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ARTICLES

PEDAGOGY

MANDATORY ARBITRATION CLAUSES IN CONSUMER CONTRACTS: A LEGALLY PERMISSIBLE MEANS OF DENYING CONSUMERS THE CONSTITUTIONAL RIGHT TO LITIGATE CONTRACT DISPUTES IN COURT AND THE RIGHT TO TRIAL BY JURY

by

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I. INTRODUCTION

Mandatory arbitration clauses in consumer contracts have had a checkered past in the United States. Courts historically viewed arbitration as a means of settling disputes with significant disfavor, a fact that has been noted by many courts, including the United States Supreme Court in numerous decisions as well as by Congress.[1]

Congress enacted the Federal Arbitration Act (FAA) in 1925 in order to overcome the judicial resistance to arbitration and declare a national policy to favor arbitration of claims that parties agree to settle through arbitration.[2] Since its enactment, the U.S. Supreme Court has interpreted the FAA as requiring that "questions of arbitrability . . . be addressed with a healthy regard for the federal policy favoring arbitration"[3] and has

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admonished lower courts to "rigorously enforce agreements to arbitrate."[4]

Some commentators write in support of arbitration clauses in consumer contracts by noting that arbitration is generally faster and cheaper than litigation as a means of resolving disputes.[5] Further, arguments advanced in support of arbitration include the elimination of the uncertainty that can result from jury verdicts, and the cost savings to over-taxed publicly funded judicial systems.[6] These and other arguments in support of binding arbitration clauses in consumer contracts have some merit. Critics, however, note that there are important questions about basic fairness and due process raised by the ubiquitous mandatory arbitration clauses in consumer contracts in light of the broad interpretation of the FAA by the U.S. Supreme Court preempting state regulation of these clauses. The same is true of class arbitration waiver clauses in consumer contracts that prevent consumers from joining class action suits and require a case-by-case resolution of consumer claims in separate arbitrations by each aggrieved consumer. Because both mandatory arbitration and class action waiver clauses can effectively bar consumers from access to the courts, it is important to examine whether the ends of justice are best served by such clauses or whether Congress needs to set some limits on such clauses when consumer contracts are involved.

II. THE U.S. SUPREME COURT'S INTERPRETATION OF THE FAA

Congressional hearings relating to the FAA make it clear that Congress intended the act to apply to merchant-to-merchant arbitrations but not to merchant-to-consumer arbitrations.[7] The purpose of the FAA was to make arbitration agreements enforceable in federal courts and toprovide a simple and expeditious process that would allow merchants to resolve their

disputes more cheaply and easily.[8] "The FAA was a bill of limited scope, intended to apply in disputes between merchants of approximately equal economic strength to questions arising out of their daily relations."[9] Congressional hearings preceding the FAA's enactment demonstrate the Act was intended to apply to contracts involving two merchants agreeing to arbitrate future disputes.[10] Be that as it may, the U.S. Supreme Court has made it very clear that the FAA applies to consumer contracts as well as to contracts between merchants.

In *AT&T Mobility LLC v. Concepcion*[11] a cellular phone contract between AT&T and the respondents provided for arbitration of all disputes arising out of the agreement and included a class action waiver requiring preventing aggrieved parties from banding together in class action arbitration.[12] Respondents brought suit in the District Court for the Southern District of California that was later consolidated with a putative class action against AT&T for false advertisement and fraud by charging sales tax on the full value of phones advertised as "free" to consumers.[13] AT&T then moved to compel arbitration and petitioners opposed the motion arguing the arbitration agreement was unconscionable and unlawfully exculpatory under California law because it disallowed class action.[14] The District Court denied AT&T's motion and the Ninth Circuit Court of Appeals affirmed, agreeing with the District Court that the class waiver provision was unconscionable under California law as announced in *Discover Bank v. Superior Court*, 36 Cal.4th 148 (2005).[15] The Supreme Court reversed in a 5-4 decision, quoting from the FAA as follows:

> "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction ... shall be valid, irrevocable, and

> enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.[16]

The majority reasoned that the saving clause permits agreements to arbitrate to be invalidated by generally applicable contract defenses, such as fraud, duress, or unconscionability, but not by defenses that apply only to arbitration itself or an agreement to arbitrate[17] In other words, the validity of the agreement to arbitrate itself cannot be the basis of a claim of unconscionability.

A second recent U.S. Supreme Court case challenging the enforcement of an arbitration clause with a class action waiver is *American Express Co. v. Italian Colors Restaurant*[18] The case involved an agreement between petitioners, American Express and a subsidiary, and respondents, merchants who accept American Express cards, requiring all of their disputes to be resolved by arbitration and provided that there "shall be no right or authority for any Claims to be arbitrated on a class action basis."[19] Respondents brought a class action against petitioners for violations of the federal antitrust laws, claiming that American Express used its monopoly power in the market for charge cards to force merchants to accept credit cards at rates approximately 30% higher than the fees for competing credit cards.[20] Petitioners moved to compel individual arbitration under the FAA and respondents opposed the motion, submitting a declaration from an economist who estimated that the cost of an expert analysis necessary to prove the antitrust claims would be "at least several hundred thousand dollars, and might exceed $1 million," while the maximum recovery for an individual plaintiff would be $12,850, or $38,549 when trebled.[21] The District Court granted the motion and dismissed the lawsuits, but the Court of Appeals reversed and remanded for further proceedings. It held that because respondents had established

that they would incur prohibitive costs if compelled to arbitrate under the class action waiver, the waiver was unenforceable and the arbitration could not proceed.[22] The U.S. Supreme Court then granted certiorari, vacated the judgment and remanded for further consideration in light of *Stolt–Nielsen S.A. v. AnimalFeeds Int'l Corp.*[23] which held that a party may not be compelled to submit to class arbitration absent an agreement to do so.[24] The Court of Appeals stood by its reversal, stating that its earlier ruling did not compel class arbitration and the U.S. Supreme Court once again granted certiorari to determine "[w]hether the Federal Arbitration Act permits courts . . . to invalidate arbitration agreements on the ground that they do not permit class arbitration of a federal-law claim."[25] The Court held the FAA does not permit courts to invalidate a contractual waiver of class arbitration on the ground that the plaintiff's cost of individually arbitrating a federal statutory claim exceeds the potential recovery.[26] The Court then went on to state in reliance on prior cases the overarching principle that arbitration is a matter of contract, that the FAA requires courts to rigorously enforce arbitration agreements according to their terms, even for claims alleging a violation of a federal statute, unless the FAA's mandate has been overridden by a contrary congressional command (citations omitted).[27]

III. THE NEED TO DISTINGUISH CONSUMER CONTRACTS FROM NON-CONSUMER CONTRACTS

The Second Circuit Court of Appeals held the arbitration and class action waiver clauses in merchants' contracts with American Express effectively prevented merchants from filing class a class action suit in court or banding together for a class action arbitration against American Express because of the prohibitively high cost of proving antitrust claims individually.[28] The U.S. Supreme Court noted in reversing the Second Circuit decision in *Italian Colors* that "the antitrust laws do not

guarantee an affordable procedural path to the vindication of every claim."[29] The holding in *Italian Colors* that class action arbitration clauses in contracts cannot be invalidated merely because the cost of arbitration exceeds any potential recovery, coupled with the interpretation of the FAA as requiring courts to rigorously enforce contracts according to their terms, is particularly troubling when contracts between merchants and consumers are involved.

