.Y. Nov. 29, 2010).

[81] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *53-54 (S.D.N.Y. Nov. 29, 2010) (citing United States v. Concepcion, 579 F.3d 214, 218 (2d Cir. 2009).

[82] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *53-54 (S.D.N.Y. Nov. 29, 2010).

[83] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *98 -102 (S.D.N.Y. Nov. 29, 2010).

[84] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *98-100 (S.D.N.Y. Nov. 29, 2010).

[85] United States v. Rajaratnam, 2010 U.S. Dist. 143175, at *99-100 (S.D.N.Y. Nov. 29, 2010) (citing United States v. Scott, 436 U.S. 128 (1978)). Judge Holwell also rendered the minimization requirement inapplicable to calls that do not exceed two minutes in duration. United States v. Rajaratnam, No. 09 Cr. 1184 (RJH), 2010 U.S. Dist. LEXIS 143175, at *100 (S.D.N.Y. Nov. 29, 2010) (citing United States v. Salas, 07 Cr. 557 (JGK), 2008 U.S. Dist. LEXIS 92560, at *6 (S.D.N.Y. Nov 5, 2008). Danielle Chiesi independently challenged the minimization efforts on grounds that 155 wiretapped calls related only to personal issues; however, Judge Holwell rejected this argument, and noted that the minimization requirement does not limit lawful interception to only those conversations dealing only with criminal topics. United States v. Rajaratnam, No. 09 Cr. 1184 (RJH), 2010 U.S. Dist. LEXIS 143175, at *101-102 (S.D.N.Y. Nov. 29, 2010).

[86] United States v. Rajaratnam, 802 F.Supp.2d 491, 495-96 (S.D.N.Y. Aug 16, 2011).

[87] *Id*. at 499-512.

[88] United States v. Rajaratnam, 802 F.Supp.2d 491, 511 (S.D.N.Y. Aug. 16, 2011); FED. R .EVID. 801(d)(2)(E).

[89] As Judge Holwell noted, Section 801(d)(2) of the Federal Rules of Evidence permits consideration of co-conspirator's statements; however, such statements alone will not establish "the existence of the conspiracy and the participation therein of the declarant and the party against whom the statement is offered. " United States v. Rajaratnam, 802 F.Supp.2d 491, 511 (S.D.N.Y. Aug. 16, 2011); FED. R. EVID. 801(d)(2).

[90] SEC v. Galleon Mgmt., LP, 683 F.Supp.2d 316, 317 (S.D.N.Y. Feb. 9, 2010).

[91] *Id*.
[92] SEC v. Galleon Mgmt., LP, 683 F.Supp.2d 316, 318 (S.D.N.Y. Feb. 9, 2010).
[93] SEC v. Galleon Mgmt., LP, 683 F.Supp.2d 316, 318 (S.D.N.Y. Feb. 9, 2010) (referencing 18 U.S.C. § 2517(3)).
[94] SEC v. Galleon Mgmt., LP, 683 F.Supp.2d 316, 318 (S.D.N.Y. Feb. 9, 2010).
[95] *Id*. at 319.
[96] Securities Exchange Act of 1934 § 21(a)(1) (2012), 15 U.S.C. § 78u(a)(1) (2012). *See also* SEC News Room, Office of Public Affairs, *How Investigations Work*, www.sec.gov/new/newsroom/howinvestigationswork.html (last visited December 1, 2012).
[97] Securities Act of 1933, § 20(b) (2012), 15 U.S.C. § 77t(b) (2012); Securities Exchange Act of 1934 § 21(a)(1) (2012), 15 U.S.C. §§ 78u(c) – (e) (2012).
[98] Securities Act of 1933, § 20(b) (2012), 15 U.S.C. § 77t(b) (2012); Securities Exchange Act of 1934 § 21(d)(1) (2012), 15 U.S.C. § 78u(d)(1) (2012).
[99] United States v. Rajaratnam, No. 09 Cr. 1184 (RJH), 2010 U.S. Dist. LEXIS 143175, at *3-4 (S.D.N.Y. Nov. 29, 2010).
[100] The efforts of both the USAO and the FBI in criminally investigating Rajaratnam resulted in his indictment. Indictment, United States v. Rajaratnam, No. 09 Cr. 1184 (RJH) (S.D.N.Y. Dec. 15, 2009).
[101] *Id*.
[102] *See, e.g.*, Securities Act of 1933 §§ 5, 11, 12, 15, 17 (2012); Securities Exchange Act of 1934 §§ 5, 9, 10, 18, 20, 20A, 21A (2012).
[103] Securities Exchange Act of 1934 § 23(a) (2012), 15. U.S.C. § 78j(b) (2012).
[104] Securities Exchange Act of 1934 §21(a)(1) (2012); Rebecca Gross, Lauren Britsch, Kirk Goza & Jaclyn Epstein, Article, *Securities Fraud*, 49 AM. CRIM. L. REV. 1213, 1266 (2012).
[105] Rebecca Gross, Lauren Britsch, Kirk Goza & Jaclyn Epstein, Article, *Securities Fraud*, 49 AM. CRIM. L. REV. 1213, 1266 (2012).
[106] *Id*. at 1267.
[107] Securities Exchange Act of 1934 §21(b) (2012), 15 U.S.C. § 78u(b) (2012).
[108] Rebecca Gross, Lauren Britsch, Kirk Goza & Jaclyn Epstein, Article, *Securities Fraud*, 49 AM. CRIM. L. REV. 1213, 1267 (2012).

[109] Securities Exchange Act of 1934 § 21(e) (2012), 15 U.S.C. § 78u(e) (2012).
[110] Securities Exchange Act of 1934 § 21(d)(3) (2012), 15 U.S.C. § 78u(d)(3) (2012).
[111] Rebecca Gross, Lauren Britsch, Kirk Goza & Jaclyn Epstein, Article, *Securities Fraud*, 49 AM. CRIM. L. REV. 1213, 1268 (2012). Civil actions commenced by the SEC may seek the same remedies. *Id*. at 1269-72.
[112] Securities Exchange Act of 1934 §21(d)(1) (2012), 15 U.S.C. § 77t(b) (2012), 15 U.S.C. § 78u(d)(1) (2012).
[113] Securities Exchange Act of 1934 §21(d)(1) (2012), 15 U.S.C. §78u(d)(1) (2012) ("The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this chapter or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter."). Rebecca Gross, Lauren Britsch, Kirk Goza & Jaclyn Epstein, Article, *Securities Fraud*, 49 AM. CRIM. L. REV. 1213, 1276 (2012); Scott Colesanti, Article, *Wall Street as Yossarian: The Other Effects of the Rajaratnam Insider Trading Conviction*, 40 HOFSTRA L. REV. 411, 424 & n.97 (2011).
[114] Rebecca Gross, Lauren Britsch, Kirk Goza & Jaclyn Epstein, Article, *Securities Fraud*, 49 AM. CRIM. L. REV. 1213, 1276 (2012).
[115] *Id*.
[116] Securities Exchange Act of 1934 §21(d)(1) (2012), 15 U.S.C. §78u(d)(1) (2012).
[117] USAO Criminal Resource Manual, USAM, Title 9 – USAM 9, 2001, available at www.justice.gov/usao/eousa/a_reading_room/usam/title9/2mcrm.htm.
[118] Rebecca Gross, Lauren Britsch, Kirk Goza & Jaclyn Epstein, Article, *Securities Fraud*, 49 AM. CRIM. L. REV. 1213, 1276 (2012).
[119] Exec. Order No. 13519, Nov. 17, 2009, "Establishment of the Financial Fraud Enforcement Task Force".
[120] *Id*.
[121] *Id*.
[122] *Id*.
[123] Exec. Order No. 13519, Nov. 17, 2009, "Establishment of the Financial Fraud Enforcement Task Force".

DEDUCTIBILITY OF BUSINESS EXPENSES: THE EMPLOYEE/INDEPENDENT CONTRACTOR CONTROVERSY

by

Richard J. Kraus *
Vincent R. Barrella**

INTRODUCTION

A person who performs services as an employee may deduct unreimbursed expenses in the performance of those services. The miscellaneous itemized deductions section of Form 1040, Schedule A, permits a list of those deductions on that form or on an attached document. These itemized deductions, however, are subject to certain limitations: they must exceed 2% of the taxpayer's adjusted gross income (AGI)[1]; and the taxpayer may have alternative minimum tax requirements.[2]

*Professor of Law, Lubin School of Business, Pace University, Pleasantville, New York, e-mail: rkraus@pace.edu

**Associate Professor of Legal Studies & Taxation, Lubin School of Business, Pace University, New York, New York, e-mail: vbarrella@pace.edu

On the other hand, a person who performs services as a statutory employee within any of four categories including drivers, full-time life insurance sales agents, work-at-home individuals and full-time traveling salesperson[3] or an independent contractor may deduct business expenses through the use of Form 1040, Schedule C, without any limitation imposed on the miscellaneous itemized deductions and without the adverse ramifications of the alternative minimum tax with respect to those deductions.

This article examines the advantages and disadvantages of requirements to use Schedule A or Schedule C, the definitions of common law employee and independent contractor and a number of recent cases which assist the professional tax counselor in formulating a plan of advice for clients. These clients include workers in the following businesses: teaching, building and construction, trucking, computers, automobiles, attorneys, taxi cab drivers and salespersons. The article concludes with a specific plan for assisting clients who face the tax dilemma of working as consultants or advisors for businesses.

ADVANTAGES AND DISADVANTAGES OF TAX STATUS

While independent contractors and statutory employees may use Schedule C to claim business deductions, these persons will be subject to pay self-employment tax upon the profits gained from the business, if the party for whom they work has not already paid those taxes.[4] On the other hand, as already indicated, common law employees are subject to the 2% AGI limitation. The range of deductions on Schedule C, however, noticeably list expenses such as advertising, fees, contract labor, depletion, employee benefits, insurance, mortgage payments, professional fees, office expenses, rents,

repairs, supplies, utilities and wages which are not contained on Schedule A. This schedule emphasizes unreimbursed employee expenses such as job travel, job education, vehicle expenses and meals and entertainment, which may also be claimed on Schedule C.[5] A worker usually prefers to claim independent contractor or statutory employee status so as to be able to deduct a wide range of expenses associated with the worker's business activity.

DEFINITIONS: COMMON LAW EMPLOYEE; INDEPENDENT CONTRACTOR

The Code, as has been noted above, explicitly defines and describes a statutory employee as an individual who usually belongs within one of four categories: driver, life insurance sales agent, home worker, full-time traveling salesperson. Statutory employees receive a W-2 form on which their status is noted.[6] This article concentrates upon the distinction between common law employee and independent contractor.

Common Law Employee

Although the Internal Revenue Code assesses income tax against taxpayers who perform services as an employee, the Code nowhere defines the term "employee" so that the common law rules apply to the definition.[7] Many specific facts and circumstances assist in the determination of the employee status. The degree of control exercised over the employee by the employer or principal is paramount; but the cases also weigh other relevant factors: worker investment in the work facility, the possibility of individual profit or loss, payment to the worker by the job or by the time, the power of the principal to discharge an individual without the payment of any damages other than back wages and other contractually agreed amounts,

the principal's regular business activity, the permanency of the work relationship, the perception of the parties about the relationship and the provision of employee benefits.[8]

Independent Contractor

The common law and statutes define an "independent contractor" as one who works for another, but the independent contractor has the right to control the means and methods of completing the work requested. The principal only has the right to control or direct the result of the work and may refuse to pay if not reasonably satisfied.[9]

The Tax Court often examines the substance of the relationship between the principal and the one who is working. It does not matter if the individual is employed part-time rather than full-time and no distinction is made between classes of employees so that officers of corporations, managers and other supervisory personnel are all employees. The only exception to this treatment concerns temporary leased staffing services that provide secretaries, nurses, and other trained workers on a temporary basis – these leased employees work for the staffing services who supply them.

In addition to statutory employees, furthermore, the Code lists statutory non-employees such as direct sellers, real estate agents and certain companion sitters employed on a fee basis and who work under a written contract designating them as non-employees. It should be noted that direct sellers include sellers of consumer products from their own homes or places of business, sellers engaged in delivering or distributing newspapers and others who earn income based on the productivity of their direct sales.[10]

CONTROVERSIES: OPPORTUNITIES FOR A PLAN

Many Tax Court cases have applied the statutory criteria to determine the tax status of a worker. Court applications concentrate upon controversies which present opportunities to understand and appreciate the necessary complexity of Code rules and to frame a plan of action for tax clients.

Rosato v. Commissioner[11]

In 1975 Thomas Rosato signed a contract with the O.C. Tanner Company to work as a salesperson for its products and services which assist companies to develop programs for recognizing and rewarding their employees. Mr. Rosato worked the New York City area sales territory in accord with this agreement which designated him as the company's employee, subject to an anti-competition clause, who was to devote his full time and best efforts to the service of the company. Rosato was permitted to participate in Tanner's retirement plan and its medical insurance and group term life insurance plans. Additionally, during the tax year 2006, at issue in this case, Rosato managed Tanner's regional office in the city; he supervised salespersons, secretaries and other personnel whom Tanner had hired. Rosato was required to, and did, attend company meetings and training sessions and he was often present at the company's New York City office, but Tanner considered him to be an at-will employee.

The agreement noted, however, that Rosato was to pay all expenses in excess of his expense allowance and would not be reimbursed for these expenses. Tanner did not set Rosato's work hours or instruct him when to work and he was permitted to perform some of his sales work from his home. Rosato paid a portion of his office rent, half the cost of his personal

secretary and of his own personal assistant; Rosato also paid commissions to other Tanner salespersons from his own commissions. Rosato did not receive reimbursements from Tanner for all of the business expenses which he reported on his monthly regional expense report, including phone, utility, postage, customer entertainment, office supplies and meal expenses.

For all of the tax years prior to 2006, Rosato had filed Form 1040 with Schedule A attached requesting deductions for unreimbursed employee expenses. For the 2006 tax year, however, Rosato left Form 1040, line 7, "Wages, salaries, tips, etc." blank and used Schedule C, "Profit of loss from Business," in order to report gross receipts and sales of $468,378. Rosato decided upon this plan of action even though he had received a Form W-2 Wage and Tax Statement from Tanner which had not checked the "statutory employee" box on the form's face.

The court agreed with the IRS determination that Rosato was a common law employee despite Rosato's arguments that he was either a statutory employee or an independent contractor.[12]

The court reasoned that an individual taxpayer may qualify as a statutory employee only if the individual is not a common law employee. The court then used the series of criteria mentioned above to determine Rosato's status:

Control: The Company exercised a good deal of control over Rosato: he was required to attend sales meetings, maintain an office presence and not compete; superiors at Tanner supervised his work.

The Perception of the Parties: Tanner and Rosato entered a written contract in 1975 which was superseded by a Golden Rule principle oral agreement in 1984, which honored the terms of the written agreement. Both the written and oral agreements named Rosato as an employee with specific salesperson's duties and as a worker who would receive Form W-2 at the end of the work year.

Worker Investment in the Work Facility: Rosato had to contribute to office rent and to the payment of office workers, but this factor must be weighed against other determinants. In addition, the court observed that there were no detailed terms for this arrangement and that it was Rosato's personal decision to incur additional costs by hiring a secretary and administrative assistant. Rosato did claim that he worked from his home on occasion, but he never presented any evidence of expenses to establish a home office.

The Possibility of Individual Profit or Loss: Rosato was not paid a wage but was awarded commissions; additionally, because he shared expenses with Tanner he did risk a net loss if his profits did not exceed those expenses.

The Provision of Employee Benefits: The contract between Rosato and Tanner included retirement plan participation, medical and life insurance plans and unemployment insurance; Rosato obviously received benefits and, despite indications of an independent contractor status, the reception of these benefits strongly indicates an employer-employee relationship.

Payment to the Worker by the Job or by the Time: The court observed that Rosato's pay came from the commissions for his sales activity and was not based upon time; Rosato, in fact, could set his own time schedule.

The Principal's Regular Business Activity: The court relied strongly upon the fact that Rosato was engaged solely in the regular business activity of Tanner and that he could not compete with them in any similar business; such a fact strongly indicates his employee status.

The Permanency of the Work Relationship: The facts indicate that Rosato had been working for Tanner since 1975; thirty-one years of employment, of receipts of W-2 forms for that entire time indicated to the court that the work relationship was quite permanent.

The Power of the Principal to Discharge an Individual: Tanner considered Rosato to be an employee at will and retained the right to discharge him at any time; this fact again strongly indicates an employer-employee relationship.

Feaster v. Commissioner[13]

A second Tax Court decision held that an accountant acted as a common law employee rather than an independent contractor. Daniel Feaster could not use Schedule C but was required to list the unreimbursed business expenses on Schedule A.

From 2002 to 2009, Feaster performed field auditing services for William Langer and Associates of South Carolina. He had provided his employer with a completed W-4 form, Employee's Withholding Allowance Certificate, and W-2s had been issued to him throughout his time of employment. Feaster's employee job description set time limits on the performance of his work, its quality, his customer charges, his progress reports and his submission of weekly itineraries.

His job description indicated that cases were to be completed and that federal, state, county and city taxes would be deducted from the billable hours for which he was paid. During the 2006 tax year, at issue in this case, Langer paid Feaster $29,650 in wages and withheld federal income, Social Security and Medicare tax; Feaster received reimbursement of $6,764 for his expenses.

Even though he received his regular W-2 form, Feaster filed his 2006, Form 1040, federal income tax return with a Schedule C attached; Feaster claimed that he was an independent contractor entitled to deductions for car, office, travel and meal and home office expenses. In an explanatory note concerning the forms and schedules filed, Feaster indicated that his self-employment tax had been partially paid by one of his clients, Langer, and that that same client deducted the necessary Social Security and Medicare tax.

The Internal Revenue Service issued a notice of deficiency against Feaster indicating that he was neither a statutory employee nor an independent contractor.

The Tax Court in this case closely followed the reasoning of the *Rosato* decision. After noting that Feaster did not claim he was a statutory employee, the court indicated that Langer's control over Feaster's work sufficed: the accountant's job description, the acceptance of employer guidelines concerning case time limits, frequency of submissions, charges to the customer, submission of itineraries and case closings signified constant employer supervision. Feaster had indicated that he was not very good about communicating with Langer and Langer never objected to this failure. But the employer had either controlled, or had power to control, its employee.

The other elements used to determine whether or not Feaster qualified as an independent contractor also clearly indicated that he was a common law employee under the *control* of the parties. The *perception of the parties* was clearly indicated in the employment agreement under the issuance of Form W-2 during the entire course of Feaster's employment. Although Feaster had to supply his own internet service and at times worked out of his home, his *investment in the business* was not considerable because he was reimbursed for hotel, meal and vehicle mileage and he had no possibility of individual *profit or loss*. Langer also provided health insurance, life insurance and retirement plan *benefits* which were available even if not used by Feaster. Feaster also received an hourly wage subject to an increase or decrease depending upon his performance – he was paid by the *time he worked,* and not by the cases he completed. Feaster's work was part of the principal's *regular business* and the accountant worked for an extended period of time so that the employment was considered to be *permanent*. In addition, Langer, the principal, possessed the *power to discharge* Feaster at any time.

The taxpayer, then, had the obligation to use Schedule A for the declaration of unreimbursed business expenses and did not have the right to use Schedule C in order to amplify those expenses.