Generally speaking, contracts between merchants involve parties with greater sophistication and real bargaining power that can provide some room for negotiation. The same is not true of adhesion contracts offered to consumers on a take it or leave it basis.[30] Merchants are also much likelier to understand the ramifications, limitations and potential costs involved with arbitration and class waiver clauses in business-to-business contracts where some negotiation to limit or omit these clauses may be possible.[31] Not so with consumers who encounter these clauses in boilerplate language at the point of sale when selecting a cell phone carrier, renting an automobile, insuring their house, car, health or life, or being admitted to a hospital for treatment. They have no bargaining power to strike an arbitration or class action waiver clause from a contract for a needed product or service even if they actually read the contract carefully, know that these clauses are binding, and understand the consequences of signing the contract that gives away their right to sue (including in a small claims court at nominal cost when modest damages are involved) if the contract is breached.

Firms that include arbitration clauses in consumer contracts tout the benefits of arbitration both for themselves and for their customers.[32] One study examined the contractual practices by well-known firms marketing consumer products and compared the firms' consumer contracts with contracts the same firms negotiated with business peers.[33] The findings of the study were

telling:

> In sum, despite their rhetorical stance in favor of arbitration, the firms in our sample did not uniformly include arbitration clauses in their contracts. Instead, the use of arbitration clauses varied markedly according to the contract type: arbitration clauses appeared routinely in employment contracts (92.9 percent), frequently in consumer contracts (76.9 percent), and rarely in non-employment, non-consumer business contracts (6.1 percent). In consumer contracts, mandatory arbitration clauses were coupled uniformly with provisions barring class arbitration, and frequently with non-severability clauses and waivers of class litigation.[34]

The study also found that every consumer contract with a mandatory arbitration clause also included a waiver of the right to participate in class-wide arbitration.[35] This led the study's authors to conclude that "[t]he most likely explanation for the pattern we observed is that firms value arbitration clauses for their effects in suppressing aggregate proceedings by consumers, and perhaps averting liability for widespread but low-value wrongs."[36]

IV. THE HIDDEN COST OF ARBITRATION

An oft-touted benefit of arbitration, including mandatory arbitration clause in consumer contracts, is that it is less expensive and faster than traditional litigation in the courts.[37] And while this statement holds true in many cases when litigation involves significant damages that would otherwise end up in the courts of record at the state or federal levels, it is highly questionable when the damages suffered by a consumer are

within the jurisdiction of a small claims court where access is inexpensive and, unlike state and federal trial courts, it will not take years for a civil case to be heard. In New York, for example, where both the general cost of living and legal fees are much higher than the national average, one can access a small claims court for a $15 filing fee in city courts for claims of up to $1,000 or $20 for claims between $1,000 and $5,000.[38] For town or village courts the filing fee is $10 for claims of up to $1,000 and $15 for claims between $1,000– $3,000.[39] Defendants are served by regular and certified mail by the clerk of the court[40] so service of process is not a separate expense in most cases. In the event that service by mail is ineffective and service of process must be done in person, the plaintiff can have a friend or family member at least 18 years of age not involved in the case serve the defendant at no cost, or a process server can be used.[41] Sheriffs can also serve process on behalf of litigants. The fee in Manhattan (New York County) for a sheriff to serve papers, as an example, is currently $52.[42] Thus a resident of New York City who wants to dispute a $300 charge imposed by her cell phone carrier for overages or long distance calls she did not make on her phone can sue the carrier for a cost of $15. And if her cell phone catches fire and causes her severe burns, she could also sue the phone maker for up to $5,000 for a total cost of $20. But if her contract for cellular service or phone purchase with her carrier contains a mandatory arbitration clause, these avenues will be closed to her. And the arbitration clause could specify that the arbitration fees will be split between the parties or even paid in whole by the losing party. In addition, the arbitration clause could specify where the arbitration must take place (which could pose inconvenience and travel expenses for the consumer), what state laws would apply, and the choice of arbitration service, among other important restrictions that could make it expensive and unfeasible to arbitrate.

Moreover, although the up-front costs for consumer arbitration are modest, they are much higher than the cost of filing in small claims court were that an option. The American Arbitration Association (AAA) requires a non-refundable filing fee of $200 if a consumer initiates arbitration pursuant to a pre-dispute arbitration agreement, with the business paying the remaining fees.[43] JAMS, a competing international provider of arbitration services, treats consumer arbitration in a similar way, requiring consumers to pay an up-front fee of $250 if the consumer initiates arbitration, with the business paying all other required fees.[44] In arbitrations conducted under the auspices of both AAA and JAMS, the business pays all fees if it initiates the arbitration and in both cases the fees can add up to many thousands of dollars.[45] A third national provider of arbitration and mediation services, National Arbitration and Mediation (NAM), states in its rules for consumer arbitration "With respect to the cost of the arbitration, it must be at a reasonable cost to the Consumer based on the circumstances of the dispute, the size and nature of the claim."[46] Notably, though, unlike AAA and JAMS, NAM does not cap the cost of consumer-initiated arbitration and requires the party that initiates the arbitration to pay an initial filing cost of $575 for disputes up to $10,000 in value.[47] The fee covers up to one hour of arbitrator's time with additional time billed at $680 per hour.[48] Thus in AAA and JAMS arbitrations, the cost for consumers that wish to initiate an arbitration is significantly higher and can impose on the consumer greater inconvenience than access to small claims courts. And in JAMS arbitration, the potential cost can be quite high as the arbitrator's hourly fees and ancillary costs can quickly amount to a sizable sum out of all proportion to the potential recovery of damages when these are minor.

In addition to the significantly higher filing fees for dispute resolution through arbitration rather than through small claims courts, mandatory arbitration can pose additional significant

costs to consumers. Businesses are free to choose any national, regional or local arbitration service provider and need not utilize a well-established provider with rules that limit the cost for the consumer who initiate arbitration proceedings. This can result in arbitration clauses requiring a consumer to pay for half of the entire cost of arbitration or even the entire cost if she/he fails to prevail and the arbitration agreement contains a loser-pays provision. That could leave a consumer liable for thousands of dollars in arbitration fees. Arbitration agreements can also require arbitration outside of the consumer's home county or state which can be both inconvenient and require additional travel-related expenses.

While it is true that arbitration clauses that make it unreasonably difficult or expensive for a consumer to effectively pursue arbitration can be challenged as unconscionable, the determination as to validity of the clause will be made not by a court of law but by the arbitrator if the contract gives the arbitrator exclusive authority to decide any issue as to the enforceability of the agreement.[49] Numerous state court decisions have likewise held that questions of arbitrability of contracts containing arbitration clauses must be decided in the first instance by the arbitrator and not the courts.[50]

V. ADDITIONAL DISADVANTAGES OF ARBITRATION CLAUSES FOR CONSUMERS

Cost issues aside, mandatory arbitration can pose additional notable disadvantages for consumers. One such disadvantage is a potential denial of access to justice. In the United States unlike in most of the rest of the world, the American Rule was adopted in colonial times requiring each person to pay for their own attorney's fees in civil litigation.[51] The main justification most often cited in support of the American System is access to justice.[52] We are told that the reason each litigant is required to

pay for their own legal fees is that if "loser pays" were the rule as it is essentially in the rest of the world, aggrieved individuals might refrain from pressing their claims in court for fear of having to pay the prevailing party's legal expenses if they fail to prove their case, resulting in a denial of access to justice.[53] Mandatory arbitration clauses in consumer contracts clearly have the potential for imposing on consumers costs that can far surpass the cost of litigation in small claims courts and can even be structured to shift the entire cost of the arbitration to consumers who do not prevail in arbitration proceedings.[54] Thus, consumers with provable damages in the hundreds (or even thousands) of dollars who are denied the right to pursue their claims in small claims courts may well opt not to demand binding arbitration of their claims for fear of having to pay the entire cost of the arbitration if they fail to prevail. And while it is true that arbitration agreements that use AAA or JAMS protect consumers from "loser pays" fee shifting clauses in the arbitration contracts, businesses are not required to use AAA or JAMS and can use the services of NAM or any other arbitration services provider which does not prevent losing parties from being required to pay the entire cost of arbitration. Given that arbitration agreements in consumer contracts are not generally subject to negotiation, businesses can insulate themselves from the risk of law suits involving modest sums of loses for consumers by selecting an arbitration services provider that allows arbitration fees to be equally paid by consumers and businesses and/or incorporating a "loser pays" provision that will require a consumer who does not prevail in an arbitration to bear the entire cost of the proceeding. In such cases, a consumer would have to think twice before pressing an arbitral claim that may require higher fees than any potential arbitral award could justify if fee splitting is required, or abandoning a claim for fear of losing when fee shifting is involved. This is a great advantage for businesses wishing to minimize the risk and cost of litigation, but it is very difficult to see what concomitant benefit mandatory

arbitration can have for consumers with modest claims under such circumstances.