Robinson v. Commissioner[14]

The *Robinson* decision and the *Hathaway*[15] determination, which follows, held that a college professor and a traveling sales representative for a clothing manufacturer could properly be designated as independent contractors. Both of these individuals, then, could use the expanded benefits for the declaration of business expenses available under Schedule

C, but were obligated to pay self-employment and other taxes associated with such designation.

Robinson worked as a full time criminal justice professor for Rowan University, located in southern New Jersey. At the same time he held a position at Temple University in Philadelphia as an adjunct professor: he was a vocational instructor in its Criminal Justice Training Program, a non-credit course of studies required by Pennsylvania state law for Pennsylvania police officers and other criminal justice personnel. Robinson was not responsible for managing the enrollment of his classes, but at the same time bore no risk of loss for under enrollment, nor the possibility of earning a profit. Topics he taught were mandated by the State of Pennsylvania; Temple supplied Robinson with those topics, but Robinson many times wrote or edited the entire curriculum which then became the property of Temple University.

From 1985 to 1996 Temple treated Robinson as an independent contractor and supplied him with Form 1099-MISC Miscellaneous Income statements for his income tax return. After this time Temple began to treat Robinson as an employee and report his income on Form W-2. Robinson requested the university to treat him as an independent contractor, but the university refused.

Temple did not supply Robinson with an office and Robinson completed his Temple assigned work in his home office. Prior to the tax year 2004 Robinson had filed Form 1040 with a Schedule C attached; in a dispute with the Internal Revenue Service about one of these prior tax returns, the Service had stipulated that Robinson had no deficiency for the tax year in issue, without determining that Robinson was an independent contractor. For the tax years 2004 and 2005 Robinson continued to file Form 1040 with a Schedule C

attached, but did not file the 2004 return until 4-19-07 and the 2005 return until 6-13-07.

On the 2004 Schedule C, Robinson and his market company manager wife claimed income of $1,795 and expenses totaling $25,164 relating to Robinson's services to Temple. On the 2005 Schedule C, Robinson and his wife claimed income of $4,045 and expenses totaling $26,825 from Robinson's work at Temple.[16] In late 2007, the IRS mailed letters to Robinson and his wife in order to indicate that their 2004 and 2005 tax returns would be examined.

At the examination, Robinson provided no documentation substantiating his reported expenses, although Robinson did continue to indicate that he should be treated as an independent contractor. The Service determined that Robinson was a common law employee but the Tax Court reversed this determination.

As in all decisions dealing with this matter, the Tax Court examined a number of relevant factors to determine whether Robinson acted as an independent contractor in his instructor work for Temple University. These same nine factors were discussed in detail in the *Rosato* decision above: degree of control; perception of the parties; work facilities investment; individual profit or loss; employee benefits; payment by job or by time; regular business activity; permanency of relationship; power to discharge.

The court observed that an adjunct professorship such as Robinson's position at Temple usually involves the university assignment of the courses to be taught and where to teach them. Robinson's duties at Temple, however, were similar to other situations[17] in which schools hired professors to teach in somewhat independent non-credit programs:

Robinson's work as a vocational instructor in a non-credit criminal justice training program. Robinson wrote course materials and syllabi for topics supplied by the state of Pennsylvania, which paid Temple University for the courses. The university did set time deadlines for the completion of the work, but did not exercise control over how Robinson completed the work. The *control test* suggests that Robinson is an independent contractor.

The *perception of the parties* clearly indicated that Temple University considered Robinson a common law employee when it began to issue him W-2 forms beginning in 1996; but Robinson had formally been treated as an independent contractor and contended that he continued to operate independently. In addition, the university did not provide Robinson with any office space in which to write and update course materials so that Robinson's *work facilities investment* could have included a home office. Robinson's *individual profit or loss* would stem not only from the enrollment success of the courses which he taught but also from the expert testimony and other criminal justice training course opportunities which would result from his work. Robinson also received no *employee benefits* from Temple, reinforcing his independent contractor status. Although Robinson was paid by the hour for his teaching duties, his *fee for writing* suggests an independent contractor relationship with Temple. Since the university is not a police training academy, Robinson's work of teaching non-credit courses to police officers through contracts with the state of Pennsylvania is not an essential part of Temple's *regular business*. Although Robinson taught in the criminal justice training program for many years, his employment during the tax years 2004 and 2005 were minimal and the relative *permanence of the work relationship* is also arguably minimal. Because Robinson's contracts with Temple were not provided, it is difficult to

determine whether or not the principal could discharge its alleged employee. Several letters during 2004 and 2005, however, indicate that Robinson was hired by the university separately for individual jobs during each year. Temple's recourse, therefore, would be to not hire him for future projects, but the university would not have the *power to discharge* him in the midst of his duties.

Despite his status as an independent contractor, however, Robinson's Schedule C claims for expenses were not allowed due to his tremendously inadequate record keeping. Robinson provided no receipts or invoices, but only some cancelled checks and credit card statements which did not give any details about the items purchased or the expenses incurred for other matters.

Due to his inaccurate filings, Robinson was held responsible for accuracy related penalties under IRC Sec. 6662(a).[18]

Hathaway v. Commissioner[19]

Hathaway began working as a traveling sales representative in 1969. During the tax years 1989 and 1990, the years in issue in this case, Hathaway worked for The Apparel Group, Ltd. (TAG). TAG manufactured clothing and its wholesale distribution and retail sale. Hathaway assisted in the distribution of men's clothing to retail customers during fall and spring sales seasons. Hathaway and twenty-two other sales representatives were experienced professionals, most of whom had been working for TAG for more than twenty years.

Each representative had his own exclusive territory. If a sales representative made a sale outside of the assigned territory, the sales representative to whom the territory was

assigned would receive the commission. Early in 1990 and during the tax years in question, Hathaway's sales territory included North Carolina, South Carolina, Wyoming and parts of Minnesota; he traveled throughout these this territory but also maintained showrooms where he solicited sales.

TAG gave no sales training to Hathaway. He and the other representatives used their own creativity and experience. They changed their methods and used their own business judgment to effectuate sales and to schedule their time. In addition, TAG provided no customer leads nor were the representatives required to report on leads to TAG. TAG did have two sales meetings each year but did not require the representatives to attend. This company's sales procedure manual detailed ways in which orders were to be placed with TAG and did request representatives to submit their schedules, but these provisions were not followed; the manual also reserved sales cancellation rights to TAG, but TAG always accepted the representatives recommendations in this regard.

Hathaway communicated with TAG minimally throughout the time of his work for the company: he sent his orders on a scratch pad which were then documented on TAG forms. Credit reports were required but no other type of report was used. Otherwise, Hathaway reported to TAG on an irregular basis. He spoke by phone from time to time to the company's national sales manager, who did have final approval when a special sales arrangement was made with a major company.

TAG paid its representatives on a commission basis and permitted a draw against the previously earned commission's reserve. TAG issued Forms W-2 to Hathaway in the amounts of $102,837.28 in 1989 and $129,283.05 for 1990; federal income taxes and Social Security (FICA) taxes were withheld.

Hathaway also participated in the TAG pension plan and the company provided him with disability, life and medical insurance benefits.

Hathaway's expenses for the tax years in question were considerable: he and other representatives had to pay their own travel, lodging, telephone and food expenses; a portion of his moving expenses, a percentage of advertising expenses and for any other materials besides order forms, swatch cards and preaddressed envelopes. Hathaway spent approximately $2,000 per year on the tools of his trade such as sample cases, business cards and stationery.

Hathaway also had to maintain his own business quarters, one in his home in Iowa and the other in a Minnesota mall. The business quarters included an office space with desk, computer, printer, bookshelf system, fax machine, copying machine and filing cabinets. His quarters also had a showroom with display tables and full glass racks to exhibit TAG merchandise. Hathaway also had to employ order writers and people to assist him at apparel shows.

If the costs of Hathaway's work in soliciting sales were greater than the commissions generated then Hathaway would have operated at a loss; he would also have suffered a loss as the result of his guaranteeing the credit of a purchaser on an account, which he did from time to time at the request of the company.

In addition, during 1989 and 1990, Hathaway handled noncompeting merchandise for a glove company for which he received commissions. Even if Hathaway were terminated by the company, he would retain commissions on eighty-five percent of unshipped orders. TAG would retain the other fifteen percent to cover the costs of orders that may later be cancelled for credit or other reasons.

The Tax Court held that Hathaway was an independent contractor in 1989 and 1990 and had the right to use Form 1040 Schedule C; he would not, however, be subject to unemployment taxes because of the amounts already paid by TAG.

The court reasoned that a taxpayer's independent contractor or common law employee designation is a question of fact which must be determined in accord with the nine criteria already mentioned. The opinion is remarkable for explicitly indicating which of the criteria argue for independent contractor or common law employee status.

TAG's *degree of control* over Hathaway was indicated as the single most important factor in determining Hathaway's independent contractor status. The court had to consider not only what actual control was exercised but what right of control practically existed. The court concluded that TAG did not control, nor have the right to control, Hathaway's actions: means or results of solicited sales; sales training; sales leads or sales reports. The statements in the sales procedure manual were "toothless"[20] as none of the procedures described in it were ever enforced, except for certain requirements about the placing and cancellation of orders. The TAG national sales manager supervision requirement, furthermore, was so limited and rare as to be inconsequential: it came into effect only when a special sales negotiation occurred with major companies. The court also rejected TAG's contention that the assignment of exclusive sales territories amounted to control as far as the sales activity itself was concerned.

The other criteria received a briefer treatment. The *perception of the parties*, gleaned from the evidence of Tax Court testimony indicated that Hathaway and sometimes TAG itself

considered Hathaway as an independent contractor or independent agent. But this testimony is contradicted by the fact that Hathaway used Form 1040 Schedule A for many years and that TAG issued Forms W-2 and withheld taxes from his commissions. The court concluded that the bulk of the evidence points to the perception that the parties considered themselves as in an employer-employee relationship. The *work facilities and sales materials and equipment investments* were so substantial, relative to TAG's reimbursement, that the court had no difficulty in reaching the conclusion that this criterion indicated Hathaway's independent contractor status. As already indicated in the factual description of his work, Hathaway's individual *opportunities for profit or loss* included non-reimbursement for order losses from merchandise which could not be shipped and losses from guaranteeing the credit of a customer who failed to pay. The evidence once again indicated that Hathaway could claim independent contractor status. TAG did provide a pension plan, disability, life and medical insurance *benefits*. Such provisions support a conclusion that Hathaway was an employee. The court never explicitly dealt with the *payment by job or by time* criterion, but it is quite obvious from the facts that Hathaway received commissions from sales jobs completed rather than from time spent in negotiating those sales – a factor that would indicate independent contractor rather than common law employee status. The court did observe that Hathaway's activity is certainly an *integral or regular part of TAG's regular business activity*; this factor, the court concluded, would again support a determination of Hathaway's status as an employee. Since Hathaway had worked for TAG since 1969, the *permanency of his relationship* with TAG would indicate his employee status. The court finally observed that TAG's *power to discharge* Hathaway and Hathaway's right to leave TAG's employment created an employment at will. TAG's right, however, does not clearly indicate employee status because, from the context,

TAG would probably have the same right to discharge an independent contractor. This criterion, then, has little impact upon a determination of status.

The current analysis of the Hathaway case, then, indicates that four criteria (control, investment, profit/loss, and job/time) argued for independent contractor status and four criteria (perception, benefits, regular business, and permanency) supported common law employee status. The power to discharge criterion was deemed inconclusive by the court.[21]

CONCLUSION: A PLAN OF ACTION

The Internal Revenue Code, IRS publications and the four decisions described above will enable the tax practitioner to plan procedures for the practitioner's benefit and for the benefit of the tax client.

The tax practitioner will receive benefit from acquaintance with code provisions concerning the additions and penalties for late and inaccurate returns; from IRS publications including Publication 15-A concerning the criteria used to determine the elements and examples of independent contractors, common law employees, statutory employees and statutory non-employees; from the Tax Court decisions which richly describe the application of the nine criteria to a number of professions including accountants, instructors and traveling sales representatives.

Tax clients, including business consultants or advisors, will receive benefit from tax professional software and other means of communication which assist them to adequately judge the need for professional counsel; to keep work records by way of computer and other media in day-to-day journals of business activity; to apply the nine criteria properly, especially

in questions of control, perceptions of the parties by way of written agreement and issuance of W-2 forms, and potential for profit and loss.

ENDNOTES

[1] IRC Section 62(a)(2); Section 63(a),(d); Section 67(a),(b); Section 162(a).

[2] IRC Section 55(a). The alternative minimum tax requires that corporations and individuals pay a certain minimum which would include the greater amount of the regular tax of the tentative minimum tax at 26% of the first $175,000 and 28% on all taxable excess. Section 56(b)(1)(A) provides that in computing Alternative Minimum Taxable Income, no deduction will be allowed for miscellaneous itemized deductions.

[3] IRC Section 3121(d)(1),(3) defines a statutory employee as any (1) any officer of a corporation; or (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or (3) any individual (other than an individual who is an employee under paragraph (1) or (2)) who performs services for remuneration for any person (A) as an agent-driver or commission-driver engaged in distributing meat products, vegetable products, fruit products, bakery products, beverages (other than milk), or laundry or dry-cleaning services, for his principal; (B) as a full-time salesman; (C) as a home worker performing work, according to specifications furnished by the person for whom the services are performed, on materials or goods furnished by such person which are required to be returned to such person or a person designated by him; or (D) as a traveling or city salesman, other than as an agent-driver or commission-driver, engaged upon a full-time basis in the solicitation on behalf of, and the transmission to, his principal (except for side-line sales activities on behalf of some other person) of orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations; if the contract of service contemplates that substantially all of such services are to be performed personally by such individual.

[4] *Daniel Feaster v Commissioner*, TC Memo 2010-157, 2010 Tax Ct. Memo LEXIS 194. Feaster argued that he was an independent contractor whose self employment tax has been paid by the business for whom he provided auditing services.

[5] IRS website at www.irs.gov Even common law employees may itemize job travel expenses for travel from home to a site other than the employee's usual place of business.
[6] IRS Publication 15-A – Employer's Supplemental Tax Guide, p.5.
[7] *Thomas Rosato, et ux. v. Commissioner*, TC Memo 2010-39, 2010 Tax Ct. Memo LEXIS 40, for a treatment of the common law employee definition; this treatment appears in many Tax Court and other cases treating the employee status.
[8] IRS Publication 15-A – Employer's Supplemental Tax Guide, pp.7, 8; *Weber v. Commissioner*, 103 T.C. 378 (19940, *aff'd*, 60 F.3d 1104 (4th Cir. 1995).
[9] *Donald T. Robinson, et ux. v. Commissioner*, TC Memo 2011-99, 2011 Tax Ct. Memo LEXIS 97; 1 Restatement of Agency, 220 (1958).
[10] IRS Publication 15-A – Employer's Supplemental Tax Guide, p.6.
[11] TC Memo 2010-39.
[12] *Thomas Rosato, et ux. v. Commissioner*, 2010 Tax Ct. Memo LEXIS 40 at 9-10. An individual qualifies as a statutory employee under section 3121(d)(3) only if the individual is not a common law employee pursuant to section 3121(d)(2). Section 3121(d) defines "employee", in pertinent part, as follows**:**

> (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of employee; or
> (3) any individual (other than an individual who is an employee under paragraph (1) or (2)) who performs services for remuneration for any person—
>
> > (D) as a traveling or city salesman, other than as an agent-driver or commission-driver, engaged upon a full-time basis in the solicitation on behalf of, and the transmission to, his principal (except for side-line sales activities on behalf of some other person) of orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations;

if the contract of service contemplates that substantially all of such services are to be performed personally by such individual; except that an individual shall not be included in the term "employee" under the provisions of this

paragraph if such individual has a substantial investment in facilities used in connection with the performance of such services (other than in facilities for transportation), or if the services are in the nature of a single transaction not part of a continuing relationship with the person for whom the services are performed;

[13] TC Memo 2010-157.

[14] TC Memo 2011-99.

[15] *Paul E. Hathaway, et ux. v. Commissioner*, TC Memo 1996-389, 1996 Tax Ct. Memo LEXIS 409

[16] The *Robinson* decision concerns the income tax status of both Robinson and his wife, but this article concentrates upon Robinson because the Tax Court did find that Robinson was an independent contractor, whereas his wife was held to be a common law employee. Since this article has already examined two decisions which determined that the taxpayer was a common law employee, the portion of the *Robinson* opinion dealing with Robinson's marketing company manager wife is omitted.

[17] *Reece v. Commissioner*, TC Memo 1992-335, 1992 Tax Ct. Memo LEXIS 358, where a full time university professor (a common law employee for his full time work) acted as a seminar instructor for an executive education program. For this work, Reece was held to be an independent contractor because he designed, led and taught the non-credit program, even though the program occurred in classrooms supplied by the university.

[18] 2011 Tax Ct. Memo LEXIS 97 at 42-43.

[19] TC Memo 1996-389.

[20] 1996 Tax Ct. Memo LEXIS 409 at 23.

[21] The *Hathaway* Tax Court, in endnote 7, noted that the Service requested that benefits provided by TAG to Hathaway should be taxable as income to him if the court determined that Hathaway was an independent contractor; this contention however, was not properly pleaded and was not considered by the court.

THE EVOLUTION OF THE "SURVIVING SPOUSE" UNDER THE ESTATES POWERS AND TRUSTS LAW

by

Elizabeth A. Marcuccio*
Colin Dwyer**

I. INTRODUCTION

Under the Estates Powers and Trusts Law (EPTL) the concept of the surviving spouse was originally used as a proxy for the person closest to and/or most dependent upon the deceased spouse; the natural object of the deceased spouse's bounty. As a result the surviving spouse has priority to administer the deceased spouse's estate, as well as priority of intestate distribution. In addition the surviving spouse has the right to take an elective share of the deceased spouse's estate. Since these rights are significant, should they be automatically available to all individuals who meet the statutory definition of "surviving spouse"? What of spouses who remain married but live apart for years? What of married partners who develop fulfilling committed relationships with other persons, without formally divorcing their spouse?

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* Associate Professor of Business Law, Siena College
** Adjunct Professor of Business Law, Siena College

What of surviving spouses who wrongfully enter into marriages with incapacitated individuals solely to manipulate a testamentary scheme for their own financial gain? Marriage is now understood as an economic partnership rather than a sacred contract for life. Thus the current estate concept of "surviving spouse" may no longer serve the purpose for which it was originally intended.

II. MARRIAGE OF CONVENIENCE

An important question to address is whether an individual should be entitled to the benefits that accrue to a surviving spouse if she effectively is in a marriage of convenience. In the *Estate of Shoichiro Hama*[1] the Court examined this issue. In *Hama* the spouse, Yuko Machida, worked for the decedent and they dated with the understanding that their relationship was not exclusive. In late 2004, with decedent's knowledge, Machida began a relationship with Travis Klose, with whom she and the decedent socialized. Early in 2005 Klose moved to Japan, and in May 2005 Machida moved into the decedent's apartment.[2]

In 2006 decedent told his accountant that he intended to sell his condominium apartment in Manhattan. Decedent was informed that there would be a capital gains tax on the sale of approximately $60,000. When asked by the decedent what could be done to mitigate this tax, the accountant stated, in jest, that if the decedent was married on the date that the apartment was sold, there would be no capital gains tax. A few weeks later, on July 7, 2006, decedent married Machida. Decedent sold his apartment on September 6, 2006, and in November 2006 decedent informed his accountant that he wanted to

divorce Machida.[3] Due to the large tax savings decedent received because of his marriage, his accountant advised him against divorce, and recommended that he stay married for approximately two years.

In 2007 decedent and Machida moved to Japan. Here, with decedent's knowledge, Machida continued her relationship with Klose. Feeling pressure from her parents, Machida registered in Japan as being married to Klose. Decedent was fully aware of her plan to register as married to Klose, and acted as a witness to said marriage, signing the marriage certificate and affixing his personal seal.[4] Despite this "registration" or "marriage", decedent still considered himself legally married to Machida and entitled to the tax benefits that resulted from that marriage. In August 2009 decedent contacted his accountant by email and discussed his intention to sell another apartment in New York. He also asked whether he could now obtain a divorce from Machida. Due to the tax savings decedent could realize on the upcoming real estate transaction, his accountant again advised against divorce. Decedent died without a will on September 4, 2009, leaving an estate of approximately $1.5 million subject to administration in New York. He was survived by his parents and Machida, his "surviving spouse".[5]

On December 4, 2009, Machida petitioned for the issuance of letters of administration to herself and her designee, and on January 11, 2010, decedent's parents cross-petitioned for the same.[6] Temporary Letters of Administration were issued to Machida's designee. The designee of decedent's parents filed a motion for summary judgment seeking revocation of the temporary letters and dismissal of Machida's administration petition based on the claim of spousal abandonment.[7]

III. SPOUSAL ABANDONMENT

The Estates Powers and Trusts Law (EPTL) provides that a husband or wife is a surviving spouse unless it is established that said spouse abandoned the deceased spouse, and such abandonment continued until the time of death.[8] The statute contains no definition of "abandonment," but historically, the courts have recognized the requirements of the Domestic Relations Law (DRL) as implicit in the EPTL.[9] The standard used to determine if a surviving spouse abandoned the decedent is the same standard used to determine whether the party would have been entitled to a decree of separation or divorce on the grounds of abandonment.[10] The DRL states that the abandonment must be for a period of one or more years,[11] and long-standing case law further states that departure from the marital abode or living apart is not enough to constitute abandonment. In *Matter of Maiden* the Court defined abandonment as the unjustified departure of a spouse from the marital home without the consent of the other spouse.[12]

That abandonment must include lack of consent by the spouse that was left behind continues to be the law to this day.[13] Even if the decedent and the surviving spouse lived apart for decades, without evidence that the spouse's departure was without the decedent's consent, there is no abandonment.[14] The burden of proof as to abandonment, including lack of consent, is on the party alleging it.[15] Applying this standard to the *Hama* case, the Court found that the decedent's parents could not meet the burden of proof. The decedent's participation in the registration of Machida's marriage to Klose is the exact opposite of the "lack of consent" needed to find abandonment.[16] The Court, however, did not rely on these

cases when deciding *Hama.* Instead the Court turned to another appellate decision, *Matter of Oswald*[17] in deciding this case.

IV. THE IMPACT OF OSWALD

In *Matter of Oswald* the "surviving spouse" alleged the he and the decedent had entered into a common law marriage in Pennsylvania some years prior to the decedent's death. The parties subsequently exchanged mutual releases, and each went on to marry another.[18] The Court found that there was abandonment, quoting language in the trial court opinion in *Matter of Bingham*[19]. "The court knows of no more convincing evidence of abandonment than the public ceremonial remarriage of the petitioner to another woman in the lifetime of the decedent and his cohabitation with such woman as husband and wife."[20] Here, instead of focusing on the lack of consent of the spouse left behind, the Court's focus is entirely on the intent of the spouse who left, defining abandonment as desertion of a spouse with the intent not to return, or with the intent that the marriage should no longer exist.[21] This is contrary to prior case law.

The Court of Appeals affirmed *Oswald* without opinion.[22] Thus it is unknown whether the Court agreed that abandonment could be found based upon the leaving party's intent not to return, creating an exception to its longstanding *Maiden*[23] decision, or whether the Court agreed that a marriage never existed, which was a hotly contested issue in this case. In the end, in deciding *Hama* the Court found that whether *Oswald* did or did not partially overrule or create an exception to *Maiden* was ultimately for the Court of Appeals to determine, and held that Machida had abandoned the decedent, thereby losing her rights as a surviving spouse.[24]

V. PUBLIC POLICY

For decades the courts have been applying the abandonment requirements of the Domestic Relations Law to determine whether an individual qualifies as a surviving spouse under the EPTL. The abandonment disqualifications of EPTL 5-1.2 (5) apply to three distinct issues relating to a deceased spouse's estate: the right to serve as administrator,[25] the right to an intestate share,[26] and the right to elect against a will where the surviving spouse is left less than one-third of the deceased spouse's estate. [27] If the deceased spouse meets the definition of a "wronged" spouse who is eligible for a divorce based on abandonment under the DRL, the living spouse does not qualify as a "surviving spouse" and is not entitled to the related benefits.

The Court in *Hama* examined the history of spousal relationships under New York's divorce law, noting that in 2010 New York did away with fault-based divorce, the system from which the concept of abandonment first arose. Now whether a spouse seeking a divorce was truly "wronged" by having been left against his or her wishes, with the accompanying burden of proving lack of consent, becomes far less important, if not irrelevant. Therefore the strict definition of abandonment in the DRL, which has been carried over into the EPTL, may no longer be valid or justified.[28]

VI. WRONGFUL MARRIAGES

Another issue that courts have addressed is whether a "surviving spouse" is entitled to an elective share if the marriage occurred while the decedent lacked the requisite mental capacity to enter into a marriage contract. New York does not have a statute that specifically addresses this situation. In *Campbell v. Thomas*[29] the decedent was diagnosed with terminal cancer and severe dementia due to Alzheimer's

disease early in 2000. His daughter, who was also his primary caretaker, took a one-week vacation in February 2001. Decedent, who was then 72 years old, was left in the care of Nidia Thomas, then 58. During this time Nidia and the decedent were secretly married, and Nidia subsequently transferred certain assets of the decedent into her name.[30]

In March 2001 decedent's daughter learned of the marriage. She confronted the decedent, who had no awareness of the marriage and adamantly denied that it occurred. Decedent died in August 2001.[31] In November 2001 decedent's children commenced an action in Supreme Court seeking a judgment declaring Nidia's marriage to the decedent to be null and void. The complaint was later amended to add causes of action alleging undue influence, conversion and fraud.[32] In January 2003 decedent's son was issued letters of administration C.T.A., and in May 2003 Nidia filed a right of election in Surrogate's Court.[33] Decedent's children moved for summary judgment in Supreme Court, submitting affidavits detailing the decedent's mental state over the past three years. Due to his dementia decedent had become extremely forgetful and experienced great confusion as to who various individuals were. The decedent's primary physician and neurologist confirmed that decedent did not have the mental capacity to provide for himself or understand his legal and financial affairs.[34] This information had been conveyed to Nidia.[35]

In opposition to the children's motion for summary judgment and in support of her cross motion for the same, Nidia submitted her own affidavit stating that she had had a 25-year, non-exclusive relationship with the decedent during which he asked her to marry him four times. She stated that he had the requisite mental capacity to enter into the marriage vows, even though he did have moments of forgetfulness. The affidavits of the pastor who performed the marriage and the

two witnesses to the marriage each asserted that the decedent knew he was marrying Nidia, however the pastor, when deposed, stated that he would not have performed the ceremony if he knew of the decedent's medical condition.[36]

The Supreme Court denied both motions for summary judgment and the decedent's children appealed. In 2007 the Second Department remitted the matter to the Supreme Court for the entry of judgment declaring the marriage and all asset transfers by Nidia null and void due to decedent's lack of capacity to understand his actions and inability to consent.[37] The Supreme Court issued an order consistent with the ruling of the Appellate Division.[38] Nidia appealed.

VII. STATUTORY INTERPRETATION

On appeal Nidia contended that pursuant to the relevant statutes, she should be considered the decedent's surviving spouse at the time of the decedent's death even if the marriage is subsequently annulled or voided. Therefore she is entitled to an elective share of the decedent's estate. The Domestic Relations Law states that if a party to a marriage is "incapable of consenting to a marriage for want of understanding" such marriage is voidable.[39] The DRL defines a voidable marriage as void from the time its nullity is declared by a court of competent jurisdiction.[40] The Court disagreed with Nidia's reasoning, stating that under the DRL the distinction is not that void marriages are nonexistent from the beginning, while voidable marriages are valid until declared void. Rather both void and voidable marriages are void from their beginning, the difference between them being that parties to a void marriage are free to treat the marriage as a nullity without the involvement of a court, while a voidable marriage may be treated as a nullity only if a court decrees it so.[41]

The Court then examined whether its determination that Nidia's marriage to the decedent was null and void rendered the marriage void from its beginning for purposes of the right of election. The DRL provides:

> An action to annul a marriage on the ground that one of the parties thereto was a mentally ill person may be maintained at any time during the continuance of the mental illness, or, after the death of the mentally ill person in that condition, and during the life of the other party to the marriage, by any relative of the mentally ill person who has an interest to avoid the marriage.[42]

Yet the EPTL provides that a husband or wife is considered a "surviving spouse" with a right of election against the deceased spouse's estate unless a final decree or judgment of divorce or annulment was in effect when the deceased spouse died or that under the DRL the marriage was void as incestuous, bigamous or a prohibited remarriage.[43] As the Court in *Campbell* noted, this provision appears to render the right of family members to obtain a post-death annulment largely illusory.[44] The marriage between Nidia and the decedent was not declared a nullity until the Court declared it so in January 2007, more than five years after the decedent's death. Thus under the EPTL Nidia technically had a legal right to an elective share as a surviving spouse.[45] However the literal terms of a statute should not be rigidly applied if to do so would allow the statute to be an instrument for the protection of fraud.[46]

VIII. EQUITABLE PRINCIPLES

The Court in *Campbell* acknowledged that the Supreme Court is a court of equity as well as law, and is empowered to grant relief consistent with the principle that a person should not be permitted to profit from her own fraud.[47] Pursuant to this doctrine, the wrongdoer is deemed to have forfeited the benefit that would flow from her wrongdoing. The Court found that there were ample facts to conclude that Nidia was aware of the decedent's lack of capacity to consent to marriage, and that she took unfair advantage of his condition for her own pecuniary gain, at the expense of the decedent's heirs. Since she procured the marriage through overreaching and undue influence, Nidia should not be permitted to benefit from that conduct. Therefore, she has forfeited any rights that would flow from that marital relationship, including her statutory right to an elective share of decedent's estate.[48]

That Nidia had known the decedent for 25 years, had a close relationship with him, and had legitimately been named as one of the beneficiaries of his retirement account does not reduce her culpability. These facts indicate that Nidia was in a position of trust, which she abused, and that she could not plausibly deny awareness of the decedent's mental incapacity.[49] Under these circumstances equity intervenes to prevent unjust enrichment of the wrongdoer.[50] The Court found that this result was necessary not only to protect incapacitated individuals and their rightful heirs from overreaching and undue influence; it was also necessary to protect the integrity of the courts themselves.[51]

IX. CONCLUSION

The current estate definition of "surviving spouse" is largely based on the antiquated societal definition of "marriage". The shifting concept of what constitutes a family, the alterations in economic dependence and the need to protect

the elderly in an aging society all suggest the need to review the statutory protections afforded a surviving spouse. This is especially true when individuals marry solely to obtain financial gain. One question deserves consideration: Does it matter whether it was the decedent or the surviving spouse who entered into the marriage to attain a financial windfall?

In the *Estate of Shoichiro Hama*[52] the decedent married Machida solely to avoid $60,000 of capital gains tax upon the sale of his Manhattan condominium. This is evident from the decedent's behavior. Decedent married Machida "a few weeks" after he learned of the tax advantages of being married. Four months after the marriage and two months after the sale of his condominium, decedent wanted a divorce.[53] Although it is unknown whether Machida was financially compensated for marrying the decedent, it was the decedent who initiated the marriage to obtain favorable treatment under the income tax laws. The Court found that Machida had abandoned the decedent, thereby losing her rights as a surviving spouse, even though prior case law did not dictate this result. Did the decedent, a sophisticated businessman who exploited the institution of marriage for financial gain, deserve the Court's sympathy? He could have easily entered into a prenuptial agreement to prevent Machida from obtaining the statutory rights of a surviving spouse. This is not true of incapacitated individuals who are enticed into marriage by wrongdoers.

In *Campbell v. Thomas*[54] the decedent's caregiver, Nidia, was well aware of the decedent's lack of capacity when she secretly married him. It appears from the facts of the case that Nidia's sole purpose in marrying the decedent was to obtain the financial benefits of a surviving spouse upon the decedent's death. Here the Court rightfully exercised its equitable powers to prevent Nidia from benefiting from her wrongdoing, and declared that she forfeited her rights as a

surviving spouse. In light of these cases, who can qualify as a "surviving spouse" under the relevant statutes deserves careful consideration by the New York legislature.

ENDNOTES

[1] *Estate of Shoichiro Hama*, 2009-4505 NYLJ 1202579753326, at 1 (Sur Ct, New York County, Decided November 26, 2012).
[2] *Id.* at 2.
[3] *Id.*
[4] *Id.* at 3.
[5] *Id.*
[6] *Id.*
[7] *Id.* at 4.
[8] N.Y. Est. Powers & Trusts Law § 5-1.2 (a)(5) (McKinney 1999).
[9] *Estate of Shoichiro Hama*, at 5.
[10] 2-32 Warren's Heaton Surrogate's Court Practice § 32.13 (2) (2012).
[11] N.Y. Dom Rel. Law § 170 (2) (McKinney 2010).
[12] *Matter of Maiden*, 284 NY 429, 432 (1940); accord, e.g. *Matter of Barc*, 177 Misc 578 (Sur Ct Kings County 1941), affd 266 AD 677 (2d Dept 1943), lv denied 266 AD 742 (2d Dept 1943).
[13] *Estate of Shoichiro Hama*, at 5.
[14] *Matter of Morris*, 69 AD3d 635 (2d Dept 2010).

[15] *Matter of Rechtschaffen*, 278 NY 336 (1938); *Matter of Ruff*, 91 AD2d 814 (3d Dept 1982).
[16] *Estate of Shoichiro Hama*, at 5.
[17] *Matter of Oswald*, 43 Misc 2d 774 (Sur Ct, Nassau County 1964), affd 24 AD2d 465 (2d Dept 1965), affd 17 NY2d 447 (1965).
[18] *Matter of Oswald*, at 775.
[19] *Matter of Bingham*, 178 Misc 801 (Sur Ct, Kings County 1942), affd 265 AD 463 (2d Dept 1943), rearg denied and lv denied 266 AD 669 (2d Dept 1943).
[20] *Matter of Bingham*, 178 Misc at 805 (Sur Ct, Kings County 1942).
[21] *Estate of Shoichiro Hama*, at 7.
[22] *Matter of Oswald*, 17 NY2d 447 (1965).
[23] *Matter of Maiden*, 284 NY 429, 432 (1940).
[24] *Estate of Shoichiro Hama*, at 8.
[25] N.Y. Surr. Ct. Proc. Act § 1001 (McKinney 2011).
[26] N.Y. Est. Powers & Trusts Law § 4-1.1 (McKinney 2012).
[27] N.Y. Est. Powers & Trusts Law § 5-1.1-A (McKinney 1999).
[28] *Estate of Shoichiro Hama*, at 10.
[29] *Campbell v. Thomas*, 73 AD 3d 103, 103 (2d Dept 2010).
[30] *Id.* at 105-106.
[31] *Id.* at 106-107.
[32] *Id*. at 106.
[33] *Id*.
[34] *Id*. at 108.
[35] *Id*. at 107.
[36] *Id.* at 108, 109.
[37] *Campbell v. Thomas*, 36 AD 3d 576, 576 (2d Dept 2007).
[38] *Campbell v. Thomas*, 73 AD 3d 103, 110 (2d Dept 2010).
[39] N.Y. Dom. Rel. Law § 7 (2) (McKinney 2010).

[40] N.Y. Dom. Rel. Law § 7 (McKinney 2010).
[41] *Campbell v. Thomas*, 73 AD 3d 103, 111 (2d Dept 2010).
[42] N.Y. Dom. Rel. Law § 140 (c) (McKinney 2010).
[43] N.Y. Est. Powers & Trusts Law § 5-1.2 (a) (McKinney 1999).
[44] *Campbell v. Thomas*, 73 AD 3d 103, 115 (2d Dept 2010).
[45] N.Y. Est. Powers & Trusts Law § 5-1.2 (McKinney 1999).
[46] *Campbell v. Thomas*, 73 AD 3d 103, 115 (2d Dept 2010).
[47] *Id*. at 116.
[48] *Id*. at 117-118.
[49] *Id*. at 118.
[50] *Id*. at 119.
[51] *Id*.
[52] *Estate of Shoichiro Hama*, 2009-4505 NYLJ 1202579753326, at 1 (Sur Ct, New York County, Decided November 26, 2012).
[53] *Id.* at 2.
[54] *Campbell v. Thomas*, 73 AD 3d 103, 103 (2d Dept 2010).

NEW YORK CITY'S PUBLIC HEALTH INITIATIVES: OBESITY AND THE NANNY STATE

by

Marlene Barken*
Gwen Seaquist**
Alka Bramhandkar***

INTRODUCTION

In light of the obesity epidemic and associated chronic diseases that are driving up health care costs, federal, state and local governments are attempting to regulate food-industry practices in the interest of public health. This paper will provide a case study of New York's initiatives to ban trans-fats, require menu labeling, and, most recently, limit portion size. The legal, scientific, health and financial justifications for such controls will be examined. Policy recommendations will focus on the optimal balance between government regulation and the free marketplace, the costs imposed on business versus the benefits anticipated, the use of mandates versus incentives to change behavior, and the role of personal responsibility in health-related decisions.

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* Associate Professor of Legal Studies, Ithaca College
** Professor of Legal Studies, Ithaca College
*** Professor of Finance & Int'l Business, Ithaca College

HISTORICAL BACKGROUND

"Those who watch with anxiety the upward movement of the weighing machine indicator will follow with interest the progress of the fat-reducing contest which began yesterday and will continue for one month. One hundred fat men and women who are to be restored to lines of grace were gathered on the roof of Madison Square Garden and addressed by Dr. Royal S. Copeland, (New York City) Health Commissioner. For a month, he said, the contestants would follow a program of diet and exercise and the winners would be awarded prizes on Nov. 23, at the Health Convention in Grand Central Plaza."[1]

While the above news item reads like a synopsis of the pilot for the popular television show "The Biggest Loser," it's actually an excerpt from *The New York Times'* close coverage of New York City's 1921 diet contest. The Health Department set the rules and even created the menus for the contestants. The portion-controlled daily bill of fare was published and looks remarkably like many of today's popular diets. Contestants were weighed and examined by a Board of Health physician and an exercise regimen was prescribed.[2] Weekly weights, successes, and confessions of "unauthorized meals" were duly reported to the public.[3] The Health Commissioner even questioned the spouses of contestants to determine whether "fat reducing" made for more harmonious home life.[4]

Perhaps New York City's current approach to diet and health stems from this early tradition, but history is replete with human struggles over weight and body image. In medieval times, religious and moral views of gluttony as a sin predominated, while later in the European romantic era, the focus was less on the act of overeating and more on the shape of the glutton. Though our own Ben Franklin led a notably profligate life during his time in France, he preached simplicity

and eating only for necessity in his *Poor Richard's Almanac*. Indeed, dieting rituals and promising reducing cures are an integral part of our cultural history, ranging from the ascetic health reformer, Reverend Sylvester Graham's first weight watchers in the 1830's, to the Jane Fonda Workout of the 1980's.[5]

What is different now is that the issue of obesity has shifted from a personal problem to an alarming matter of public health. Two-thirds of American adults are classified as overweight, and 36% of adults and 17% of children are obese. If current trends continue, by 2030 nearly half of American adults may be obese, and globally, the statistics are equally dire. Since 1990, obesity has grown faster than any other cause of disease.[6] It is commonly understood that increasing rates of obesity impose higher health care costs on society for the treatment of chronic illnesses such as Type II diabetes, hypertension, heart disease, and damage to weight-bearing joints. The Institute of Medicine estimates a $150-$190 billion per year price tag for obesity-related illnesses. Health-care costs for obese patients are roughly 40% higher than for those of normal weight.[7] If the government ultimately is going to pick up a significant portion of that tab, it has a strong stake in policies to fight obesity.