Another factor that can have a chilling effect on consumers' ability to utilize arbitration for settlement of their claims is the ability of the arbitration clause to require it in a venue that is convenient for the business and inconvenient for the consumer. Businesses that include mandatory arbitration clauses in consumer contracts can not only prevent consumers from pursuing claims in their local small claims court where they can do so quickly, cheaply and most conveniently, but can also require them to travel to inconvenient locations that can add additional costs and inconvenience to the dispute settlement process. This too can have a chilling effect of consumers' pursuit of grievances through the arbitration process.

It should come as no surprise, then, that "[i]ndividual consumers rarely use arbitration and when they do, they recover very little."[55] By contrast, corporate claims or counterclaims resolved by arbitrators have a markedly higher success rate and consistently yield much higher awards.[56]

VI. RECENT STATE LEGISLATIVE AND JUDICIAL EFFORTS TO CURB MANDATORY ARBITRATION CLAUSES IN CONSUMER CONTRACTS

Although the current pro-arbitration interpretation of the FAA by the U.S. Supreme Court preempts states from invalidating mandatory arbitration clauses in consumer contracts, there are some recent efforts by several states to try to mitigate some of the negative effects of mandatory arbitration through legislation.

California introduced a Senate Joint Resolution in 2016 urging the Consumer Financial Protection Bureau (CFPB) to

pass final regulations prohibiting mandatory arbitration clauses in consumer contracts that prohibit class actions.[57]

In 2016, legislators in Connecticut introduced a bill that would declare the following provisions in any consumer contract that contains a mandatory arbitration clause unconscionable:[58] requiring resolution of legal claims in a venue that is inconvenient to the consumer;[59] waiving of the consumer's substantive rights to assert claims or seek remedies provided by state or federal law;[60] waiving of the consumer's right to seek punitive, minimum, multiple or other statutory damages as provided by law or attorney's fees if authorized by statute or common law;[61] requiring that any action brought by the consumer with regard to the contract be initiated within a shorter time period than the applicable statute of limitations;[62] requiring the consumer pay fees and costs to bring a legal claim that substantially exceed the fees and costs that would be required to bring a claim in a state court or that makes no provision for the waiver of fees and costs for a consumer who cannot afford such fees and costs;[63] and failing to permit a party to present evidence in person or to ensure that the consumer can obtain, prior to a hearing, any information that is material to the issue to be determined at such hearing.[64]

The Illinois Senate considered a bill that would prohibit the state from doing business with companies that use mandatory arbitration agreements in contracts with their employees or with consumers.[65] The bill would also make it presumptively unconscionable for a mandatory arbitration clause in an adhesion contract when the contract involves only one individual (and an entity) and that individual did not write the contract to contain a requirement for settlement of an arbitration dispute outside of the county where the individual resides or the contract was executed.[66] It would also make it presumptively unconscionable for such contracts to contain a waiver of

remedies provided by state or federal statutes,[67] a waiver of an individual's right to seek punitive damages,[68] a provision shortening any applicable statute of limitation,[69] and the payment of any fees and costs above the cost to bring an action in the state's courts or in a federal court.[70] The proposed Act goes on to note that it is the state's policy to prohibit forced arbitration in consumer and employment agreements,[71] (a prohibition that is preempted to the extent that the FAA applies to the arbitration for reasons previously discussed), and it further declares mandatory arbitration agreements in insurance contract involving a consumer unconscionable and void.[72] The last prohibition should not be preempted by the FAA as the FAA is inapplicable to insurance contracts because it does not specifically reference the industry as covered by the Act.[73]

The New Jersey Supreme Court has ruled a mandatory arbitration clause in a consumer contract involving a home warranty contract unenforceable for lack of mutual assent because the arbitration clause was included in an inconspicuous section of the contract under the title of "MEDIATION" with a font of less than 10-point type and a general lack of clarity in the drafting language as to the binding arbitration.[74]

New York prohibits mandatory arbitration clauses in consumer contracts for the sale or purchase of consumer goods and declares such clauses void.[75] But as we have seen such general prohibitions are unenforceable when preempted by the FAA when consumer transactions affect interstate commerce. In an apparent attempt to make consumers better aware of the existence of mandatory arbitration contracts they sign, New York has introduced a bill pending before the New York State Senate as of this writing that would require all contracts for the sale of goods involving a consumer that have mandatory arbitration clauses to print such clauses in large type not smaller than 16 point type.[76] The bill would impose civil penalties on

merchants of $250 for a first offense and $500 for each subsequent offense.[77] A second bill also pending before the New York State Assembly as of this writing would require arbitrators in consumer and employment arbitration to be neutral (e.g., no conflict of interest or prior relationship to the parties) and would give Courts the ability to invalidate arbitral decisions where conflict of interest was not disclosed by the arbitrator.[78] The Act would also continue to prohibit mandatory arbitration clauses in consumer and employment contracts where permissible under the FAA.[79]

There is a bill pending before the Tennessee General Assembly that would prohibit mandatory arbitration clauses in consumer contracts.[80] (The bill would also prohibit mandatory arbitration clauses in contracts involving infants or adjudicated incompetents[81] and in certain claims with respect to estates in real property.[82])

VII. SHOULD CONGRESS ACT TO PRESERVE CONSUMERS' ACCESS TO JUSTICE?

In passing the Federal Arbitration Act, Congress intended to overcome judicial resistance to arbitration and declare a national policy in favor of arbitration.[83] This goal was achieved, but the broad interpretation by U.S. Supreme Court decisions of the FAA has created unintended negative consequences for consumers with modest claims that at once deny them access to the courts and can leave them with no economically feasible means of seeking redress through arbitration. Mandatory arbitration clauses in consumer contracts coupled with a restriction on consumers banding together as a class in arbitration allow businesses to leave aggrieved consumers with no economically feasible remedy to redress modest losses when a contract is breached. Given that consumer contracts are typically adhesion contracts, consumers have no choice but to

give up the right to seek redress in court (including small claims courts) and the right to file class action lawsuits when that restriction is also imposed contractually if they wish to avail themselves of the product or service they need which are offered by companies that incorporate these clauses in consumer contracts.

Mandatory arbitration (and class arbitration waiver) clauses in consumer contracts overwhelmingly benefit businesses at the expense of consumers. By using these clauses businesses can effectively prevent aggrieved consumers to quickly, conveniently and very inexpensively seek redress in small claims courts. They can also prohibit them from banding together in both class action lawsuits and class action arbitration, thus making it economically unfeasible for consumers who suffer slight economic losses due to a breach of contract to obtain remedies for their losses. It is telling that according to at least one study, companies overwhelmingly use mandatory arbitration clauses in their consumer contracts but rarely do so in their non-consumer contracts where both parties have real negotiating power and both contracting parties must actually want mandatory arbitration to be a part of the contract.[84] The study found that mandatory arbitration appeared in more than three quarters of sampled firms' consumer contracts but fewer than one-tenth of their business-to-business contracts.[85] All companies in the study's sample that used mandatory arbitration clauses in consumer contracts also included a waiver of the right to participate in class-wide arbitration.[86]

Congress has repeatedly introduced legislation since 2007 that would ban compulsory arbitration of nearly all employment, civil rights, franchise, and consumer matters.[87] To date, however, legislation limiting compulsory arbitration and class-wide arbitration wavers in consumer contracts has not been enacted. It is past time for Congress to address the issue and

clarify to what extent, if any, the FAA should apply to Consumer contracts.