First Lady Michelle Obama's "Let's Move!" campaign and focus on childhood obesity helped garner support for the 2010 improvements to the school-lunch program adopting new dietary guidelines.[8] She also has focused attention on both urban and rural "food deserts," low-income communities where individuals cannot improve their eating habits and lose weight because they reside a significant distance from full-fledged grocery stores. Some of the $373 million of the 2010 federal stimulus package earmarked for health and wellness efforts has been used to bring healthy, affordable foods to economically

disadvantaged communities.[9] Such behavioral "nudges," or "soft paternalism," are designed to make healthy choices desirable, without annoying people.[10] The question is, do they work?

In light of the national health imperative, New York City's Health Department has gone well beyond diet contest incentives and subtle nudges. During his long tenure, Mayor Michael Bloomberg aggressively pushed multiple health-based measures to change consumer behavior. In 2002, New York City banned public smoking in the city's bars and restaurants. At the mayor's urging, in 2005, New York was the first city to force restaurants and other food vendors to phase out the use of artificial trans-fats, which have been linked to obesity and heart disease.[11] Then in 2008, New York became the first city to pass a law requiring food service providers to post calorie counts on menus.[12] New York successfully defended the ensuing legal challenge, and many cities followed New York's lead. In 2012 a federal law requiring any restaurant chain with more than 20 locations to publish calorie counts on their menus went into effect. In 2011, the mayor banned smoking in outdoor public venues, including public parks, plazas and beaches. He repeatedly attempted to regulate consumption of sugary sodas, and salt was also on the mayor's hit list. He wanted packaged food makers and restaurants to reduce sodium by 25% to lower high blood pressure and heart disease.[13]

The mayor's identification of soda as a chief culprit in the obesity epidemic is well supported. Noted nutritionist, Marian Nestle, calls soda "liquid candy,"[14] and a recent study from the University of California attributed 20% of America's weight gain between 1977 and 2007 to sugary drinks.[15] In 2010, Mayor Bloomberg proposed barring people from using food stamps to purchase carbonated and non-carbonated beverages

sweetened with sugar or high-fructose corn syrup. City officials estimated that residents spent $75-$135 million in food stamp benefits on such beverages annually. Arguing that the initiative would give New York families more money to spend on healthy food and beverage alternatives, Mr. Bloomberg sought permission from the Department of Agriculture to test its proposal in a two-year project. Fearing that any restrictions on soft drinks would set a precedent for the government to distinguish between good and bad foods (rather than bad diets), the food industry united in a fierce lobbying effort to defeat the request. Allies included anti-hunger groups and members of the Congressional Black Caucus who worried that the measure would stigmatize food stamp recipients.[16] The Department of Agriculture ultimately rejected the proposal as too difficult to enforce.[17]

Concurrent efforts included the city's graphic anti-soda advertising campaign and the mayor's endorsement of the state legislature's 2010 attempt to pass a penny-per-ounce tax on soda to generate revenue for education and health care.[18] That measure also failed to pass.[19] Then in May of 2012, the mayor proposed a "Portion Cap Rule" on the sale of sweetened drinks in containers larger than sixteen ounces at restaurants, delis, theatres, stadiums, and food courts. The New York City Board of Health approved the ban in September of 2012, and it was scheduled to go into effect March 12, 2013.[20] The American Beverage Association immediately responded with a vivid advertisement depicting Mayor Bloomberg as a nanny, and late night talk show hosts had a field day.[21] Opponents filed suit contending that such regulations were properly within City Council's purview. Industry groups called the limits unfair and argued that they would disproportionately affect small-business owners who would lose sales to nearby drug and grocery stores that were not affected. City attorneys asserted the Board of Health's authority to enact regulations to protect public health,

citing statistics that 58% of New York City adults and nearly 40% of city public school students in eighth grade or below are obese or overweight.[22] Mayor Bloomberg urged the state to remove any inconsistencies by extending the city's new law to those establishments not within the city's jurisdiction, and thus not covered by the ban.[23] Table 1 below delineates the beverages covered by the ban and the affected vendors.

One day before the Portion Cap Rule was to go into effect, State Supreme Court Judge Milton Tingling invalidated the law on the grounds that the city Board of Health lacked the jurisdiction to enforce it. He further held that the rule was "arbitrary and capricious" because it would not accomplish what it set out to do.[24] In July, 2013, New York's Appellate Division, First Department upheld Justice Milton Tingling's decision and reasoning. It found that the limit on sodas and other sugary drinks arbitrarily applied to only some sugary beverages and some places that sell them. Additionally, the court held that the Board of Health exceeded the bounds of its lawfully delegated authority as an administrative agency when it promulgated the ban.[25] Mayor Bloomberg vowed to continue the fight and appealed the decision to the New York State Court of Appeals, which agreed to hear the case.[26]

Meanwhile, the three big soft-drink companies are taking note. In a move aimed at stopping other cities from adopting similar rules, Coca-Cola, PepsiCo and Dr. Pepper Snapple Group voluntarily began displaying their products' calorie information on vending machines. A national campaign including messages intended to push consumers toward less sugary drinks is expected. The New York ban on large-sized sodas already has inspired serving-size and soda-tax proposals in other cities,[27] and many New York City establishments are voluntarily enacting restrictions on super-sized beverages.[28] Yet on a contrary note, Mississippi, which has the nation's

highest rate of obesity, recently passed an "Anti-Bloomberg" bill. The new law declares that only the state legislature has the authority to regulate the sale and marketing of food on a statewide basis, thus preventing counties, districts and towns from enacting portion size controls. Signing the new measure into law, Mississippi Governor Phil Bryant asserted that the government should not "…micro-regulate citizens' dietary decisions…The responsibility for one's personal health depends on individual choices about a proper diet and appropriate exercise."[29]

LEGAL ANALYSIS OF THE PORTION CAP RULE

In September of 2012, the New York City Board of Health passed §81.53 of the Health Code limiting the container size of sugary drinks to 16 ounces. The regulation specifically provides that "[a] food service establishment may not sell, offer, or provide a sugary drink in a cup or container that is able to contain more than 16 fluid ounces"[30] and that "[a] food service establishment may not sell, offer, or provide to any customer a self-service cup or container that is able to contain more than 16 fluid ounces."[31]

Prior to implementation, multiple plaintiffs representing groceries, delicatessens and "small stores" that regularly sell soda in cups, brought an action in New York County Supreme Court challenging the enactment. Unlike previous challenges to Mayor Bloomberg's public health regulations, the central issue in this case was based on a balance of powers argument. The soda advocates argued that the Board of Health had no power to pass legislation because such action is reserved to either the New York City Council or the New York State Legislature.

Agreeing with the basic tenets of this argument, Judge Tingling's ruling was based on a technical balance of powers

argument. The court relied on the seminal New York case of *Boreali v. Axelrod*[32] in its decision. That case involved a 1980's law passed by the New York State legislature banning smoking in public places, specifically, libraries, museums, theaters and public transportation facilities.[33] When attempts by the legislature to expand the law to other venues failed, the Public Health and Planning Council, an administrative agency of New York State, "promulgated the final set of regulations prohibiting smoking in a wide variety of indoor areas that are open to the public, including schools, hospitals, auditoriums, food markets, stores, banks, taxicabs and limousines."[34] The Public Health and Health Planning Council is empowered via Public Health Law S225 "at the request of the commissioner, to consider any matter relating to the preservation and improvement of public health."[35] The question before the court in *Boreali* was whether "the challenged restrictions were properly adopted by an administrative agency acting under a general grant of authority and in the face of the Legislature's apparent inability to establish its own broad policy on the controversial problem of passive smoking."[36]

While a legislature may delegate to an administrative agency, the grant of power must be "within reason." The limitation of the delegation is set out in the New York State Constitution: "The legislative power of this state shall be vested in the senate and assembly."[37] To determine whether or not the delegation exceeds the scope of the New York Constitution, the *Boreali* court adopted a four-part test that is directly applicable to the soda case. The four factors to be considered are:

1. *Whether the administrative promulgation weighed different factors when writing the enactment; is it laden with economic and social concerns?*

In *Boreali*, the court found that "Striking the proper balance among health concerns, cost and privacy interests… is a uniquely legislative function…"[38] and proof that the administrative agency had exceeded its authority. Likewise, in the soda case, the court found that, "The regulation is laden with exceptions based on economic and political concerns."[39] The court noted, for example, that the Big Gulp at a 7-11 is exempt as is soy-based milk; but other milk substitutes such as almond, hemp and rice milk are not exempt. The court interpreted the random nature of the exemptions, and the suspicions that the rules were applied based on political, social and economic concerns, as characteristics of legislative behavior.

2. *Was the regulation created on a clean slate, thereby creating its own comprehensive set of rules without the benefit of legislative guidance?*

The *Boreali* court stated this second factor without elaborating. In the soda case, however, the court engaged in an expansive review of the extent of the Board of Health's authority. The Board argued that it had an "extraordinary grant of authority" and could implement whatever rules necessary for the health of the citizens of New York City,[40] but the court disagreed with such sweeping powers. To determine the scope and limitations of the Board of Health's powers, the court conducted an exhaustive analysis of the City Charter. It then concluded that "the intention of the legislature with respect to the Board of Health is clear. It is to protect the citizens of the city by providing regulations that prevent and protect against communicable, infectious, and pestilent diseases."[41] Given that obesity is a disease, albeit not communicable or infectious, one could argue that the City Charter allows its regulation and thus by implication the regulation of soda cup sizes. The court

found, however, that "one thing not seen in any of the Board of Health's powers is the authority to limit or ban a legal item under the guise of 'controlling chronic disease' as the Board attempts to do herein."[42] Thus the power to pass regulations such as the Portion Cap Rule lies with the New York City Council, the legislative body of the City of New York, and not the Board of Health.

> 3. *Did the agency act in an area in which the Legislature had repeatedly tried--and failed--to reach agreement in the face of substantial public debate and vigorous lobbying by a variety of interested factions?*

In *Boreali* the state legislature had banned smoking in some public places. The administrative agency then tried to expand the legislature's ban to various indoor areas. It is significant that the state legislature had already acted in the smoking cases, because here the City argued that no legislation on cup size was ever passed and therefore, this prong of the test was not violated. The court disagreed, however, noting that "[a]ddressing the obesity issue as it relates to sugar-sweetened drinks, or sugary drinks, is the subject of past and ongoing debate within the City and State legislatures."[43] According to the court, no specific legislation enactments are needed to meet this prong, as long as discussions have occurred in a legislative body.

> 4. *Does the regulation require the exercise of expertise or technical competence on behalf of the body passing the legislation?*

Of the four factors in *Boreali*, this was the only one that the court found in favor of the City because hearings had been held and some modicum of expertise was evident in the

development of the Portion Cap Rule. Nevertheless, the other three prongs of *Boreali*, when taken in their totality, evidenced that the rule exceeded the scope of the Board of Health's powers.

If the *Boreali* analysis failed to convince, the court further held that the rule was laden with arbitrary and capricious consequences. The Board was entitled to judicial deference and had acted reasonably pursuant to the standards of an Article 78 proceeding when it enacted a rule on the stated premise of addressing rising obesity rates. Nonetheless, an administrative regulation is upheld only if it has a rational basis.[44] The court went on to explain that "It is arbitrary and capricious because it applies to some but not all food establishments in the City, it excludes other beverages that have significantly higher concentrations of sugar sweeteners and/or calories on suspect grounds, and the loopholes inherent in the Rule, including but not limited to no limitations on refills, defeat and/or serve to gut the purpose of the Rule."[45]

Judge Tingling ended his unusually critical opinion with disdain: "The Portion Cap Rule, if upheld, would create an administrative Leviathan and violate the separation of powers doctrine. The Rule would not only violate the separation of powers doctrine, it would eviscerate it. Such an evisceration has the potential to be more troubling than sugar sweetened beverages."[46]

COST/BENEFIT ANALYSIS AND FINANCIAL IMPLICATIONS

It is not easy to determine the extent of the economic harm asserted by the various trade organizations that brought this proceeding. The large beverage companies such as Coca Cola have operations in more than two hundred countries.

According to analyst Thomas Mullarkey, Coca-Cola "generate(s) roughly 70% of its revenue and about 80% of its operating profit from outside of the United States."[47] Unless the Portion Cap Rule became a common practice in every city and town around the world, analysts are not expecting any significant adverse effects on revenue. For locations in New York City, clearly there would be some slippage in profit due to the fact that large size sodas generate very high profit margins. It is not clear if this loss of profit would be made up by an increase in sales of other equally profitable but not banned beverages such as smoothies. Mullarkey noted that while the super-sized ban is "on the margin bad" for Coca-Cola and Pepsi Co, it's not "…bad enough to move the needle on their stock prices".[48] In addition, while describing his valuation of Coca-Cola in his report, under the list entitled "Bears Say," the only regulatory related concern he expressed was that "Governments may look to increase taxes on sugary drinks, thereby, stunting Coke's volume growth trajectory."[49]

More immediately impacted would be the National Association of Theatre Owners of New York State. Executive Director Robert Sunshine said that beverages contribute more than 20% to their bottom line and 98% of soda sales are in containers greater than 16 ounces.[50] Plaintiffs also argued that the ban would disproportionately hurt small mom-and-pop stores and minority-owned small businesses, which would face greater competition from larger convenience stores like 7-Eleven and other exempt establishments under the city's patchwork of covered and non-covered establishments.[51] It is worth noting that Coca-Cola maintains significant ties to the African American community through its contributions to the N.A.A.C.P.'s Project Help, a program with a health education focus.[52] Likewise, Coca-Cola is closely connected with the Hispanic Federation, and last year hired their former president.[53]

As far as the suppliers of cups are concerned, The Food Service Packaging Institute President Lynn Dyer said in court documents that reconfiguring 16 ounce cups that are actually made slightly bigger to leave room at the top, is expected to take cup manufacturers three months to a year and cost them between $100,000 to several million dollars.[54] Though this organization did not join the suit, their concerns raise the environmental issue whether the proposed ban would lead to higher consumption and the disposal of far more small cups. Another packaging problem is illustrated by Honest Tea, whose parent company is Coca-Cola. They sell sweetened tea in a bottle containing 16.9 ounces. This could pose a major problem for them as they would need to shift manufacturing to adjust for the extra .9 ounces.[55] In the short run, vendors may have to stock more inventory (replace few large cups with more small cups), take up more space for the storage, and pay more to acquire small cups.

While it appears that The American Beverage Association and The National Restaurant Association bankrolled the litigation, it is fair to say that they brought together a diverse coalition with legitimate gripes. Indeed, though not a party to the suit, a group consisting of 3,000 organizations, called "New Yorkers for Beverage Choices," has expressed its concern about the size ban.[56] Although many of the 25,000 food service venues in the five boroughs combined are taking a wait and watch approach, others are taking preemptive steps to avoid paying the $200 fine.[57] For example, Dallas BBQ, which owns 10 restaurants in New York City, has placed an order for new 16 ounce size glasses.[58] Beverage companies like Coca-Cola have been taking steps to diversify their operations geographically through their presence in many countries around the world as well as by the type of beverages they sell, ranging from NOS energy drink, to plain and vitamin water.[59] It has also printed flyers to explain the new rules.[60] As

noted earlier, the big three soft drink companies have taken some voluntary steps to head off additional regulation.

POLICY IMPLICATIONS AND RECOMMENDATIONS

It is difficult to predict what will happen to the Portion Cap Rule on appeal. Countering the beverage industry's alliance with minority business interests, an impressive array of fifteen professional organizations and medical experts submitted a strong amicus brief in support of the city's appeal. Many of them represent minority groups and contend that the chronic diseases related to obesity are disproportionately borne by the city's poor who lack adequate access to healthy food choices. They offer ample evidence of the link between obesity and soda consumption, and they maintain that the rule is tailored to meet its objectives. All administrative agencies "draw lines" and the Board of Health met the rationality test by setting a rule that applied to all businesses within its jurisdiction.[61] Though Judge Tingling and the Appellate Division paid little credence to similar arguments, the city may fair better before the New York State Court of Appeals. It looks likely that the new mayor Bill de Blasio, who took office in January, 2014, will pursue the appeal. During his campaign, de Blasio confirmed his support for Bloomberg's approach: "...I believe the mayor is right on this issue," he said. "We are losing the war on obesity ... It's unacceptable. This is a case where we have to get aggressive."[62]

Even if the city prevails, enforcement and evaluation of the effectiveness of the restrictions will remain difficult. The rule discriminates based on venue as well as type of beverage served, and the numerous loopholes identified by the plaintiffs allow consumers ample opportunity to locate a super-sized sugary drink. While the economic harm the plaintiffs allege is

speculative at best, they are correct that a broad state-wide legislative approach would be preferable. As part of their separation of powers argument, plaintiffs enumerated a long list of failed proposals to limit and/or tax sugar-sweetened beverages.[63] Naturally, the beverage industry avoids any reference to their strenuous (and expensive) lobbying efforts to defeat such measures. The industry instead adopts the traditional personal responsibility and freedom of choice mantra reflected in the earlier quoted statement by Mississippi's Governor Bryant.

In the context of Mayor Bloomberg's long struggle to do something about the obesity epidemic and its resulting high costs to the city, the Portion Cap Rule makes some sense. Behavioral psychologists agree that portion size matters, and artificial barriers help people decide when to stop.[64] One could conclude that the real reason the soda industry is worried about any point of sale limitation is that it might work. Though this measure seems especially paternalistic and problematic because of its multiple exemptions, the case has highlighted the critical need to do something about the behaviors that lead to obesity. If the strong "nudge" approach will not pass judicial review, then it's time for state and federal governments to take more draconian, across the board action. High junk food "fat" taxes, the removal of farm subsidies for corn products, and a prohibition on the use of food stamps for high-calorie sweetened foods would all go a long way toward forcing people to take meaningful responsibility for their food choices.

Table 1

Drinks Included in Soda Ban	Drinks Exempt from Soda Ban
• All high-sugar drinks over 16 ounces	• Diet Sodas
• Fountain drinks or prepackaged bottles or cans	
• Sweetened Teas	• Drinks that are at least 70% fruit or vegetable juice
• Energy Drinks	• Alcoholic Beverages
• Fruit Drinks with more than 25 calories per 8 ounces	• Dairy-based drinks like lattes and milkshakes that contain more than 50% milk

Businesses that Must Comply	Businesses Not Included
• Sit-down restaurants	• Supermarkets
• Fast-food restaurants	• Convenience stores
• Delis	• 7-Eleven
• Movie theatres	• Bodegas
• Stadiums	• Gas Stations
• Mobile food carts and trucks	

- Any other establishment that receives a grade from the city health department.
- Establishments governed by the New York State Health Department

Source: Sommer Mathis, *Everything You Need to Know About the New York Soda Ban*, THE ATLANTIC CITIES (Sept. 13, 2012), http://www.theatlanticcities.com/politics/2012/09/everything-you-need-know-about-new-york-soda-ban/3263/.[65]

Endnotes

1 *Dr. Copeland Starts Fat-Reducing Contest*, N.Y. TIMES (Oct. 19, 1921), http://query.nytimes.com/mem/archive-free/pdf?res=9507E3D8103CE533A2575AC1A9669D946095D6CF.

2 *Id.*

3 *481 3-4 Pounds Lost by Fifty Fat Women*, N.Y. TIMES (Nov. 1, 1921), http://query.nytimes.com/mem/archive-free/pdf?res=9504E6DB103EEE3ABC4953DFB767838A639EDE.

4 *Finds Fat Reducing Makes Happy Homes*, N.Y. TIMES (Nov. 3, 1921), http://query.nytimes.com/mem/archive-free/pdf?res=9E03E7D9103EEE3ABC4B53DFB767838A639EDE.

5 HILLEL SCHWARTZ, NEVER SATISFIED: A CULTURAL HISTORY OF DIETS, FANTASIES AND FAT 3-24 (Doubleday 1990) (1986).

6 *The Big Picture,* ECONOMIST, Dec. 15, 2012, at 3. The definitions of overweight and obesity are based on measures of body mass index.

[7] *Id. See also The Nanny State's Biggest Test*, ECONOMIST, Dec. 15, 2012, at 13.

[8] *The Nanny State's Biggest Test*, *supra* note 7.

[9] Jennifer Couzin-Frankel, *Tackling America's Eating Habits, One Store at a Time*, SCIENCE, Sept. 21, 2012, at 1473‐75.

[10] *The Nanny State's Biggest* Test, *supra* note 7.

[11] Unlike the Portion Cap Rule, the New York City Council enacted ratifying legislation to expressly incorporate the ban on artificial trans-fat into the Administrative Code. *See* N.Y.C. LOCAL LAW No. 012 (Mar. 28, 2007), http://legistar.council.nyc.gov/LegislationDetail.aspx?ID=446729&GUID=02C54DF5-DE14-4E6B-A98B-3CFECEA20274&Search=&Options=.

[12] New York City Board of Health Regulation §81.50 required that all restaurant chains with fifteen or more restaurants post nutritional information on their menus. Unlike the trans-fat ban, this mandate was challenged in court, by *New York State Restaurant Association v. New York City Board of Health*, No. 08 Civ. 1000 (RJH), 2008 WL 1752455 (S.D.N.Y Apr. 16, 2008). The plaintiffs raised two challenges. First, the Restaurant Association argued that the Board of Health mandate was preempted by the federal Nutrition Labeling and Education Act (the "NLEA"), Pub. L. No. 101‐535, § 104 Stat. 2353 (1990); and second, that the mandatory disclosure violated First Amendment rights. The Court rejected the preemption doctrine argument on the grounds that the federal law explicitly left such regulation to local entities; and that under traditional preemption analysis, a health and safety argument is within the purview of the States. With regard to the First Amendment claim, since Regulation 81.50 "compels only the disclosure of 'purely factual and uncontroversial commercial information-the calorie content of restaurant menu items' and such disclosure 'attempts to address a state policy interest by making information available to consumers,' the Regulation passes constitutional muster as long as there is a rational connection between the disclosure requirement and the City's purpose in imposing it." The district court

denied the preliminary injunction and stay. The appellate court affirmed, finding that Regulation §81.50's calorie disclosure rules are reasonably related to its goal of reducing obesity##. N.Y. State Rest. Ass'n v. N.Y.C. Bd. of Health, 556 F.3d 114, 136 (2d Cir. 2009).

[13] Alice Park, *The New York City Soda Ban, and a Brief History of Bloomberg's Nudges*, TIME, May 31, 2012.

[14] MARION NESTLE, FOOD POLITICS 198 (2007) (citing nutritional analysis by the Center for Science in the Public Interest).

[15] *Food for Thought*, ECONOMIST, Dec. 15, 2012, at 10.

[16] Robert Pear, *Soft Drink Industry Fights Proposed Food Stamp Ban*, N.Y. TIMES, Apr. 29, 2011, http://www.nytimes.com/2011/04/30/us/politics/30food.html?_r=0.

[17] N.Y.C. LOCAL LAW No. 012 (Mar. 28, 2007), http://legistar.council.nyc.gov/LegislationDetail.aspx?ID=446729&GUID=02C54DF5-DE14-4E6B-A98B-3CFECEA20274&Search=&Options=.

[18] A.G. Sulzberger, *Bloomberg Says a Soda Tax 'Makes Sense,'* N.Y. TIMES, Mar. 7, 2010, http://www.nytimes.com/2010/03/08/nyregion/08soda.html.

[19] N.Y.C. LOCAL LAW No. 012 (Mar. 28, 2007), http://legistar.council.nyc.gov/LegislationDetail.aspx?ID=446729&GUID=02C54DF5-DE14-4E6B-A98B-3CFECEA20274&Search=&Options=.

[20] N.Y.C. HEALTH CODE § 81.53. *See also* Michael Howard Saul, *NYC Board of Health Passes 'Soda Ban,'* WALL ST. J., Sept. 13, 2012, http://blogs.wsj.com/metropolis/2012/09/13/nyc-board-of-health-passes-soda-ban/.

[21] Cass R. Sunstein, *It's For Your Own Good!*, NEW YORK REVIEW OF BOOKS (Mar. 7, 2013), http://www.nybooks.com/articles/archives/2013/mar/07/its-your-own-

good/?pagination=false (review of SARAH CONLY, AGAINST AUTONOMY: JUSTIFYING COERCIVE PATERNALISM (2012)).

[22] Michael Howard Saul, *Beverage Leaders, Businesses File Suit Against 'Soda Ban'*, WALL ST. J., Oct. 12, 2012, http://blogs.wsj.com/metropolis/2012/10/12/beverage-leaders-businesses-to-file-suit-against-soda-ban/.

[23] David Seifman, *Bloomberg Tells State to Follow City's Ban on Sodas Larger than 16 oz*, N.Y. POST, Feb. 25, 2013, http://www.nypost.com/p/news/local/bloomberg_tells_state_than_follow_645DXS92v5Gqzi4CyXy4XK.

[24] N.Y. Statewide Coalition v. N.Y.C. Dept' of Health, No. 653584/12 (N.Y. Sup. Ct. March 11, 2013). *See also* Meredith Melnick, *New York City Soda Ban Health Fallout: Bloomberg's Legislation Struck Down… Now What?* HUFFINGTON POST, Mar. 12, 2013, http://www.huffingtonpost.com/2013/03/12/new-york-city-soda-ban-bloomberg-loses-judge_n_2856642.html.

[25] *Matter of New York Statewide Coalition of Hispanic Chambers of Commerce v. New York City Dept. of Health & Mental Hygiene*, 110 A.D.3d 1, 970 N.Y.S.2d 200 (1st Dept. 2013).

[26] *Matter of New York Statewide Coalition of Hispanic Chambers of Commerce v. New York City Dept. of Health & Mental Hygiene*, 22 NY 3d 853, 998 NE 2d 1972, 976 NYS2d 447, Unpublished Disposition, 2013 WL 5658229, 2013 NY Slip Op. 88505, (Oct. 17, 2013).

[27] *NYC Soda Rules Spur Calorie Counts on Vending Machines*, WALL ST. J., Oct. 10, 2012, http://blogs.wsj.com/metropolis/2012/10/10/nyc-soda-rules-spur-calorie-counts-on-vending-machines/.

[28] Saul, *supra* note 22.

[29] Holly Yan, *No Soda Ban Here: Mississippi Passes 'Anti-Bloomberg' Bill*, CNN (Mar. 21, 2013), http://www.cnn.com/2013/03/21/us/mississippi-

anti-bloomberg-bill.

[30] N.Y.C. HEALTH CODE § 81.53.

[31] *Id.*

[32] Boreali v. Axelrod, 71 N.Y.2d 1, 523 N.Y.S.2d 464, 517 N.E.2d 1350 (1987).

[33] N.Y. PUB. HEALTH LAW, art. 13-E, § 1399-N–1399-X (1975).

[34] *Boreali*, 71 N.Y.2d at 7.

[35] *Id.* at 17.

[36] *Id.* at 9.

[37] N.Y. Const. art. III, § 1.

[38] *Boreali*, 71 N.Y.2d at 12.

[39] Id.

[40] "Respondents state Charter SS 556 (c) (2) & (9), which specifies areas which the DOH may regulate, including control of communicable and chronic diseases and the oversight of the food and drug supply of the city, as specifically granting authority for the promulgation of the Portion Cap Rule." N.Y. Statewide Coalition v. N.Y.C. Dept' of Health, No. 653584/12 at 16 (N.Y. Sup. Ct. March 11, 2013).

[41] *Id.* at 27.

[42] *Id.*

[43] The court noted numerous attempts by the New York City Council to pass resolutions dealing with sugar sweetened beverages, including warning labels for such beverages and prohibiting food stamp use for such beverages. *Id.* at 29‐ 30.

[44] *Id.* at 34 (citing N.Y. State Ass'n of Counties v. Axelrod, 78 N.Y.2d 158 (1991); Matter of Consolation Nursing Home v. Comm'r of N.Y. State Dept. of Health, 85 N.Y.2d 326 (1995)).

[45] *N.Y. Statewide Coalition*, at 34.

[46] *Id.* at 35

[47] Thomas Mullarkey, *Coke's Global Brands and Distribution Network are Unmatched*, MORNINGSTAR (Feb.12, 2013), http://www.alacrastore.com/storecontent/Morningstar_Credit_Research-Coke_s_global_brands_and_distribution_network_are_unmatched_Updated_Forecasts_and_Estimates_from_12_Feb_2013-2137-12927.

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[52] Grynbaum, *supra* note 51.

[53] *Id.* In February 2012, after a seven year tenure with the Hispanic Federation, President Lillian Rodriguez Lopez took a position with Coca-Cola.

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[55] Ax, *supra* note 50.

[56] Bruce Kennedy, *NYC Soda Ban: Who is Affected and How They Are Preparing for It*, COCA-COLA CO. (Oct. 30, 2012), http://www.coca-colacompany.com/stories/nyc-soda-ban-who-is-affected-and-how-are-they-preparing-for-it.

[57] Paul Frumkin, *Bloomberg's Soda Siphon*. NATION'S RESTAURANT NEWS (June 25, 2012), http://nrn.com/government/bloombergs-soda-siphon.

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[60] Peltz, *supra* note 58.

[61] Brief for The Nat'l Alliance for Hispanic Health et al. as Amici Curiae, N.Y. Statewide Coalition v. N.Y.C. Dept. of Health, No. 653584/12 (N.Y. Sup. Ct. March 11, 2013).

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[64] Sarah Nassauer, *The Psychology of Small Packages*, WALL ST. J., Apr. 15,2013,http://online.wsj.com/article/SB10001424127887324485004578424650545311848.html.

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HOSANNA-TABOR EVANGELICAL LUTHERAN CHURCH AND SCHOOL v. EQUAL EMPLOYMENT OPPORTUNITY COMMISSION—AN AFFIRMATION OF THE MINISTERIAL EXCEPTION

by

J.L.Yranski Nasuti, MDiv, JD, LLM*

Since the passage of the Civil Rights Act of 1964,[1] federal discrimination statutes have had a significant impact on employment law in the United States. Employment decisions may no longer be based on a person's membership in a protected class and employers may not retaliate against employees who seek to enforce their statutory rights. That is unless the employee works for a religious organization and falls within the "ministerial exception." In the case of *Hosanna-Tabor Evangelical Lutheran Church and School v. Equal Employment Opportunity Commission (*hereinafter *Hosanna-Tabor),*[2] the U.S. Supreme Court has held, as a matter of first impression, that employees who are deemed to be "ministers" are precluded from claiming protection under employment discrimination statutes when their employers are religious institutions.

I.

The Hosanna-Tabor Evangelical Lutheran Church (hereinafter Hosanna-Tabor), which is located in Redford, Michigan, is a member of the Missouri Synod of the Lutheran

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*Professor of Legal Studies in Business
Iona College, New Rochelle, New York

Church. As part of its mission Hosanna-Tabor operates a small elementary school that offers a "Christ-centered education" that helps parents by "reinforcing biblical principals [sic] standards."[3] As is the case for all schools within the Missouri Synod, Hosanna-Tabor employs two types of teachers—those who are "called" and those who are "lay." A called teacher is one who has been chosen to his or her vocation by God through a particular congregation. In order to receive a call, a teacher typically completes a "colloquy" program at a Lutheran college or university. It is only after a teacher has taken eight theological courses, been endorsed by his or her local Synod district, and passed an oral exam administered by a faculty committee that the teacher may be called by a congregation. Once called a teacher is given the formal title of "Minister of Religion, Commissioned" and serves an open-ended term. A called teacher may also receive a special income tax housing allowance so long as the teacher is conducting activities "in the exercise of ministry."[4] If a person is hired to be a lay or contract teacher, he or she does not have to be trained by the Synod nor even be a member of the Lutheran Church. A lay teacher is appointed by the school board (without a vote by the congregation) and receives a one-year renewable contract.[5] In the hiring process, preference is given to called teachers. This is true despite the fact that called and lay teachers generally perform the same services.

In 1999, Hosanna-Tabor hired Cheryl Perich to teach kindergarten as a lay teacher. At that time, Perich was already attending colloquy classes at Concordia College. Upon completing her course work in February 2000, she was called by the Hosanna-Tabor Evangelical Lutheran Church and was, thereafter, listed as a commissioned minister in the Lutheran Church—Missouri Synod. Perich's responsibilities as a called teacher were the same as those that she had as a lay teacher.[6] She taught math, language arts, social studies, science, gym,

art, and music. Four days a week she conducted a thirty minute religion class and one day a week she attended a chapel service with her students. She also led her class in prayer three times a day and, in her final year, joined her class in a devotional service for five to ten minutes each morning. Approximately twice a year, Perich, in rotation with other teachers (called and lay), led the chapel service. Over the course of a seven-hour school day, Perich spent approximately forty-five minutes in activities related to religion.[7]

Perich became ill while attending a Hosanna-Tabor golf outing in June 2004. As her doctors struggled to diagnose her condition, Perich and the school administrators agreed that it would be best for her to go on disability leave for the 2004-2005 academic year.[8] In December, Perich notified the school's principal, Stacy Hoeft, that she had been diagnosed with narcolepsy and would be able to resume her teaching duties in two to four months (depending on how long it took to stabilize her condition with medication). During the next month the school informed Perich that it had decided to hire a substitute teacher to take over her responsibilities. (Up until that point, another teacher at Hosanna-Tabor had assumed responsibility for three grade levels in order to cover for Perich.) The school also asked Perich to begin discussing with her doctor what she would have to do in order to return to the classroom the following fall. Perich subsequently informed the school that when she returned, she would be fully functional through the use of medication. Two days later, Hoeft notified Perich by e-mail of a proposed amendment to the employee handbook that would request employees who had been on disability for more than six months to resign their calls so that the school could responsibly fill their positions.[9] Employees who resigned because of disabilities would, however, not be precluded from seeking reinstatement of their calls if they health was restored. At that time Perich was told of the

proposed amendment, she had been on disability leave for over five months.

Perich immediately called Hoeft to her tell that she would be returning to work within the month. Hoeft became worried that Perich's early return would not be in the best interest of the students—especially since Perich had informed the school only a few days earlier of her continued inability to function fully. Three days later, at a meeting of the Hosanna-Tabor Evangelical Church, the school administration expressed concerns that Perich would not be able to return to teaching either that year or the next. Based on those representations, the congregation voted in favor of a resolution asking Perich to agree to a peaceful release agreement.[10] Under the terms of the agreement, Perich would resign her call and the congregation would pay for a portion of her health insurance for the remainder of the calendar year. Perich rejected the congregation's offer and submitted a note from her doctor indicating that she would be able to return to work within a few weeks. Her refusal to submit a letter of resignation continued even after the school board urged her to reconsider her decision and informed her that it no longer had a position for her.

When Perich returned to the school on the morning of the first day she was medically cleared to work, she was immediately told by Hoeft to leave. That afternoon, Hoeft called Perich to tell her that it was likely that she was going to be fired. Perich responded by informing Hoeft that she had consulted with an attorney and was prepared to take legal action. The school board met that same night and subsequently informed Perich that it was reviewing the process for rescinding her call in light of her "regrettable" actions.[11] A case for termination was then presented to and accepted by the congregation. The two main grounds given for removing Perich's call were her "insubordination and disruptive

behavior" on the day she attempted to return to work and the damage "beyond repair" that she had done to her "working relationship" with the school by "threatening to take legal action."[12]

Perich filed a charge with the Equal Employment Opportunity Commission (hereinafter EEOC) based on a wrongful termination claim under the Americans with Disabilities Act (hereinafter ADA).[13] The ADA not only prohibits an employer from discriminating against a qualified employee based on a disability, but it also prohibits an employee from retaliating "against any individual because such individual has opposed any act or practice made unlawful by [the ADA] or because such individual made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under [the ADA]."[14] The EEOC filed a lawsuit against Hosanna-Tabor in the U.S. District Court based on the claim that Perich had been fired in retaliation for threatening to sue under the ADA. Perich intervened in the case alleging similar claims of unlawful retaliation under the ADA and the Michigan Persons with Disabilities Civil Rights Act.[15]

Hosanna-Tabor filed a motion for summary judgment asserting a "ministerial exception" that precludes government interference with "quintessentially" religious matters. The Church argued that the First Amendment barred lawsuits when they involved employment relationships between religious organizations and their ministerial employees. It went on to claim that Perich was a ministerial employee and that the reason she was fired was based on the Synod's religious belief that Christians should resolve their disputes internally. The U.S. District Court granted Hosanna-Tabor's motion for summary judgment on the grounds that the church had treated Perich as one of its ministers long before the litigation began.[16]

On appeal, the U.S. Court of Appeals for the Sixth Circuit vacated the lower court decision and remanded the case instructing the trial court to consider the merits of the retaliation claims. Although the Circuit Court acknowledged that a ministerial exception would bar certain employment discrimination claims, it concluded that Perich's claim could proceed since she was not in fact a "minister."[17]

II.

A. Majority Opinion

When the U.S. Supreme Court justices heard oral arguments in the *Hosanna-Tabor* case, it was clear that many of the justices were trying to find a way to balance the government's concern for the victims of employment discrimination with the religious organization's concern that that same government not meddle in its internal affairs.[18] Three months later those concerns were addressed by Chief Justice John Roberts in a unanimous opinion in favor of the Hosanna-Tabor Evangelical Church and School. In the concluding paragraph of his opinion, Robert wrote that "the interest of society in the enforcement of employment discrimination statutes is undoubtedly important. But so too is the interest of religious groups in choosing who will preach their beliefs, teach their faith, and carry out their mission. When a minister who has been fired sues her church alleging that her termination was discriminatory, the First Amendment has struck the balance for us. The church must be free to choose those who will guide it on its way."[19] In such a case, the Establishment and Free Exercise Clauses of the First Amendment bar employment discrimination suits by ministers against their churches.