VIII. CONCLUSION

Given recent U.S. Supreme Court decisions interpreting the FAA, only Congress can redress the unintended consequences for consumers in the FAA by clarifying whether the Act was intended to apply to all business and consumer contracts, including adhesion contracts. If it is the will of Congress that the FAA apply to consumer contracts, then Congress needs to find some reasonable protection for consumers in order to preserve the right of access to justice.

This could be accomplished in numerous ways short of a wholesale exclusion of arbitration clauses from consumer contracts. The U.S. Constitution protects the right to a trial by jury for all civil claims in excess of $20 in value.[88] That right should not be abrogated by a clause in a contract of adhesion at a minimum unless a consumer willfully, knowingly and specifically gives up that right. One solution is making mandatory arbitration clauses in consumer contracts optional and valid only if a consumer agrees to it in a separate writing. Another solution is to retain the validity of such clauses but provide consumers and businesses with the option to bring suit in small claims court in lieu of arbitration. Maintenance of the status quo should at a minimum require Congress to amend the FAA to protect the integrity and fairness of the arbitration process. Such protections should include all of the following:

1. Requiring arbitration to take place in the consumer's home county or in the county where the contract was executed;

2. Requiring mandatory arbitration and waivers of class arbitration clauses in contracts to be conspicuous in all consumer contracts (e.g., written in a larger font size than other contractual clauses and/or bold-faced font for emphasis);

3. Prohibiting the selection of an arbitrator with past business dealings or other conflict of interest as relates to the parties;

4. Making it presumptively unconscionable to include waivers of otherwise applicable state or federal consumer protection laws; and

5. Requiring arbitrators in all contract-based arbitration involving consumer contracts to provide the parties written award letters that include findings of fact and conclusions of law where applicable to provide a written record that could be examined by an appellate court in case of claims of fraud, conflicts of interest, or arbitrary or capricious decisions by an arbitrator.

Of course, Congress could also simply make mandatory arbitration and class-wide arbitration waivers inapplicable in consumer contracts which is this author's preferred solution.

In the interest of justice, Congress should revisit this issue of vital importance to consumers. Even in the current political climate, this is an issue that should allow Senators and Representatives to find common ground regardless of their party affiliation or political ideology as it involves fundamental issues of fairness and access to justice for all Americans on which

reasonable politicians should be able to reach that most precious, rare and nearly extinct quality of effective leadership: compromise.

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[1] 7 Williston on Contracts § 15:11 (4th ed.), May 2017 Update.

[2] *Id.* (Referencing *Buckeye Check Cashing Inc. v. Cardegna*, 546 U.S. 440, 443 (2006); *Preston v. Ferrer*, 552 U.S. 346 (2008); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 25 (1991); and *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510 (1974).

[3] Steven C. Bennett, Dean A. Calloway, "A Closer Look at the Raging Consumer Arbitration Debate", 65-OCT Disp. Resol. J. 28, 30 (2010) (Quoting *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

[4] *Id.* (Quoting *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985)).

[5] *Id.* at 31

[6] *Id.*

[7] Margaret L. Moses, *Statutory Misconstruction: How the Supreme Court Created a Federal Arbitration Law Never Enacted by Congress*, 34 FLA. ST. U. L. REV. 99, 106 (2006).

[8] *Id.* at 111.

[9] I*d.* at 111-112.

[10] Rhys E. Burgess, *Protecting Those Who Cannot Protect Themselves: the Efficacy of PRE-Dispute Arbitration Agreements in Nursing Homes*, 17 Loy. J. Pub. Int. L 1, 5 (Fall 2015).

[11] 131 S.Ct. 1740 (2011).

[12] *Id.* at 1744.

[13] *Id.*

[14] *Id.* at 1744-45.

[15] *Id.* at 1745.

[16] *Id.*

[17] *Id*. at 1746.

[18] 133 S.Ct. 2304 (2013).
[19] *Id*. at 2306.

[20] *Id*. at 2308.

[21] *Id*.

[22] *Id*. (Referencing *In re American Express Merchants' Litigation*, 554 F.3d 300, 315–316 (C.A.2 2009).
[23] 559 U.S. 662, 130 S.Ct. 1758, 176 L.Ed.2d 605 (2010).
[24] *Italian Colors* at 2308.

[25] *Id*.

[26] *Id*. at 2308-2312.

[27] *Id*. at 2308-2309.

[28] *In re American Express Merchants' Litigation*, 554 F.3d 300, 315–316 (C.A.2 2009).

[29] *Italian Colors* at 2309.

[30] Mindy R. Hollander, 46 HOFLR 363, 365 (Fall 2017).

[31] *Id*.
[32] Theodore Eisenberg, Geoffrey P. Miller, Emily Sherwin, Mandatory Arbitration for Customers but Not for Peers: *A Study of Arbitration Clauses in Consumer and Non Consumer Contracts*, 92 Judicature 118 (2008).

[33] *Id*. at 119.

[34] *Id*. at 122.

[35] *Id*. at 121.

[36] *Id*. at 123.

[37] See generally, e.g., Steven C. Bennett, Dean A. Calloway, "A Closer Look at the Raging Consumer Arbitration Debate", 65-OCT Disp. Resol. J. 28 (2010) (Quoting *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

[38]*A Guide to Small Claims & Commercial Small Claims in the New York State City, Town & Village Courts* at 6, New York State Unified Court System (Updated August 2018), at Available online at http://www.nycourts.gov/courthelp/pdfs/SmallClaimsHandbook.pdf (Last accessed October 8, 2018).

[39] *Id*.

[40] *Id*. at 8.

[41] *Id*. at

[42] See New York City Department of Finance available online at https://www1.nyc.gov/site/finance/sheriff-courts/sheriff-serving-legal-papers.page (Last accessed October 8, 2018).

[43] *American Arbitration Association Consumer Arbitration Rules*, Amended and Effective September 1, 2018 available online at https://www.adr.org/sites/default/files/Consumer_Fee_Schedule_0.pdf (Last accessed October 8, 2018).

[44] *JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness*, Effective July 15, 2009, available online at https://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_Consumer_Min_Stds-2009.pdf (Last accessed October 8, 2018).

[45] See https://www.adr.org/sites/default/files/Consumer_Fee_Schedule_0.pdf for AAA arbitration fees (last accessed September 2, 2019). (For business-initiated arbitration filings, a filing fee of $500 for 1 arbitrator or $625 for three arbitrators is required. In addition, the business must also pay a case management fee of $1,400 for one arbitrator or $1,775 for three arbitrators and an additional $1,500 to the arbitrator(s).) See https://www.jamsadr.com/consumer-minimum-standards/ and https://www.jamsadr.com/arbitration-fees (lst accessed September 2, 2019). (JAMS requires businesses to pay all fees in business-initiated arbitration, including a $1,500 fee in two-party arbitration and an additional case management fee equal to 12 percent on all professional fees, including time spent for hearings, pre- and post-hearing reading and research and award preparation. The actual hourly rate payable to each arbitrator is set by the arbitrator.)

[46] *NAM's Minimum Standards of Procedural Fairness for Consumer Arbitrations* (Effective November 6, 2009), Standard #6, Available online at https://www.namadr.com/wp-content/uploads/2018/07/Consumer-MinimumStandards.pdf (Last accessed October 8, 2018).