Roberts began his analysis of the First Amendment religion clauses by recalling significant moments in Anglo-American

history where there had been controversies between church and state over appointments to religious offices.[20] He postulated that it was because of these kinds of controversies that "the founding generation sought to foreclose the possibility of a national church."[21] This was accomplished through the inclusion of the Religion Clauses in the First Amendment of the Bill of Rights. The Establishment Clause precluded the government from being involved in the appointment of ministers and the Free Exercise Clause similarly prevented the government from interfering with a religious group's right to select its own ministers.[22]

In his attempt to review prior Supreme Court decisions involving the Religion Clauses, Roberts was not surprised to find so few cases involving issues relating to the interference by the government in the ministerial selection process. He credited this phenomenon to a general understanding of the Religion Clauses—as well as to the absence of employment regulatory laws prior to the 1960s.[23] He did, however, find support for his belief "that it is impermissible for the government to contradict a church's determination of who can act as its ministers"[24] in a number of cases involving disputes over church property.

In the nineteenth century case of *Watson v. Jones (*hereinafter *Watson),*[25] the U.S. Supreme Court declined to question a decision by the Presbyterian Church involving church property that was located in Louisville, Kentucky. The General Assembly of the Presbyterian Church had awarded the property to an antislavery faction over the objections of a proslavery faction. The Court based its decision on the grounds that "whenever the questions of discipline, or of faith, or ecclesiastical rule, custom, or law have been decided by the highest of church judicatories to which the matter has been carried, the legal tribunals must accept such decisions as final,

and as binding on them."[26]

Eighty years later, in the case of *Kedroff v. Saint Nicholas Cathedral of Russian Orthodox Church in North America (*hereinafter *Kedroff),*[27] the Supreme Court was asked to decide who had the right to use a particular Russian Orthodox cathedral in New York City. Following the Bolshevist Revolution in 1917, many of the Russian Orthodox churches in North America split from the Supreme Church Authority of the Russian Orthodox Church in Moscow (which was thought to have become a tool of the Soviet government.) The separation from the mother church in Russia included the establishment of an autonomous administration for the North American Russian Orthodox Church. The Russian Orthodox churches in North America consequently argued that the right to use the cathedral in New York belonged to an archbishop elected by them. The Supreme Church Authority in Russia, on the other hand, claimed that that right belonged to an archbishop appointed by the patriarch in Moscow. Under New York statutory law (known as Article 5-C), Russian Orthodox churches in New York were required to recognize the authority of the governing body of the North American churches. [28] The U.S. Supreme Court, ruling in favor of the Supreme Church Authority in Russia, found the state law to be unconstitutional on the grounds that it "directly prohibit[ed] the free exercise of an ecclesiastical right, the Church's choice of hierarchy."[29]

The right of a church to select its own hierarchy was reaffirmed in *Serbian Eastern Orthodox Diocese for United States and Canada v. Milivojevich* (hereinafter *Milivojevich),*[30] another case involving the issue of who should have control over a diocese, including it property and assets. Dionisije Milivojevich had been removed as the bishop of the American-Canadian Diocese after a dispute with church hierarchy. He sued the church in an Illinois state court claiming that the

proceedings leading to his removal violated the church's laws and regulations. The U.S. Supreme Court reversed the state court's decision in favor of Milivojevich on the grounds that hierarchical religious organizations have a First Amendment right "to establish their own rules and regulations for internal discipline and government, and to create tribunals for adjudicating disputes over these matters."[31] Consequently the decisions of those tribunals had to be recognized as binding by civil courts. It was therefore unconstitutional for a court to undertake "the resolution of quintessentially religious controversies whose resolution the First Amendment commits exclusively to the highest ecclesiastical tribunals."[32]

Roberts then turned to the primary issue that differentiated *Hosanna-Tabor* from *Watson, Kedroff,* and *Milivojezich*--whether a religious organization's freedom to select its own ministers could be restricted by employment discrimination statutes. Although this was a matter of first impression for the Supreme Court, it was one that had been addressed by the Courts of Appeals for many years.[33] Their uniform approach had been to recognize the existence of a "ministerial exception" that was based on the First Amendment and that precluded ministers from bringing claims against religious institutions based on anti-discrimination employment legislation. The Supreme Court agreed with the Circuit Courts that such an exception was necessary since it ensured that the members of a particular religious group, and not the government, could best decide which ministers "will personify its beliefs."[34] That was why it would be a violation of the Religion Clauses of the First Amendment for the government to invoke Title VII of the Civil Rights Act to compel the Catholic Church or an Orthodox Jewish Seminary to ordain women.[35]

A more difficult issue for the Court to decide was that of

who was covered by the ministerial exception. Roberts noted that every Circuit Court that had considered the scope of the exception had concluded that it was not limited the heads of religious congregations—the priests, the ministers, and the rabbis. While he agreed with that conclusion, he declined to provide any "rigid formula" for deciding when an employee qualifies as a minister. He stated instead that "it was enough for us to conclude, in this our first case involving the ministerial exception, that the exception covers Perich, given all the circumstances of her employment."[36]

Roberts went on to highlight a number of factors that contributed to the Court's conclusion that Perich was in fact covered by the ministerial exception. Many of those factors had to do with her call and commissioning. Hosanna-Tabor held her out to be a called minister with a role distinct from other members of the congregation.[37] She was accorded the title of "Minister of Religion, Commissioned."[38] When she received her call, she was tasked to perform her office "according to the Word of God and the confessional standards of the Evangelical Lutheran Church as drawn from the Sacred Scriptures."[39] At her commissioning, the congregation prayed that God "bless [her] ministrations to the glory of His holy name, [and] the building of His church."[40] The congregation also periodically reviewed her "skills of ministry" and "ministerial responsibilities" and provided her with "continuing education as a professional person in the ministry of the Gospel."[41] Prior to receiving her call, she had spent six years completing eight college-level theology courses in subjects including biblical interpretation, church doctrine, and the ministry of the Lutheran teacher in order to obtain the endorsement of her local Synod district. She subsequently passed an oral exam by a faculty committee at the Lutheran college and she was commissioned by the Hosanna-Tabor congregation.[42]

Perich actions also indicated that she considered herself to be a minister. She accepted the call.[43] She claimed a special housing allowance on her taxes that was only available to those earning compensation "in the exercise of the ministry."[44] In a letter that she sent to the Synod following her termination, she affirmatively stated that "I feel that God is leading me to serve the teaching ministry . . . I am anxious to be in the teaching ministry again soon."[45] The Court concluded that she considered her teaching duties to include the conveying of the Church's message and the carrying out of its mission.[46]

Roberts then addressed the three errors that the Court of Appeals committed when it concluded that Perich was not a minister covered by the ministerial exception. The first was the court's failure to assign any relevance to the fact that she was a commissioned minister.[47] The second was the weight it gave to the fact that lay teachers performed the same religious duties as Perich.[48] The final error was the court's emphasis how much of Perich's teaching time was allocated to secular duties as opposed to religious duties.[49] On the later point, Roberts disagreed with the EEOC's suggestion that the ministerial exception should only apply to employees who perform exclusively religious functions. If that were the case, the heads of religious congregations would not qualify as ministers since their duties typically include a mix of religious and secular functions including the raising of money, the supervising of non-religious personnel, and the overseeing of the maintenance of church property.[50] In fact, the amount of time that an employee devoted to religious functions might be less relevant than the nature of those religious functions.[51]

In the original complaint, Perich had sought a variety of remedies including reinstatement to her teaching job as well as frontpay. Since Perich was covered by the ministerial

exception, her request for reinstatement was inappropriate on the grounds that to do so would violate Hosanna-Tabor's First Amendment right to select its own ministers. The Court similarly rejected her request for frontpay since it would also "operate as a penalty on the Church for terminating an unwanted minister, and would be no less prohibited by the First Amendment than an order overturning the terminations."[52]

Roberts also addressed Perich's claim that Hosanna-Tabor's alleged theological reason for discharging Perich was only a pretext for getting rid of an employee with a disability. He concluded that if an employee was covered by the ministerial exception, that employee would not prevail even if he or she could establish that the termination was for a non-theological reason. In ministerial exception cases, that exception is the affirmative defense to an otherwise cognizable claim.[53] The reason for that is because "the exception instead ensures that the authority to select and control who will minister to the faithful—a matter "strictly ecclesiastical"—is the church's alone."[54]

The opinion ended with a brief reference to the "parade of horribles" that Perich and the EEOC claimed would result if the Court recognized the ministerial exception.[55] While Roberts did not offer the Court's view with regard to the appellants' concerns, he did note those of Hosanna-Tabor.[56] Finally, Roberts acknowledged that the only thing that had been decided in the *Hosanna-Tabor* case was that the ministerial exception barred employment discrimination lawsuits. The Court left until a future time the issue of whether the ministerial exception could be applied to other types of lawsuits including actions brought by employees against their religious employer for breach of contract or tortious conduct.[57]

B. Concurring Opinions

Although Roberts' opinion was joined by all nine members of the Court, Justices Clarence Thomas and Samuel Alito (joined by Elena Kagan) each submitted concurring opinions that focused on the question that Roberts chose not to address. That question was who actually qualifies to be a minister under the ministerial exception.

Thomas' three paragraph opinion suggested that if the courts were going to uphold the Religion Clauses' guarantee that religious organizations were autonomous in matters of internal governance (including their selection of ministers), then the courts had to be willing to "defer to the religious organization's good-faith understanding of who qualifies as its minister."[58] He was particularly concerned that any attempt to establish a bright-line test or multi-factor analysis would disadvantage religious groups whose beliefs, practices, and membership were less traditional. [59]

Alito's concurring opinion, on the other hand, embraced the idea of establishing some specific criteria for determining who should be covered by the ministerial exception. He began by rejecting the suggestion that the ministerial exception should only apply to those employees who had been formally ordained or been given the title of "minister."[60] One reason for his conclusion was that most religious groups, other than Protestants, do not refer to their clergy as ministers. Another reason was that while the concept of ordination may be a common practice in many Christian churches and in Judaism, it is not so in all Christian denominations or in other religions. That being the case, when a court applied the ministerial exception, it needed to pay far more attention to the actual functions that were performed by the people working for religious organizations. Alito went on to identify three general

categories of employees whose functions were essential to practically all religious groups—"those who serve in positions of leadership, those who perform important functions in worship services and in the performance of religious ceremonies and rituals, and those who are entrusted with teaching and conveying the tenets of the faith to the next generation."[61] The ministerial exception was applicable in *Hosanna-Tabor* because of the substantial role Perich played in "conveying the Church's message and carrying out its mission."[62] That she also taught secular subjects did not matter since she "played an important role as an instrument of her church's religious message and as a leader of its worship activities."[63] Alito concluded by rejecting the need to engage in a pretext inquiry for cases where the ministerial exception applied. Such an inquiry would force the court or jury to make a judgment about church doctrine. The adjudication of doctrinal questions would require the trier of fact to not only to judge what a church really believed but also how important that belief was the church's mission. This would be result in an unacceptable course of action that would "pose grave problems for religious autonomy."[64]

III.

The Supreme Court's ruling in *Hosanna-Tabor* was unequivocal--ministerial employees are barred from suing their religious employers based on alleged violations of discrimination laws. The decision was, in fact, an affirmation of a ministerial exception that had been applied by the Circuit Courts for many years. In this case, the Religion Clauses of the First Amendment trumped the civil rights statutes. Unfortunately, by not directly addressing the issue of who is considered a minister for the purposes of the ministerial exception, the Court left many religious organizations and their employees scratching their heads. The deferential approach

proposed by Thomas does not[65] seem to be something that his fellow justices felt comfortable endorsing. That would suggest that attempts by religious organizations to characterize all of their employees as ministers will not insulate them from litigation arising out of claims of employment discrimination. At the same time, the Court was equally reluctant to accept Alito's functional test for determining which employees were covered by the ministerial exception.

The fact that the Supreme Court justices unanimously agreed that the discrimination claim could not succeed in *Hosanna-Tabor* was based on a particular set of facts. Perich had not only applied for and received the title of "called minister" but she had subsequently used that status to receive government relief in the form of a tax benefit. What *Hosanna-Tabor* did not address were those instances where the employee had never affirmatively sought ministerial status. Would the Court be so willing to accept the employer's claim for a ministerial exception when the employee in question had neither sought ministerial status nor conceived of his or her job in a catechetical context? One place where this issue might arise would be in the area of higher education. What would *Hosanna-Tabor* mean for a professor who teaches at a college or university that follows a particular religious tradition, has a mission statement that reflects particular religious values, and also affirms the value of academic freedom? Would the validity of that institution's claim for a ministerial exception with regard to a particular professor depend on that person's discipline? Would the claim be treated differently if the professor taught theology or religious studies—even though the professor was considered a lay person within the canonical structure of the institutional church? Would such a designation be appropriate for a professor in other fields such as biology or business law? Would it apply to a professor in any discipline who participated in service-learning courses co-sponsored by

the school's campus ministry program? Or would the employee be able to challenge the institution's claim of a ministerial exception on the grounds that calling the employee a minister was merely a pretext for avoiding liability for illegal discriminatory actions?

If the Chief Justice was looking for consensus is this case, he was successful—but only to the limited extent that all of the justices were willing to acknowledge a ministerial exception. His inability to suggest future guidelines for who qualifies as a minister may indeed be the consequence of a Court that was "reluctant . . . to adopt a rigid formula for deciding when an employee qualifies as a minister."[66] On the other hand, it may also be the result of a genuine disagreement among the justices which will only be resolved as additional cases work their way through the legal process.

ENDNOTES

[1] 42 U.S.C. §2000e *et seq.*

[2] 132 S. Ct. 694 (2012).

[3] *Supra*, note 2, at 699.

[4] *Supra*, note 3, at 883 (citing Def's Mot. for Partial Sum. J., Ex. Q.)

[5] *Supra*, note 2, at 699-700.

[6] *Supra*, note 3, at 883-884.

[7] *Id.* at 884.

[8] *Id.* at 884.

[9] *Id.* at 884.

[10] *Id.* at 884.

[11] *Id.* at 885.

[12] *Id.* at 885.

[13] 104 Stat. 327, 42 U.S.C. §12101 *et seq*. (1990).

[14] Id. at §12203(a).

[15] Mich. Comp. Laws §37.1602(a) (1979).

[16] *Supra*, note 3, at 892.

[17] *Equal Employment Opportunity Commission v. Hosanna-Tabor Evangelical Lutheran Church and School*, 597 F. 3rd 769, 784 (6th Cir., 2010).

[18] During oral arguments, the justices expressed broad concerns over questions of how to determine whether an employee is a "minister" and whether it is possible to withhold a ministerial exception when the employment decision was not based on a dispute over religious doctrine but was instead a pretext for an illegal employment practice. On the other hand, the justices also raised questions on narrower matters such as how to apply the ministerial exception when all of the members of a particular church are considered to be "ministers."

[19] Supra note 2, at 710.

[20] He pointed to the first clause of the Magna Carta--which provides that

"the English church shall be free, and shall have its rights undiminished and its liberties unimpaired"—including the right to freely elect its own officials. Subsequent practice demonstrated that that right "may have been more theoretical than real" in many cases. *Id.* at 702. He then noted changes that had been made under the reign of Henry VIII—including the designation of the monarch as the supreme head of Church with the authority to appoint the high officials of the Church. Eventually the assertion of this power by the monarchy caused a number of early colonists (the Puritans to New England and William Penn to Pennsylvania and Delaware) to flee England in order to be free of the control of the Church of England. *Id.* at 702. Even in the southern colonies where the Church of England was firmly established, controversies arose over the right of the colonial governor and the Bishop of London to appoint clergy in Virginia and North Carolina. *Id.* at 703.

[21] *Id.* at 703.

[22] *Id.* at 703. Roberts then referred to two events involving James Madison, the primary architect of the religion clause in the First Amendment. In the first, Secretary of State Madison cautioned President Thomas Jefferson not to advise the first Roman Catholic bishop in the United States, John Carroll, on whom to appoint to direct the affairs of the Catholic Church in the newly acquired Louisiana territory—since the selection of church "functionaries" was an "entirely ecclesiastical" matter that should be left to the Church's own judgment. (Citing "Letter from James Madison to Bishop Carroll" (Nov. 20, 1806), reprinted in 20 RECORDS OF THE AMERICAN CATHOLIC HISTORICAL SOCIETY 63 (1909). In the second case, President Madison vetoed a bill incorporating the Protestant Episcopal Church, in what was then the District of Columbia, on the grounds that the bill, which among other things included rules and procedures for the election and removal of the Church's clergy, "exceeds the rightful authority to which Governments are limited, by the essential distinction between civil and religious functions, and violates, in particular, the article of the Constitution of the United States, which declares, that 'Congress shall make no law respecting a religious establishment.'" 22 Annals of Cong. 982-9823 (1811).

[23] *Id.* at 704.

[24] *Id*. at 704.

[25] 80 U.S. 679, 13 Wall. 679, 20 L.Ed. 666 (1972).

[26] *Supra*, note 2, at 727.

[27] 344 U.S. 94, 73 S. Ct. 143 (1952).

[28] New York State statute not only defined which groups constituted the "Russian Church in America" but it also specifically noted that while the churches may have been "subject to the administrative jurisdiction of the Most Sacred Governing Synod in Moscow until in or about nineteen hundred seventeen, later the Patriarchate of Moscow," they were now "an administratively autonomous metropolitan district created pursuant to resolutions adopted at a general convention (sobor) of said district held in Detroit, Michigan, on or about or between April second to fourth, nineteen hundred twenty-four." Religious Corporations Law, § 5, 50 McKinney's N.Y. Laws §105. The statue went on to state that every Russian Orthodox church in New York is subject to the jurisdiction of the Russian Church in America even if it had been incorporated before the creation of the Russian Church in America and that the trustees of every Russian Orthodox church had "the custody and control of all temporalities and property, real and personal, belonging to such church and of the revenues therefrom and shall administer the same in accordance with the by-laws of such church, the normal statutes for parishes of the Russian Church in America . . . and any amendments thereto and all other rules, statutes, regulations and usages of the Russian Church in America." *Id.* at §107.

[29] *Supra*, note 28, at 119.

[30] 426 U.S. 692. 96 S. Ct. 2372 (1976).

[31] *Id*. at 724.

[32] *Id*. at 720.

[33] See *Natel v. Christian and Missionary Alliance,* 878 F. 2d 1575, 1578 (1st Cir. 1989); *Rweyemamu v. Cote*, 520 F. 3d 198, 204-209 (2nd Cir. 2008); *Petruska v. Gannon University*, 462 F. 3d 294, 303-307 (3rd Cir. 2006); *EEOC v. Roman Catholic Diocese,* 213 F. 3rd 795, 800-801 (4th Cir. 2000); *Combs v. Central Texas Annual Conference,* 173 F. 3d 343, 345-350 (5th Cir. 1999); *Hollins v. Methodist Healthcare, Inc.,* 474 F. 3d 223, 225-227 (6th Cir. 2007); *Schleicher v. Salvation Army,* 518 F. 3d 472, 475 (7th Cir. 2008); *Scharon v. St. Luke's Episcopal Presbyterian Hospitals,* 929 F. 2d 360, 362-363 (8th Cir. 1991); *Werft v. Desert Southwest Annual Conference,* 377 F. 3d 1099, 1100-1104 (9th Cir. 2004); *Bryce v. Episcopal Church*, 289 F. 3d 648, 655-657 (10th Cir. 2002); *Gellington v. Christian Methodist Episcopal Church, Inc.*, 203 F. 3d 1299, 1301-1304 (11th Cir. 2000); *EEOC v. Catholic University*, 83 F. 3d 455, 460-463, 317 U.S. Appl. D.C. 343 (DC Cir. 1996).

[34] *Supra* note 2, at 706.

[35] Roberts rejected as untenable the EEOC's suggestion that religious organizations could defend against employment discrimination claims based on a First Amendment right to freedom of association rather than freedom of religion. *Id*. at 706.

[36] *Id*. at 707.

[37] *Id.* at 707.

[38] *Id.* at 707, citing App. 42.

[39] *Id.* at 707, citing App. 42.

[40] *Id.* at 707, citing App. 43.

[41] *Id.* at 707, citing App. 49.

[42] *Id.* at 707.

[43] *Id.*, at 707.

[44] *Id.* at 708, citing App. 220.

[45] *Id.* at 708, citing App. 53.

[46] *Id.* at 708.

[47] *Id.* at 708. Roberts thought that it was significant that Perich had not only been commissioned as a minister but had also undergone significant theological training in preparation for a position with a recognized religious mission.

[48] *Id.* at 708. That lay teachers performed the same duties as Perich was relevant to, but not dispositive of, the issue of whether the ministerial exception applied to her. Roberts also noted that lay teachers were only hired when called teachers were unavailable.

[49] *Id.* at 708.

[50] *Id.* at 709.

[51] *Id.* at 709.

[52] *Id.* at 709.

[53] *Id.* at 709.

[54] *Id.* at 709.

[55] The plaintiffs alleged two categories of horribles. In the first, churches might be able to retaliate against a ministerial employee who reported criminal misconduct by the church or testified against the church's interests before a grand jury or in a criminal trial. In the second, churches might invoke the ministerial exception in order to violate employment laws with regard to the hiring of children or aliens who were not authorized to

work in the United States. *Id*. at 710.

[56] Tabor-Hosanna response was that ministerial exception would neither bar criminal prosecutions of religious organizations from interfering with law enforcement investigations and proceedings nor bar the government from enforcing general laws restricting eligibility for employment. To support its claim, Tabor-Hosanna noted that the lower courts have been applying the ministerial exception for over 40 years and it had "not given rise to the dire consequences predicted by the EEOC and Perich." *Id*. at 710.

[57] *Id.* at 710.

[58] *Id*. at 710.

[59] *Id.* at 711.

[60] *Id.* at 711.

[61] *Id*. at 712.

[62] *Id.* at 715.

[63] *Id.* at 715.

[64] *Id.* at 715.

[65] *Id*. at 707.

"FEWER" BUSINESS STUDENTS LEFT BEHIND: USING KOLB'S MODEL OF LEARNING PREFERENCES IN AN UNDERGRADUATE LAW COURSE

by

Regina M. Robson*

INTRODUCTION

One of the most common syllabus objectives of the undergraduate business law course is to teach students to "think like lawyers" – a somewhat amorphous goal that ranges from evaluating the impact of law on business scenarios to the more ambitious aim of optimizing critical thinking skills. Beyond the explicit objective to teach students to "think like lawyers," is the implicit assumption that business students will also "learn like lawyers" – that they will adopt the learning style, and adapt to teaching style, that predominates in law schools.

This article examines how particular learning preferences impact both the study – and teaching – of law at the undergraduate level. Specifically, it describes the learning styles identified by educational psychologist, David Kolb, and explores how the learning preferences of students and faculty may impact undergraduate business law classes. It argues that in order to accommodate the diverse learning styles characteristic of an undergraduate population, instructors in law must be willing to diverge from their preferred teaching styles and incorporate pedagogical

* Associate Professor, St. Joseph's University, Philadelphia, PA. Special thanks to Ms. Mariana Da Silva for her assistance and enthusiasm.

techniques that accommodate diverse learning preferences. The article also suggests pedagogical approaches that might be used to reach students whose preferred learning method is not congruent with the learning preference dominant among law students and law professors. The paper concludes that a conscious consideration of both learning preferences – and teaching preferences – can ensure that in the race to enhance critical thinking skills, "fewer" business students are left behind.

LEARNING STYLES: LEARNING HOW WE LEARN

Learning Preferences

There are few areas in pedagogy literature of greater interest – or controversy – than the topic of what constitutes "real" learning.[1] Educational theory posits distinct hierarchies of learning - a progression that involves not only the ability to recall information, but the capability of analyzing it, integrating it and ultimately synthesizing it to solve problems and generate new insights.[2]

Contrary to popular belief, a number of attributes affect a person's penchant for learning; "being smart" is not enough. The quality of learning – whether information is "absorbed" and whether it is sufficiently integrated to be available for innovation or problem solving - is affected by a number of attributes including but not limited to personality, intelligence, social motivation, instructional environment and information management preferences.[3]

Although evidence suggests that personality and intelligence are relatively constant throughout life,[4] the literature does suggest that the methods by which individuals prefer to "manage" information – how they acquire it and process it - are more fluid and can be affected by pedagogical techniques[5] and the student's subjective understanding of "how they learn best."[6]

The definition of "Learning Style" is somewhat elastic,[7] encompassing not only *how* individuals learn,[8] but also how they *prefer* to learn.[9] Since most determinations of learning style are based on self-assessment,[10] it is more accurate to think of learning style as a preference, rather than a imperative. As one commentator noted, "Each individual will adopt an approach to learning with which they are most comfortable and in doing so leave behind the approaches with which they are less comfortable."[11]

While individuals frequently utilize more than one learning style depending on the task,[12] a student's meta-cognitive awareness of her dominant learning style can affect classroom engagement and academic success.[13]

If there is no consensus about how to define a preferred learning style, there is even less agreement on how best to describe such preferences. Scholarly literature posits the existence of numerous "models" for distinguishing learning preferences.[14] Theories abound, buttressed by research in psychology,[15] neuroscience,[16] and the front-line experience of teachers.[17] Although such theories are not necessarily mutually exclusive, there is no overarching framework to unite such disparate theories. Moreover, there is significant academic criticism of the instruments used to determine learning styles.[18] Many of the instruments rely on self-identification as a basis for determining learning preferences,[19] with limited empirical research to determine if there is a correlation between self-proclaimed learning style and the student's actual mode of learning.[20] Another source of criticism is the sale of measurement instruments[21] acompanied by consulting opportunities for the proponents of such instruments.[22]

Beyond issues of data validation and potential conflict of interest, the most potentially pernicious risk of the adoption of a learning style model is the "pigeon-hole effect" – the risk that students will be seen *only* as intuitives, visual learners, kinesthetics or a host of other "types."[23] Such

ham-handed applications ignore not only the individuality of students but also ignore the use of models as indicative of a *preference* – not an immutable characteristic.

Despite these shortcomings, however, a conscious consideration of different learning styles – albeit imprecisely defined – benefits students. A study that examined the relationship between learning styles and academic success found that students who were cognizant of their own learning style had higher grade point averages than students who were not aware of their learning preferences.[24] Understanding what techniques "feel comfortable" can offer students the opportunity to adjust the manner in which they study and how they approach a task.

Research also suggests that teaching techniques that acknowledge and engage different learning modalities benefit *all* students, not only those students whose learning preference is disparate from the predominant learning style of the class. During the process of learning, individuals cycle through different phases of learning: experiencing, reflecting, analyzing and applying information.[25] "Deep learning" occurs only when individuals venture out from their preferred learning styles and use multiple modes of information acquisition and processing.[26]

The Kolb Learning Model

Teachers seeking to adopt pedagogical techniques that resonate with students with diverse learning styles face practical challenges. The nature of some disciplines dictates that a particular learning style will predominate. Moreover, research suggests that instructors tend to *teach* using techniques which are compatible with the instructor's own learning style.[27] Consequently, instructors benefit from understanding both the learning styles of their students and their *own* learning preferences.

The Kolbian model of learning preferences provides a practical "lens" through which to understand learning modalities and to evaluate pedagogical techniques. The Kolb model is a refinement of experiential learning theory – a pedagogical theory that posits that learning occurs when an individual transforms experience into knowledge.[28] For Kolb and other experiential learning theorists,[29] learning is the result of "*grasping* and *transforming* experience."[30]

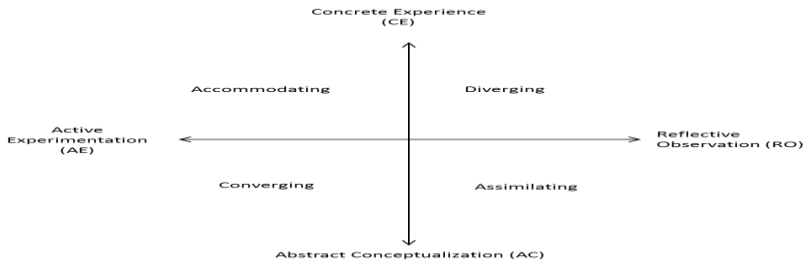
Individuals have preferred methods for "grasping and transforming" information (collectively "information management"). Both are critical for true learning to occur.[31] In Kolbian terms, an individual's preferred method of information acquisition occurs along a continuum (the "Perception Continuum") that runs from Abstract Conceptualization ("AC") through Concrete Experience ("CE").[32] At one end of the continuum, CE, are students whose preferred method for acquiring information is sensory and intuitive, rather than reflective.[33] For such students information acquisition may be influenced by feelings about the professor, the class or the work group.[34] Simply stated, "CE learners focus on the people portion of learning."[35]

In contrast to CE learners, AC students are "theorists" who acquire information by organizing and categorizing it.[36] While adept at classifying information, AC learners may have difficulty applying theory to practice.[37]

"Processing" information is as important as acquiring information and also proceeds along a continuum (the "Processing Continuum). "Processing" information is characterized by internalization, making it available for generating new insights and problem solving. In Kolb's model, an individual's preferred mode of processing extends from Active Experimentation ("AE") through Reflective Observation ("RO").[38] Similar to CE students who acquire information through hands-on experiences, AE learners gain deeper appreciation of information through application and

experimentation.[39] They are application driven and learn best through an iterative process of "discovery."[40] Conversely, RO learners prefer to process information by "watching" rather than doing.[41] Such learners generally require ample time for reflection as they try to structure a theory that accommodates the information they have observed.[42]

Student preferences for acquiring and processing information are not interdependent. For example, a student whose preferred mode of acquiring information might be through a tactile experience, might nonetheless internalize such information through the process of reflection rather than experimentation. Kolbian theorists typically present these options in graph form, with the Perception Continuum plotted on the "y" axis and the Processing Continuum plotted on the "x" axis.



The quadrants formed by graphing of the Perception Continuum and the Processing Continuum describe four discrete learning styles, which Kolb identifies as Assimilating, Converging, Diverging and Accommodating.[43]

Assimilating learners are "thinker-watchers" combining a preference for Reflective Observation and Abstract Conceptualization.[44] Such students are " typically analytic learners, who absorb and process information sequentially.[45]

They tend to be less interested in people and more interested in ideas and abstract concepts.[46] Assimilators tend to ask the question "what" and benefit from time to reflect.[47] In a classroom, they are copious note takers and may find discussion distracting.[48] They are adept at ordering and categorizing information in a logical framework.[49] Because they tend to focus on logic rather than social interactions, Assimilating learners may create solutions that are hard to implement. [50]

A student with a Converging learning style prefers to acquire information through thinking and reflection (AC) and process it through active experimentation (AE).[51] Convergers gather information through trial and error in the context of specific problems.[52] Dubbed "thinker-doers,"[53] such learners are application focused, valuing the use of theories, not for their own sake, but in the context of problem solving.[54] Less interested in people or interpersonal interaction, these learners prefer simulations, laboratory assignments and practical applications.[55]

An individual with a Diverging learning style prefers to acquire information through concrete experience and process it through reflective observation.[56] Kolb labels this style as "diverging" because such learners tend to function best in situations requiring idea generation and out-of-the-box thinking.[57] Divergers frequently ask, "why?" and prefer to see how new material relates to other information.[58] Such students are motivated to learn only when they understand the purpose of the learning.[59] They prefer to work in groups[60] and benefit from personal feedback.[61]

Individuals with an Accommodating learning style both acquire and process information through hands-on experiences.[62] They are action oriented and sometimes eschew logical analysis – to the chagrin of Assimilators[63] - relying instead on intuition or on other people as a source of information.[64] Accommodating Learners frequently ask "what if" and focus on applying information to solve

problems.[65] In the classroom, such learners prefer to collaborate with classmates, do field work and test out different approaches to problem solving.[66]

While Kolbian theory posits the existence of preferred learning styles, it rejects the notion that such preferences are static. To the contrary, Kolb argues that experiential learning occurs only when an individual "touches all the bases" by revisiting knowledge through all modes of information acquisition and processing.[67] In Kolbian theory, effective problem solving occurs when an individual fully integrates the four learning modalities.[68] Consequently, pedagogical techniques that encourage students to explore all learning styles benefit all students, not just those with the non-dominant learning style.

Learning Like Lawyers

The few studies that examine the correlation of learning styles with law school populations have found that Assimilating and Converging learners predominate over Accommodating and Diverging learners,[69] despite the fact that there is some evidence to suggest that the Accommodating learning style is the predominant style within the population as a whole.[70]

If Assimilating and Converging learning styles predominate among law students, it should also be no surprise that the front of the classroom is usually occupied by an instructor whose learning style mirrors that of the class. In a recent survey eighty-one percent of law school faculty were identified as Assimilating learners and nineteen percent as Converging learners.[71] No law school faculty member represented any other learning style.[72] Not surprisingly, an analysis of the syllabi of the law courses offered at the same university contains language that suggests an emphasis on reflection and abstract conceptualization over concrete experiences and active experimentation.[73] Only twenty-five percent of the course

syllabi included projects or exercises that suggested information acquisition through Active Experimentation and only six of the forty-four courses relied on pedagogical techniques emphasizing Concrete Experience as a mode of information acquisition.[74]

The research on law schools has interesting implications for teaching law as part of an undergraduate curriculum. While the author has found no study examining undergraduate business law courses, it is not an illogical extrapolation to assume that law school trained professors teaching at the undergraduate level have a similar learning preference to their colleagues who teach at law schools.

Considering the learning preferences of faculty is not simply an “academic” exercise. There is research to suggest that students’ academic performance is better when their learning styles are congruent with that of their instructors.[75] This may present challenges when teaching law at the undergraduate level where presumably the learning preferences of the student population differ from the style predominant in law school. While survey data conducted on MBA students suggests that graduate business students have learning styles similar to law students,[76] such data is not necessarily representative of undergraduate business majors whose career choices may be more fluid or for the undergraduate population as a whole.

While some studies found that as in law school, Assimilators predominated in business schools,[77] other studies of undergraduate business students found that Convergers were most common followed closely by Assimilators and Divergers.[78] Moreover, within various business majors, a particular style might predominate. For example, one study reported that the Converging style predominated among accounting majors.[79] Assimilators were found to be the predominant style among finance majors;[80] other studies found Divergers[81] and Accommodators prevalent among marketing and sales

professionals.[82] A pedagogy that may be adequate – or even preferred – for teaching law students and other Assimilators may ignore students whose learning style is Accommodating or Diverging.

Learning Like Art Students

Is a pedagogy focused on Assimilators and Convergers fundamentally different from teaching aimed at Divergers and Accommodators? A comparison of pedagogical approaches in a graduate management class with the techniques used in an art class is illuminating. Accommodating and Diverging learning styles are the predominate learning styles both among art students and art instructors.[83] In contrast, the MBA classroom, like the law school class, is dominated by instructors whose preferred learning style is Assimilating and Converging. [84]

MBA courses were described as "text-driven," focusing on materials that "deliver an authoritative scientific discourse."[85] Classes were described as "discursive"[86] - with each topic being treated sequentially with little "doubling back." Instructor emphasis was on "telling,"[87] emphasizing theory over demonstration.[88] Sections were also described as "batched,"[89] with limited individualized feedback.

In contrast, classes for art students were described as "demo-practice-production-critique;" "recursive;" "showing;" and "individualized." [90] Art classes frequently took an "inside-out" approach, with students experiencing multiple aspects of a subject simultaneously.[91] Classes were distinguished by individualized attention and feedback.[92]

TEACHING STRATEGIES

Comparing pedagogic techniques at the extreme – it is difficult to imagine two more diverse disciplines that art and

business – suggests some interesting strategies to reach more students in the legal environment class.

Pedagogy scholarship is replete with descriptions of mock trials, contract drafting exercises or service learning courses designed to make students participants in their own learning. Whether presented in the Kolbian "language" or under the more general rubric of "active learning," such techniques, by requiring "hands-on" activity, group work, or real world applications are likely to have strong appeal for Divergers and Accommodators. However, courses at the undergraduate level rarely have time for more than one active learning exercise. Such techniques may engage diverse learners temporarily, only to leave them floundering when the class returns to the more assimilating/converging approach. It may be more beneficial – and more sustainable – to "drizzle" approaches geared to such learners throughout each topic. In a series of small adjustments, faculty may be able to engage – and retain – students whose learning preferences are frequently unaddressed. A small sampling of techniques might serve to encourage new approaches to teaching; each has the virtue of being easy to implement and adaptable to large classes.

Learning Like an "Arts" Major: A conscious effort to "import" the liberal arts into the business law classroom can pay dividends.[93] Presenting cases as "stories" whose endings have been determined by the courts can engage the "people focus" of Divergers and Accommodators. "Rehumanizing" parties by using names rather than the procedural labels of "plaintiff" and "defendant," and providing a "backstory" may engage emotion and provide context for legal principles.[94] Literature can also illuminate cases, helping students to understand the underlying values that animate the law.[95] Even "war stories" and personal anecdotes can help students relate to material.[96]

Drawing Pictures: If a picture truly is worth a thousand words, "diagraming" concepts in law could prove

remarkably efficient. Professor Jacobson provides a graphic description of a "properly pleaded complaint" under Section 8(a) of the rules of Civil Procedure and taps into another way of learning.[97] Utilizing cases or examples with a strong visual component can also help students whose preferred method for information acquisition is visual or tactile.[98] Even the ubiquitous PowerPoint can become "art" by adding color, diagrams and sound.[99]

Use Media: Harness music and song in service of the law. Professor Mark DeAngelis, for example, has mined the creative and visual arts for examples that illustrate legal concepts.[100] Law "lessongs" reinforce the definitions of legal terms through a combination of rhyme, music and humor that appeals to all learning styles. It is hard to imagine the concept of a holder in due course being interesting, but the *Holder in Due Course Blues* explains the concept in a way that is accessible and meaningful to undergraduates.[101]

Eat, Drink and Move Around: Researchers found that over twenty-five percent of law students preferred to eat or drink when learning something new.[102] While such accommodations are not always feasible in the classroom, allowing students to snack may create a relaxed environment conducive to learning while helping students to maintain energy levels.[103] Learners who acquire information from concrete experiences and process it through active experimentation frequently benefit from field trips and interviews.[104] Yet, even brief periods of mobility – the use of short breaks or the ability to move to different workstations within a classroom– can help to anchor the attention of active learners.[105]

Assign Homework: Periodic assignments, both developmental and graded, offer instructors a way to incorporate exercises which appeal to diverse learners – without "betting the house" that a particular project will have a disproportionate impact on grades. Assignments

offer a *consistent, recurring* way to reach students whose learning styles do not mirror those of the class; they offer instructors a way to "road test" a technique and evaluate its efficacy; and they provide all learners – both faculty and student – with an opportunity to "try on" a new way of acquiring and processing information.