[47] *NAM Comprehensive Fees*, Available online at https://www.namadr.com/wp-content/uploads/2016/07/Comprehensive-Fees-7.1.18-1.pdf (Last accessed October 8, 2018).

[48] *Id*.

[49] See *Rent-A-Center West, Inc. v. Jackson*, 130 S.Ct. 2772, 2776-2781 (2010). (Holding that in an employment contract containing an arbitration clause that gave the arbitrator the exclusive authority to resolve any dispute as to its enforceability, only unconscionability relating to the clause delegating the authority to resolve any dispute relating to the enforceability of the contract could be challenged in court, but not any other issue such as the unconscionability of the arbitration itself.)

[50] See, e.g., **Landers v. Federal Deposit Ins. Corp.,** 402 S.C. 100 (2013); BossCorp, Inc. v. Donegal, Inc., 370 S.W.3d 68 (2012); Tiri v. Lucky Chances, Inc., 226 Cal.App.4th 231 (2014); Baltimore County Fraternal Order of Police Lodge No. 4 v. Baltimore County, 429 Md. 533 (2012); Schumacher Homes of Circleville, Inc. v. Spencer, 237 W.Va. 379 (2016); Monarch Consulting, Inc. v. National Union Fire Ins. Co. of Pittsburgh, PA, 26 N.Y.3d 659 (2016); HPD, LLC v. TETRA Technologies, Inc., 2012 Ark. 408 (2012); Locklear Automotive Group, Inc. v. Hubbard, 252 So.3d 67 (2017).

[51] See generally Victor D. López, Eugene T. Maccarrone, *Leading the World in the Wrong Direction: Is It Time For The United States To Adopt The World Standard "Loser Pays" Rule In Civil Litigation?*, North East Journal of Legal Studies: Vol. 32 , Article 1 (Fall 2014) available at http://digitalcommons.fairfield.edu/nealsb/vol32/iss1/1 (last accessed 2/2/2019).

[52] *Id*. at 3 (referencing John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice*, 42 Am. U.L. Rev. 1567 (Summer 1993).

[53] *Id*.

[54] See Section IV *supra*.

[55] Lauren Guth Barnes, *How Mandatory Arbitration Agreements and Class Action Waivers Undermine Consumer Rights and Why We Need Congress to Act*, 9 Harv. L. & Pol'y Rev. 329 (Summer 2015) at 329.

[56] *Id*.

[57] 2015 CA S.J.R. 25 (Introduced August 3, 2016). (It passed the Senate on August 11, 2016 but died on the inactive file in the Assembly on November 30, 2016.)

[58] 2016 CT H.B. 5561. (The bill was Raised by the House of Representatives in its February 2016 session but has not been enacted as of this writing.)

[59] *Id*. at § 2(1)

[60] *Id*. at § 2(2)

[61] *Id*. at § 2(3)

[62] *Id*. at § 2(4)

[63] *Id*. at § 2(5)

[64] *Id*. at § 2(5)

[65] 2017 IL S.B. 983 (NS) § 5-15(a) (Introduced February 7, 2017; Reintroduced January 6, 2019 with no further action as of this writing.)

[66] *Id*. at § 10-10(1)

[67] *Id*. at § 10-10(2)

[68] *Id*. at § 10-10(3)

[69] *Id*. at § 10-10(4)

[70] *Id*. at § 10-10(5)

[71] *Id*. at § 15-5

[72] *Id*. at § 15-10

[73] See 7 Williston on Contracts § 15:11 (May 2017 Update). See also 15 U.S.C.A. § 1011("Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.") Since the FAA does not specifically reference the insurance industry, it is inapplicable to it and states can continue to regulate it, including making forced arbitration inapplicable if they so choose.

[74] See *Kernahan v. Home Warranty Administrator of Florida*, 2019 WL 166309 (2019).

[75] McKinney's General Business Law § 399-c (2).

[76] 2017 NY S.B. 7111 (NS) (Introduced January 3, 2018; reintroduced in the NYS Assembly as 2019 NY A.B. 2497 January 23, 2019 and is still pending in the 1919-1920 legislative session).
[77] *Id*.

[78] 2017 NY A.B. 6983 (NS) (introduced March 28, 2017; reintroduced as 2019 NY A.B. 326 on January 29, 2019 and is still pending in 1919-1920 legislative session).

[79] 2019 NY A.B. 326 at § 7516(b).

[80] 2015 Bill Text TN H.B. 2388 § 1(a)(3) (Introduced January 21, 2016).

[81] *Id*. at § 1(a)(1)

[82] *Id*. at § 1(a)(2)

[83] See Willinston on Contracts, supra note 2.

[84] See generally Theodore Eisenberg, Geoffrey P. Miller, Emily Sherwin, *Mandatory Arbitration for Customers but Not for Peers: A Study of Arbitration Clauses in Consumer and Non-Consumer Contracts*, 92 Judicature 118 (2008).

[85] *Id*. at 119.

[86] *Id*. at 121.

[87] John R. Schleppenbach, *Something Old, Something New: Recent Developments in the Enforceability of Agreements to Arbitrate Disputes Between Nursing Homes and Their Residents*, 22 Elder L.J. 141, 143 (2014) (Referencing the Arbitration Fairness Act of 2011, S. 987, 112th Cong. §§ 1-4 (2011); Arbitration Fairness Act of 2009, H.R. 1020, 111th Cong. §§ 1-5 (2009); Arbitration Fairness Act of 2007, S. 1782, 110th Cong. §§ 1-5 (2007)).

[88] U.S. Const. Amend. VII.

THE REGULATION OF VIRTUAL CURRENCIES IN THE UNITED STATES

by

Bradford H. Buck*

I. INTRODUCTION

There are three terms commonly used to describe currencies like Bitcoin: digital currencies; virtual currencies; or cryptocurrencies. Since laws mentioned in this article use the term "virtual currency", this article will use that term when referring to currencies such as Bitcoin. Also, the terms "coins" or "tokens" are both used to describe the units of virtual currency. "The difference between a coin and a token is that a coin is a form of cryptocurrency that operates independently of other platforms… Tokens, on the other hand, are built on top of another platform in order to function. For the purposes of regulation, this is a distinction likely to be more form than substance."[1]

Virtual currencies are not fiat currency. Fiat currency is "currency that is issued or backed by a governmental authority

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without being tied to any tangible asset (such as gold). For example, American dollars have value as a medium of exchange first and foremost because the U. S. government has declared that they will be legal tender."[2] So virtual currencies are not backed by a government authority and are not legal tender which has to be accepted in exchange for goods and services. However, virtual currencies can be a form of currency. "In order to operate as a currency, the digital interest needs to have one of the generally accepted attributes of currency, such as acting as a medium of exchange, a store of value, or a unit of account."[3] However, virtual currencies such as Bitcoin, are very volatile[4] and therefore not a relatively stable store of value.

Virtual currencies have two main types: centralized; or decentralized. "[Virtual currencies either] emanate … from a centralized issuer or they result from the work of a person solving a puzzle with the virtual currency being "issued" as a reward for the work expended."[5] Ripple (and its XRP token) is an example of a centralized virtual currency and Bitcoin and Ethereum are examples of decentralized virtual currencies. "The XRP token was not designed to function as a currency, and Ripple chose to focus solely on strengthening blockchain rather than giving any priority to support the value of the XRP Token…. XRP has no miners and relies on a "centralized" blockchain [that is] …not open, and although information is safely stored and protected through cryptography, only "trusted" operators in the network are allowed access."[6]

For decentralized currencies such as Bitcoin and Ethereum, there is a blockchain to record transactions. "A "block" is a

permanently recorded time-stamped transaction aggregated with other transactions that have occurred at about the same time. … Each block entry will also contain a reference to the immediately preceding block (so the system knows where it is to be placed in the chain) and a difficult to solve mathematical puzzle. The problem in the block must be solved before the next block can be added to the chain. This is necessary so that blocks are added to the chain ("Blockchain") in the same sequence by everyone in the network."[7] Miners work on these transactions with a reward of some of the virtual currency. As of January 2, 2020, "there are currently 18,163,837.5 Bitcoins in existence. This number changes about every 10 minutes when new blocks are mined. Right now, each new block adds 12.5 Bitcoins into circulation… The maximum and total amount of Bitcoins that can ever exist is 21 million."[8] Someone must have an extremely large amount of computer resources to solve these mathematical puzzles and it can take some time to record these transactions. Someone wanting their transaction recorded quicker can offer a fee. The higher the fee offered, the quicker a miner will process the transaction. Once the transaction is processed, it is permanent and cannot be reversed for any reason.

Businesses can encounter several types of transactions involving virtual currencies. The virtual currencies themselves can be issued by a central authority or to miners solving a mathematical problem. Those virtual currencies can be transferred by the holders to transferees whether in exchange for goods and services or a simple transfer of the virtual currency itself. Intermediaries can assist with the transfers of virtual currency and hold virtual currencies for the owners. Lastly, a new virtual currency can be provided later in exchange for an

investment made by an investor and paid in U.S. dollars or another virtual currency. In addition, there may or may not be an investment return promised to investors. Some of these investments are referred to as an initial coin offering or "ICO".

II. FEDERAL REGULATION OF DIGITAL CURRENCIES

At the federal level, the federal administrative agencies and courts have applied existing laws and regulations to virtual currency transactions.

Commodities Futures Trading Commission and the Commodities Exchange Act

Section 1a(9) of the Commodities Exchange Act ("CEA") defines commodities as, among other things, "all goods and articles … and all services, rights and interests … in which contracts for future delivery are presently or in the future dealt in."[9] "Exclusive jurisdiction over "accounts, agreements … and transactions involving swaps or contracts for the sale of commodities for future delivery" has been granted to the CFTC."[10] The CFTC along with other federal agencies claim concurrent jurisdiction over virtual currencies. [11] The CFTC has determined that virtual currencies are commodities under the Commodities Exchange Act and regulated by the CFTC[12] and therefore, persons involved in those transactions must comply with the CEA and the regulations thereunder.

In *CFTC v McDonnell*,[13] the U.S. District Court for the Eastern District of New York held that the CFTC may regulate virtual currency as a commodity and, in addition, has jurisdiction over fraud that does not directly involve the sale of commodities. In that case, the CFTC brought an action against Patrick McDonnell and his company, Cabbagetech Corp. d/b/a Coin Drop Markets, for offering virtual currency trading and investment services. Customers paid for membership and were offered exit prices and profits up to 300% per week. After receiving membership payments and virtual currency investments from the investors, the defendants deleted social media accounts and stopped communication with customers. The defendants hardly provided advice and never achieved the return on investments. Customers demanded their virtual currency back and the defendants refused. The defendants argued that this was not a commodity under the Commodity Exchange Act and the CFTC had no jurisdiction. The court disagreed and held this was a commodity and the CFTC had jurisdiction. In *CFTC v. My Big Coin Pay, Inc.*[14], the court, citing CFTC v. McDonnell, also held the transaction involved was a commodity and the CFTC had jurisdiction.

Therefore, the CFTC has jurisdiction over fraud in connection with the sale of virtual currencies and contracts for the future delivery of virtual currencies. There is an exemption for "a contract for the sale of a commodity that results in "actual delivery" of the commodity within 28 days. There is some uncertainty as to how the actual delivery standard will apply to any leveraged, margined or financed sales to retail buyers of assets that the CFTC considers to be virtual currencies and the

CFTC's position on what constitutes actual delivery for virtual currencies is in a state of flux."[15]

Securities and Exchange Commission and the Federal Securities Laws

A security is defined as any "note, stock, treasury stock, security future, security-based swap, bond … [or] investment contract."[16] The U.S. Supreme Court has defined an investment contract as any contract, transaction or scheme involving: (1) an investment of money; (2) in a common enterprise; and (3) the expectation that profits will be derived from the efforts of the promoter or a third party.[17] Based on this Howey test, a number of federal district courts have held that transactions involving virtual currencies are securities and therefore, must comply with the securities laws or be exempt.

In *SEC v. Trendon T. Shavers and Bitcoin Savings and Trust,*[18] the U.S. District Court for the Eastern District of Texas held that the virtual currency transaction involved was a security. Shavers had formed Bitcoin Savings and Trust ("BTCST)" and made solicitations to have lenders invest in opportunities involving Bitcoin. Shavers offered up to 1% interest daily until investors withdrew their funds or BTCST deals stopped and it could no longer be profitable. Shavers obtained 700,467 Bitcoins from investors. Some investors lost a total of 263,104 Bitcoins. The court noted that it was not asked to decide if "Bitcoin itself is a security, or whether the offer, sale, trade or exchange of bitcoins constitutes the offer or sale of

securities." The court held that this transaction was an investment contract. Next, the court analyzed whether Bitcoin was money. The SEC defined "money" as "anything that functions as a medium of exchange, a unit of account or a store of value." The court held that Bitcoin was money and therefore this was a security under the Howey test. U.S. District Courts in *Rensel v. Centra Tech, Inc.*[19] and *SEC v. Blockvest,* LLC [20] have also held that the virtual currency transactions involved were securities.

The SEC acted against several companies involved in virtual currency transactions. In one case,[21] the SEC filed charges against Lacroix and PlexCorps for marketing securities called PlexCoin on the internet to investors claiming that investments in PlexCoin would yield a 1,354% profit in 29 days and alleged that LaCroix and PlexCorps violated the anti-fraud and the registration provisions of the federal securities laws. In another case,[22] the SEC entered a consent order with Munchee Inc. for a virtual currency transaction involving restaurant reviews.

On April 3, 2019, the SEC Strategic Hub for Innovation and Financial Technology published a framework ("Framework") for analyzing whether a virtual currency is offered and sold as a security under the federal securities laws and the SEC Division of Corporation Finance released a no-action letter ("No-action Letter") for a virtual currency transaction.[23] The Framework, which states it is not an official rule, discusses in detail the elements of the Howey test in virtual currency transactions as well as discussing whether a transaction that is initially a security will always remain a security. The No-action Letter

involved a party who was really offering a pre-paid gift certificate as a part of a membership program for an air charter company. The party requested the no-action letter because under the Howey test, there was an expectation of profits. This No-action Letter showed that the SEC is willing to consider this relief in certain circumstances.

Based on the above, certain virtual currency transactions can be a security and must be registered or exempt. However, at the time of this article, there has been one registration statement for a virtual currency transaction filed with the SEC by Grayscale Investments. [24] Therefore, an easier way to navigate a virtual currency transaction through the securities laws may be to utilize an exemption to the securities laws.

Financial Crimes Enforcement Network and the Bank Secrecy Act

Under the Bank Secrecy Act ("BSA"),[25] a money transmitter must register with the Department of the Treasury Financial Crimes Enforcement Network ("FinCen") as a money services business ("MSB") and implement a risk based anti-money laundering program ("AML"). Pursuant to the BSA and its implementing regulations, an AML program will include certain mechanisms for meeting MSB transaction monitoring, reporting and record keeping obligations, including "know-your customer" requirements. Under Section 5330 of the BSA, a money transmitter is a "person that provides money transmission service" or "other person engaged in a transfer of funds." Money

transmission services means “the acceptance of currency, funds or other value that substitute for currency … to another location or person by any means.”[26] “The following persons are exempt from MSB status: (a) bank…..; (b) persons registered with ….. regulated or examined by the U.S. Securities and Exchange Commission (SEC) or the U.S. Commodity Futures Trading Commission (CFTC),….; or (c) natural persons who engage in certain MSB activities (i.e., dealing in foreign exchange, check cashing, issuing or selling traveler’s checks or money orders, providing prepaid access, or money transmission) on an infrequent basis and not for gain or profit.”[27] One of the problems with this exemption is the definition of “infrequent basis”.