Explicitly Acknowledge Diverse Learning Styles: A simple acknowledgement both at the beginning of the semester and throughout the year that students *do* have different learning preferences can encourage students to evaluate – and potentially adjust – their learning strategies. Asking students how they "like" to learn and prodding them to devise ways to use their preferred techniques carries benefits beyond the legal classroom. In a class evaluation, one student commented, "I don't like reading but drawing diagrams was helpful."[106]

CONCLUSION

Despite the plethora of scholarly discussion on the existence and contours of learning preferences, the overarching question remains: "so what?" There is significant disagreement about what – if anything – instructors should do to accommodate student learning styles. [107] While faculty may give lip-service to the notion that pictures speak as effectively as text, for lawyers raised on the casebook method and Socratic inquiry, all other approaches may be "legal analysis lite." Moreover, precious class time and resources could be wasted in inept, efforts to "appease" a particular learning style.[108] However, if the overarching purpose of every course is to expose students to multi-layered learning, to lead them beyond discrete "factoids" to transformational knowledge, then exposing students to different modes of learning becomes paramount. To teach law at the undergraduate level requires not only good lawyers, but also committed teachers. Research suggests that students – and presumably professors – actually become "more proficient" learners to the extent that

they are exposed to new learning mechanisms.[109] Incorporating exercises, however small, that consistently expose students to all four methods of information management can guide students toward higher-order learning.[110]

Ultimately, whether faculty chooses to adapt pedagogical techniques aimed at diverse learning styles goes to the core of an instructor's personal educational philosophy. However, even absent any accommodation, an understanding of both student *and* faculty learning preferences can help create a more empathetic and respectful learning environment. The unrelieved use of a teaching style incompatible with a student's preferred learning style may create barriers to learning. It may be that students "don't get it," not because of a lack of intelligence or diligence, but because they simply do not speak the same "language" as the instructor. Even if the ultimate goal is to teach students a new "language" for learning, it is of inestimable value if the professor is able to speak - or at least recognize - the native tongue. While it may not be possible to engage all students on a consistent basis, an appreciation of learning preferences will ensure that, if not all, at least *fewer* business students will be "left behind."

ENDNOTES

[1] *Compare* B. F. Skinner, *The Shame of American Education*, 39 AM. PSYCHOL. 947, 951(1984)(arguing that learning is a process of changing behavior through repeated reinforcement of desired outcomes), and DAVID A. KOLB, EXPERIENTIAL LEARNING: EXPERIENCE AS THE SOURCE OF LEARNING AND DEVELOPMENT 26 (1984) available at http://www.learningfromexperience.com/images/uploads/process of experiential learning.pdf (arguing that learning is not a "storehouse of facts" but a process in which concepts are derived and modified by experience)(hereinafter "Source of Learning").

[2] *See, e.g.*, TAXONOMY OF EDUCATIONAL OBJECTIVES: THE CLASSIFICATION OF EDUCATIONAL GOALS 201-207 (Benjamin S. Bloom et al. eds., 1956)(distinguishing higher order thinking skills such as “critical thinking,” “analysis,” “synthesis” and “evaluation” from “knowledge”).

[3] M. H. Sam Jacobson, *A Primer on Learning Styles: Reaching Every Student*, 25 U. SEATTLE L. REV. 139, 144-169 (2001). *See also* Jonathan L. Ross, Maureen T. B. Drysdale & Robert A. Schulz, *Cognitive Learning Styles and Academic Performance in Two Postsecondary Computer Application Courses*, 33 J. RES. ON COMPUTING EDUC. 400, 401(2001)(reporting on findings that environmental, emotional, personal and biological factors affect learning preferences).

[4] Jacobson, *supra* note 3 at 146. *See also* Eric A. DeGroff & Kathleen A. McKee, *Learning Like Lawyers: Addressing the Differences in Law Student Learning Styles*, 2006 BYU EDUC. & L. J. 499, 511 (2006) (“[I]intelligence is not generally considered to be subject to improvement in adult learners.”).

[5] Robin H. Boyle & Rita Dunn, *Teaching Law Students Through Individual Learning Styles*, 62 ALB. L. REV. 213, 224 (1988)(“Professors who use the identical strategies in teaching all students in a class with diverse learning styles will find it is likely to be less effective for some students.”).

[6] *See infra* note 24 and accompanying text.

[7] *See, e.g.*, ALAN PRITCHARD, WAYS OF LEARNING 41 (2d ed.2009)(noting that “learning style” is frequently used interchangeably with “cognitive style” and identifying eight, somewhat overlapping definitions of learning style).

[8] DeGroff & McKay, *supra* note 4 at 509 (defining “learning style” as “the way in which students perceive, absorb and process new information.”).

[9] Jacobson, *supra* note 3 at 142 (describing learning style as “those cognitive, affective and psychological behaviors that indicate how learners interact with and respond to the learning environment and how they perceive, process, store and recall what they are attempting to learn.”); Pritchard, *supra* note 7 at 41 (noting that “learning style” can be considered as “the particular way in which an individual learns; a mode of learning – an individual’s *preferred* or best manner(s) in which

to think, process information and demonstrate learning; habits, strategies or regular mental behaviors concerning learning…")(emphasis added).

[10] *See infra* note 19 and accompanying text.

[11] Pritchard, *supra* note 7 at 43.

[12] *Id.* at 43 (noting that individuals may adopt different learning styles for different tasks).

[13] *Id.* at 42. *See also infra* note 24 and accompanying text.

[14] For an accessible and comprehensive discussion of mainstream learning style theories, *see* Pritchard, *supra* note 7 at 35-57, 86-113.

[15] *See, e.g.*, Isabel Brigg Myers, THE MEYERS-BRIGGS TYPE INDICATOR (1962); Rita Stafford Dunn, Kenneth J. Dunn & Gary E. Price, THE LEARNING STYLE INVENTORY (1989); Howard Gardner, MULTIPLE INTELLIGENCE: THE THEORY IN PRACTICE (1992); Alice Y. Kolb & David A. Kolb, *Experiential Learning Theory: A Dynamic, Holistic Approach to Management Learning, Education and Development*, in THE SAGE HANDBOOK OF MAN AGEMENT LEARNING, EDUCATION AND DEVELOPMENT 42, 49-69 (Steven J. Armstrong & Cynthia V. Fukami, eds., 2009)(hereinafter "Holistic Approach").

[16] *See, e.g.*, JAMES E. ZULL, THE ART OF CHANGING THE BRAIN: ENRICHING TEACHING BY EXPLORING THE BIOLOGY OF LEARNING 31-47 (2002)(arguing that learning results from, and creates changes in, the brain); Walter L. Leite, Marilla Svinicki & Yuying Shi, *Attempted Validation of the Scores of the VARK:Learning Styles Inventory with Multitrait-Multimethod Confirmatory Factor Analysis Models*, 70 EDUC. & PSYCHOL. MEAS. 323, 326 (2010), available at http://epm.sagepub.com/content/70/2/323 (observing that the VARK (visual, auditory, rear/write, kinetic) construct is based on neurolinguistic programming).

[17] STUDENT LEARNING ASSESSMENT 97(Middle States Com. On Higher Educ. ed., 2003)("Learning styles make intuitive sense.").

[18] *See, e.g.*, R. David Mitchell, *The Impact of Educational Technology: A Radical Reappraisal of Research Methods*, in ASPECTS OF EDUCATIONAL TECHNOLOGY XXVII 49 (describing the evidence with regard to the existence and impact of learning styles as "intellectual pollution").

[19] *See, e.g.*, David A. Kolb, LEARNING STYLE INVENTORY: TECHNICAL MANUAL (1976) (utilizing a self-administered, self-scored questionnaire as a basis for assessment); Myers, *supra* note 15 (utilizing a participant’s responses to questions as a basis for determination of personality type).

[20] Maryanne M. Jennings, *In Defense of the Sage* on *the Stage: Escaping from the “Sorcery” of Learning Styles and Helping Students Learn How to Learn*, 29 J. LEGAL STUD. EDUC 191, 212 (2012) (observing that there has been “insufficient intellectual curiosity” to research the question of whether there is any correlation between self-professed learning preferences and actual learning style).

[21] *See, e.g.* Hay Group, *Kolb Learning Style Inventory (KLSI), available for purchase at* *http://www.haygroup.com/leadershipandtalentondemand/ourproducts/item_details.aspx?itemid=118&type=2&t=2*.

[22] Jennings, *supra* note 20 at 212-14 (identifying studies critical of the instruments used to determine the classification of learning preferences and the impact of learning style on learning).

[23] Jennings, *supra* note 20 at 215 (observing that in some instances the learning styles assessment has “devolved into questionable diagnosis mechanisms….”).

[24] Ross, Drysdale & Schulz, *supra* note 3 at 400 (citation omitted).

[25] PETER HONEY & ALAN MUMFORD, Learning Styles Helper’s Guide 7-8 (2006) (positing that multiple ways of processing and experiencing information are necessary for effective learning); Jacobson, *supra* note 3 at 171 (identifying the stages of the learning process and arguing that all phases must be “in balance.”).

[26] Alice Y. Kolb & David A. Kolb, *Learning Styles and Learning Spaces: Enhancing Experiential Learning in Higher Education*, 4 ACAD. MANAGEMENT LEARNING & EDUC. 193, 194 (arguing that the learning process is a “spiral” in which an individual learns utilizing all four modalities: experiencing, reflecting, thinking and acting)(hereinafter “Learning Spaces”).

[27] Robin A. Boyle, *Employing Active-Learning Technologies and Metacognition in Law School: Shifting Energy from Professor to*

Student, 81 U. DET. MERCY L. REV. 1,16 (2003)(suggesting that professors teach either in accordance with their own learning preference or adopt the learning style in which they were taught). *See also* Carol Marshall, *Teachers' Learning Styles: How They Affect Student Learning*, 64 THE CLEARING HOUSE, 225, 225-26 (1991)(noting that in response to an informal query, of "why do you teach the way you do? teachers consistently responded with "it's the way I was taught" or "it's the way I learn.").

[28] Kolb (Source of Learning), *supra* note 1 at 38.

[29] Kolb & Kolb (Learning Spaces), *supra* note 26 at 194 (describing six propositions central to experiential learning theorists).

[30]David A. Kolb, Richard E. Boyatzis & Charalampos Mainemelis, *Experiential Learning Theory: Previous Research & New Directions* in *PERSPECTIVES* ON THINKING, LEARNING AND COGNITIVE STYLES (Robert J. Stenberg & Li-Fang Zhang eds., 2001)("[T]he learner must continually choose which set of learning abilities he or she will use in a learning situation.")(hereinafter "New Directions).

[31] *See* Kolb & Kolb (Learning Spaces), *supra* note 26 at 195 (positing the existence of a "learning cycle" where an individual acquires and processes information using both preferred and non-preferred modes of information management). *But see* William Wesley Patton, *Opening Students Eyes: Visual Learning in the Socratic Classroom*, 15 LAW & PSYCHOLO. REV. 1, n.3 (1991)(arguing that the acquisition phase may be the most important part of information management, since without such acquisition, processing and integration cannot occur).

[32] Kolb & Kolb (Learning Spaces), *supra* note 26 at 193.

[33]Kolb (Holistic Approach), *supra* note 15 at 45 (suggesting that CE learners tend to be right-brained, holistic learners).

[34] Jennings, *supra* note 20 at 202.

[35] *Id.* at 203.

[36] *Id.* at 202-03.

[37] *Id.* at 202.

[38] Kolb & Kolb (Holistic Approach), *supra* note 15 at 44.

[39] Kolb (Source of Learning), *supra* note 1 at 30.

[40] Jennings, s*upra* note 20 at 202 (noting that when drafting a paper, AE students rarely complete the research in advance but proceed through numerous drafts, researching as they write).

[41] Kolb (Source of Learning), *supra* note 1 at 30.

[42] Jennings, *supra* note 20 at 203.

[43] Kolb & Kolb (Learning Spaces), *supra* note 26 at 196. Kolb and other researchers have further refined the four original learning styles. *See id*. at 197-99 (describing refinements that result in nine distinct learning types).

[44] Jennings, *supra* note 20 at 205.

[45] DeGroff & McKee, *supra* note 4 at 515.

[46] Kolb & Kolb (Learning Spaces), *supra* note 26 at 196.

[47] Pritchard, *supra* note 7 at 50.

[48] Jennings, *supra* note 20 at 206.

[49]Kolb & Kolb (Learning Spaces), *supra* note 26 at 196.

[50] *Id.* at 196-7.

[51] *Id*. at 197.

[52] Pritchard, *supra* note 7 at 50.

[53] Jennings, *supra* note 20 at 207.

[54] Kolb & Kolb (Learning Spaces), *supra* note 26 at 197; DeGroff & McKee, *supra* note 4 at 515-16.

[55] Kolb & Kolb (Learning Spaces), *supra* note 26 at 197.

[56] *Id.* at 197.

[57] *Id.*

[58] Pritchard, *supra* note 7 at 49-50.

[59] Jennings, *supra* note 20 at 205 (citations omitted).

[60] *Id.*

[61] Kolb & Kolb (Learning Spaces), *supra* note 26 at 196.

[62] *Id.* at 197.

[63] Jennings, *supra* note 20 at 207 (noting that when working together in groups, Accommodators may "irritate" Assimilators who value logical responses rather than the "gut feelings" characteristic of Accommodators).

[64] Kolb & Kolb (Learning Spaces), *supra* note 26 at 197.

[65] Pritchard, *supra* note 7 at 50.

[66] Kolb & Kolb (Learning Spaces), *supra* note 26 at 197.

[67] *Id.* at 195 (describing learning as a "recursive" process involving all four modes of learning).

[68] Kolb & Kolb, (Holistic Approach), *supra* note 15 at 51-52 (providing a model for problem solving that integrates decision analysis with the four learning styles).

[69] John H. Reese & Tania H. Reese, *Teaching Methods and Casebooks*, 38 BRANDEIS L. J. 169, 177 (2000); DeGroff & McKee, *supra* note 4 at 521.

[70] Saul McLeod, (2010) *Kolb's Learning Styles and Experiential Learning Cycles*, *http://www.simplypsychology.org/learning-kolb*. (last accessed August 15, 2013).

[71] DeGroff & McKee, *supra* note 4 at 521.

[72] *Id.*

[73] *Id* at 542-544.

[74] *Id.*

[75] *See, e.g.* Boyle & Dunn, *supra* note 5 at 215(citing research finding that college students’ performance improved when the instructor’s learning style was the same as their own); Rita Dunn et al., *Effects of Matching and Mismatching Corporate Employees’ Perceptual Preferences and Instructional Strategies on Training Achievement and Attitudes*, 11 J. APPLIED BUS. RES. 30, 33 (1995)(“[M]atching …perceptual preferences with complementary instructional resources significantly affected training achievement and attitude test scores toward their instruction.”).

[76] Kolb & Kolb, (Learning Spaces) *supra* note 26 at 201-02.

[77] James Giorando & Regina H. Rochford, *Understanding Business Majors’ Learning Styles*, 11 COMMUNITY C. ENTERPRISE 21, 23-24 (2005)(noting that many students enrolled in business courses are analytical learners who crave structure); Jennings, *supra* note 20 at 200 (“[B]usiness students tend to be Kolb assimilators, favoring analytical approaches to learning….”).

[78] Robert Loo, *A Meta-Analytic Examination of Kolb’s Learning style Preferences Among Business Majors*, 77 J. EDUC. BUS 252, 253 (2002)(reporting on several studies examining Kolb’s preferred learning styles in educational settings).

[79] *Id.* at 253 (reporting on a 1984 study which used Kolb’s LSI to determine the preferred learning style of accountants). But see, *id.* (reporting on a 1987 study that found no predominant learning style among accounting majors).

[80] *Id*. (reporting on a 1987 study that found that over 30% of finance majors were Assimilators).

[81] *Id*. (describing the results of a 1987 study which studied Kolb learning styles among marketing majors).

[82] Kolb & Kolb (Learning Spaces), *supra* note 26 at 196.

[83] *Id*. at 203.

[84] *Id.*

[85] Kolb & Kolb, (Learning Spaces), *supra* note 26 at 202.

[86] *Id*. at 203.

[87] *Id.*

[88] *Id.*

[89] *Id.*

[90] *Id.*

[91] *Id.*

[92] *Id.*

[93] For an excellent discussion of the benefits of utilizing the liberal arts in business education, *see* Joan V. Gallos, *Artful Teaching: Using the Visual, Creative and Performing Arts in Contemporary Management Education* 187, 187-212 in THE SAGE HANDBOOK , *supra* note 15 at 187-212.

[94]Donna M. Steslow & Carolyn Gardner, *More than One Way to Tell a Story: Integrating Storytelling Into Your Law Course*, 28 J. LEGAL STUD. EDUC 249, 257(2011(noting that use of stories addresses multiple pedagogical challenges).

[95] See, e.g., Deborah Waire Post, *Teaching Interdisciplinarily: Law and Literature as a Cultural Critique*, 44 ST. LOUIS L. J 1247, 1258 (2000)(discussing the use of a short story focused on the experience of welfare recipients in connection with a case which absolved a medical provider from liability because there was no consideration for the services).

[96] Steslow & Gardner, *supra* note 94 at 260 ("War stories remain a viable source for stories in the classroom.").

[97] Jacobson, *supra* note 3 at 175.

[98] *See, e.g.*, Robert C. Bird, *Moral Rights: Diagnosis and Rehabilitation*, 46 AM. BUS. L. J. 407, 408 (2009)(describing a case involving the jigsawing of a Picasso linocut that could easily be adapted as a vehicle for discussing ethics, contracts and intellectual property).

[99] Boyle, *supra* note 27 at 19-20 (describing how to tweak PowerPoint to appeal to diverse learners).

[100] Professor DeAngelis' blog site is available at *http://legalstudiesclassroom.blogspot.com/2011/02/law-music-video-bill-of-rights.html* (last visited August 10, 2013). *See also* Boyle & Dunn, *supra* note 75 at 232 (suggesting that instructors require students to utilize information that they have learned in a creative activity).

[101] The *Holder in Due Course Blues* is available at *http://legalstudiesclassroom.blogspot.com/search/label/holder%20in%20due%20course* (last visited January 3, 2014).

[102] *Id.* (reporting on student reported behavior in study conducted by the authors).

[103] *Id.*

[104] Jennings, *supra* note 20 at 231.

[105] Boyle & Dunn, *supra* note 5 at 234 (noting that one fourth of the students in a learning preference study preferred periodic mobility when learning new material).

[106] Anonymous Student Evaluation, Fall, 2012, MGT 360 Legal Environment of Business, on file with the author.

[107] DeGroff & McKay, *supra* 4 note at 535 (describing the tension between law school pedagogy which focuses on the learning style of the student and that focused on the demands of the discipline).

[108] Jennings, *supra* note 20 at 216.

[109] DeGroff & McKee, *supra* note 4 at 540; Kolb & Kolb (Learning Spaces), *supra* note 26 at 194 (noting that transformational learning occurs when a learner "touches all the bases – experiencing, reflecting, thinking and acting – in a recursive process that is response to the learning situation….").

[110] Jacobson, *supra* note 3 at 169 (noting that teaching to different learning styles leads all students to more "complex learning").