On March 18, 2013, FinCen provided guidance on how these regulations apply to virtual currencies.[28] In that guidance, FinCen said that users of virtual currency are not a MSB but an administrator or exchanger of virtual currency is a MSB. FinCen distinguished between real currency which is legal tender and virtual currency that does not have all the attributes of real currency but does have an equivalent value in real currency. FinCen also distinguished between centralized and decentralized virtual currencies. A centralized virtual currency has a central repository. The administrator will be a MSB if it allows transfers of value between persons or from one location to another. In a decentralized virtual currency, a person who creates units and uses it to purchase real or virtual goods and services is not subject to regulation as a money transmitter. However, a person who creates virtual currency and sells those units to another person for real currency or its equivalent is a money transmitter.

In the case of *U.S. v. Faiella,*[29] the defendant was charged with the operation of an underground market in Bitcoin via the website "Silk Road". Specifically, the defendant was charged with operating an unlicensed money transmission business under 18 U.S.C. §1960 and conspiracy to commit money laundering under 18 U.S.C. §1956(h). The defendant moved to dismiss on the grounds that Bitcoin was not money under § 1960, operating a Bitcoin exchange does not constitute transmitting money under §1960 and the defendant is therefore not a money transmitter. The court held Bitcoin qualified as money. In addition, the court held that the defendant was transmitting money and qualified as a money transmitter.

On April 18, 2019, FinCen issued a civil money penalty against Eric Powers for violating the BSA registration and reporting requirements because Powers failed to register as a MSB, had no policies or procedures for ensuring compliance and failed to report suspicious transactions.[30] Powers advertised on the internet to purchase and sell Bitcoin. Powers processed numerous suspicious transactions and never filed suspicious activity reports including transactions involving the Silk Road. Powers conducted over 200 transactions involving the transfer of more than $10,000 but failed to file currency transfer reports ("CTR"). Powers conducted 160 purchases of Bitcoin for $5 million through in person cash transactions and of these, 150 were over $10,000 and required CTR's that Powers never filed. Powers paid a $35,350 fine and agreed to an industry bar.

Internal Revenue Service

In 2014, the Internal Revenue Service ("IRS)" issued a notice regarding the tax treatment of transactions in virtual currency.[31] The IRS noted that a sale or exchange of virtual currency or its use to pay for goods and services has tax consequences. Specifically, the IRS stated virtual currency is property. A taxpayer who receives virtual currency as payment for goods and services must include the fair market value of that currency in gross income. Also, if the fair market value of property received in exchange for virtual currency exceeds the taxpayer's adjusted basis, the taxpayer has taxable gain and if it is less, the taxpayer has a taxable loss. Also, a taxpayer who mines virtual currency must include the fair market value as income.

III. STATE REGULATION OF DIGITAL CURRENCIES

At the state level, states have passed new laws or regulations specifically governing virtual currency and virtual currency transactions, applied existing laws and regulations to that currency and those transactions or do not have any laws, either existing or amended, that specifically cover that currency or those transactions.

New State Virtual Currency Laws or Regulations

The New York Department of Financial Services ("NYDFS") promulgated a new regulation covering virtual currencies.[32] Section 200.2 (q) provides that this regulation applies to "Virtual Currency Business Activity" which consists of: "(1) receiving "Virtual Currency" for Transmission or

Transmitting Virtual Currency…; (2) storing, holding or maintaining custody or control of Virtual Currency on behalf of others; (3) buying or selling Virtual Currency as a customer business; (4) performing Exchange Services as a customer business; or (5) controlling, administering or issuing Virtual Currency." Under Section 200.2(p), "Virtual Currency" means "any type of digital unit that is used as a medium of exchange or a form of digitally stored value… [and includes] digital units of exchange that: (i) have a centralized repository or administrator; (ii) are decentralized and have no centralized repository or administrator; or (iii) may be created or obtained by computing or manufacturing effort…[but does not include:] (1) digital units that (i) are used solely within online gaming platforms …; digital units that can be redeemed for goods, services, discounts or purchases as a part of a customer affinity or rewards program…; or digital units used as part of Prepaid Cards." Section 200.3 provides that engaging in a "Virtual Currency Business Activity', requires a license unless the activity falls within the following exemptions: New York state chartered banks approved for Virtual Currency Business Activity; or merchants and customers who utilize Virtual Currency solely for the purchase or sale of goods or services or for investment purposes. As of March 2019, 18 companies have been granted these so-called "bitlicenses" by New York, including: Circle; Ripple; Coinbase; Gemini; Square; Bitpay; Coinsource; and Robinhood.[33]

The National Conference on Uniform State Laws approved the Uniform Regulation of Virtual-Currency Business Act.[34] Under Section 102(25), the Act applies to "Virtual Currency Business Activity" which means: exchanging,

transferring or storing "Virtual Currency"; or engaging in Virtual Currency administration. "Virtual Currency" is defined in Section 102(23) as a digital representation of value that: is used as a medium of exchange, unit of account or store of value; and not used for legal tender but does not include: a merchant grant as a part of an affinity or rewards program; or a digital representation of value used solely within an on-line gaming platform. Section 103 provides that Act does not apply to: transactions covered by the Electronic Fund Transfer Act, Securities Exchange Act of 1934, Commodities Exchange Act or the states securities laws; a bank; other licensed money transmitters; persons that merely provides services for exempt transactions; foreign exchange; computer software or computer services provided in connection with Virtual Currency; persons using Virtual Currency as payment for goods or services on their own or family's behalf or for academic purposes; and certain other exemptions. Under Section 201 of the Act, any person may not engage in Virtual Currency business unless licensed in its state or another state or unless exempt as noted above. No state has adopted this Act yet.

Money Transmitter Laws

Many states have had money transmission laws for some time and several states have enacted the Uniform Money Services Act.[35] These laws have similar license and regulatory requirements as the NYDFS regulation noted above. Several states have amended these laws to specifically include virtual currencies and transactions and, therefore, person engaged in these currencies or transactions must comply.

Connecticut also amended its Money Transmission Act.[36] Section 36a-597 of this Act provides that no person shall engage in the business of money transmission in the state (Connecticut) without a license and a person is engaged in the business of money transmission "if the person: (1) has a place of business in …[the] state; (2) receives money or monetary value in …[the] state or from a person in …[the] state; (3) transmits money or monetary value from a location in the state or to a person located in …[the] state…; (4) issues stored value or payment instruments that are sold in …[the] state; or (5) sells stored value or payment instruments in …[the] state." Under Section 36a-596(9), "Money transmission" means "engaging in the business of issuing or selling payment instruments or stored value, receiving money or monetary value for current or future transmission or the business of transmitting money or monetary value within the United States or to locations outside the United States by any means." In Section 36a-596(8), "Monetary value" means "a medium of exchange, whether or not redeemable in money." Section 36a-596(18) provides that "Virtual currency" means "any type of digital unit used a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology… [and includes] digital units of exchange that (A) have a centralized repository or administrator; (B) are decentralized and have no centralized repository or administrator; or (C) may be created by computing or manufacturing effort…[but does not include:] digital units that are used solely within gaming platforms …or exclusively as a part of a customer affinity or rewards program but cannot be converted into or redeemed for fiat currency." Washington made a similar amendment to its Uniform Money Services Act.[37]

The following is a list of actions by other states: (a) Alabama, North Carolina and Rhode Island have amended their money

transmission laws to include virtual currencies; Colorado, Georgia, Hawaii, Kansas, Louisiana, New Hampshire, New Mexico, Oregon, Vermont and Virginia have issued guidance that virtual currencies are subject to their money transmission laws; a Florida appellate court case held that selling Bitcoin requires a money service business license; and Alaska, Illinois, Maryland, North Dakota, Pennsylvania, Tennessee, Texas and Utah have provided or stated that virtual currencies are not covered by their money transmission laws.[38]

State Securities Laws

Several states have acted against persons involved in virtual currency transactions under their state securities laws. Massachusetts has entered into three consent orders in connection with violations of its securities laws. In the first such consent order, the Massachusetts Securities Division ("MSD") found Across Platforms, Inc., d/b/a Clickable TV to be in violation of those laws.[39] In that case, Across Platforms announced it was launching an ICO of ClickableTV tokens ("CVT"). This ICO would allow users to purchase products using CTV backed by an advertising platform built on blockchain technology. The price for 1,000 CTV was 1 Ethereum. After receiving a subpoena from the Division, Across Platforms stopped selling. The consent provided that this a violation of the Massachusetts Security Act because this a covered investment contract and the offering was not registered or exempt. The MSD entered into two other consent orders involving an ICO of Planet Kids Coins by18moons[40] and mining allocations by Blue Vase[41] for state security law violations.

The Texas Securities Board issued two cease and desist orders in connection with violations of its securities laws. In the first such cease and desist order, the entity involved was BitConnect located in the UK.[42] Texas investors could: (1) purchase BitConnect Coins that were a decentralized virtual currency allowing owners to store and invest wealth; (2) invest in the BitConnect lending program and earn up to 40% per month; or (3) invest in the BitConnect staking program and also earn up to 120% per year. Also, BitConnect was about to offer an ICO for tokens known as bitconnectx. None of these offers were registered in Texas and were being sold by fraudulent practices. The Board concluded these were all securities under the Texas Securities Act and BitConnect was to cease and desist from any sales of these offerings in Texas until the offerings were registered or exempt. Another case involving LeadInvest also had a fraudulent scheme and similar cease and desist order.[43]

IV. CONCLUSION

The law has determined that virtual currencies are money, but those currencies are not fiat currency backed by the government. Given the lack of government backing and the volatility and taxability of virtual currencies, it is hard to see how most providers of goods or services would accept any of the existing virtual currencies in their transactions and therefore, how those currencies would act as a medium of exchange or unit of account. However, to the extent virtual currency is involved in an exchange for goods or services, those transactions probably are not subject to any laws except having potential tax

consequences. The same should apply to merely mining virtual currency. Therefore, the more likely use of existing virtual currencies is as an investment.

Also, obtaining virtual currencies for personal investment and then transferring those personal holdings of virtual currencies are also probably not subject to any laws except having potential tax consequences. However, ICO's and some other transactions involving virtual currency (especially centralized issuance of virtual currencies) or exchanges of virtual currency are probably regulated by the CFTC as commodities, the SEC as securities and FinCen as a money transmission business and must comply with the laws and regulations administered by those agencies or be exempt. There are several available exemptions from registration under the federal securities laws. Also, these transactions could be regulated in several states under the state securities, money transmission or other laws or regulations such as New York. These state laws and regulations (especially state securities laws) may have some exemptions that could apply. Any investor in or other party involved in virtual currency transaction would be prudent to ensure that the party sponsoring or involved in the transaction or holding the virtual currency, has all the necessary governmental licenses, registrations and approvals.

The federal government and state governments may continue to pass laws or regulations governing virtual currency. In addition, federal and state agencies will continue to regulate virtual currency transactions under the existing laws and

regulations. This is an area that should be continuously monitored for future developments.

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[1] Carol Goforth, *The Lawyer's Cryptionary: A Resource for Talking to Clients about Crytotransactions*, 41 CAMPBELL L. REV. 47, 97 (2019).
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DEMOCRACIES IN DANGER: THE HIGH COST OF GLOBAL TAX LIBERALIZATION

by

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I. INTRODUCTION

Academics have long argued that the collection of tax revenue lays a foundation for the development of accountable, democratic and responsive governance. Taxation supports the relationship between a nation and the citizens and a government seeking greater tax revenue is likely to face demands from these citizens for reciprocal services and expanded accountability.[1] As more and more citizens complain about globalization,[2] it is sensible to ask why it isn't working as anticipated for such large numbers of people and how taxation contributes to this growing discontent.

Despite the growing academic and public attention, the understanding of the relationship between globalization, democracy and taxation in developing nations has remained limited. Research has provided an increasing but still fragmented amount of evidence on the specific links between

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taxation, globalization and governance.[3] This paper seeks to help fill the gap through an examination of the links between taxation, globalization and democracies in the developing world.

II. GLOBALIZATION AND TARIFFS

How would globalization trigger a revenue crisis in a substantial number of developing nations? The answer lies in how the governments of the developing nations that joined the wave of globalization raised their money prior to the 1990s.[4] These governments collected extensive revenues from taxes on imports and exports. Tariffs on consumer goods produced domestically on average accounted for 40 percent of all tax revenues in developing economies and 35 percent in lower, middle-income economies. Combined, they comprised almost 33 percent of tax revenues in the full sample of developing economies.[5]

Reliance on trade taxes continued through the early 1990s, mainly because they are generally easy to collect. Trade taxes include import duties, export duties, import monopolies, export profits, exchange profits and exchange taxes. They can be monitored and solicited at centralized locations, such as border areas and don't require a complex bureaucracy to manage.[6]

Starting in the late 1980s, after the Latin American debt crisis, there was a growing movement towards opening up international markets. In order to obtain structural adjustment packages, nations would have to become members of the World Trade Organization (WTO), which encouraged the lowering of tariffs. For many developing nations, this lowering of tariffs led to a loss of a primary source of tax revenue.[7]

Developing nations now needed to replace almost a third of their tax revenue with domestic taxes, which are more difficult to collect. Many had to increase income taxes on individuals and corporations and implement a value-added tax (VAT). The VAT involves fees at various level of productions and can be quite complicated to collect. Broadening income taxes is even more difficult since a large percentage of individuals and corporations in poor nations are logistically difficult to tax. Inefficient bureaucracies, untrained staff and weak technologies only amplify the problem of domestic tax collection. Besides, governments feel the pressure to keep domestic income taxes low so that domestic firms can survive in the global market competition. All of this can lead to a tax revenue shock for developing nations with poor revenue streams to begin with.[8]

III. GLOBALIZATION AND TAX HAVENS

The basic tax problems faced by the governments of developing nations are similar to those faced by tax collectors anywhere. Governments want to tax the profits of corporations and wealthy individuals, while many of these potential taxpayers want to hide as much of their profits and wealth as possible. The challenges of taxing global financial transactions are even more difficult because of the complexity of the global tax system.[9]

In a world where capital can flow easily across national borders, multinational corporations and wealthy individuals find numerous opportunities to hide their wealth from their own national governments. Effective global cooperation could overcome the challenges national governments face in collecting revenues from multinational corporations and wealthy individuals but such cooperation has been limited in practice.

Technically, there is no global tax system. Instead, there is a network of overlapping national arrangements, principles endorsed by global organizations, bilateral treaties, international agreements in addition to custom and practice. The effectiveness of these arrangements depends on willing compliance, which changes based on the political environment at the time.[10]

The so-called rules governing global taxation have largely been made by the richer and more powerful nations. This means that the rules have been broadly designed to benefit their creators and the powerful interests located within their arenas. Initial debates about the right to tax focused on the difference between "residence nations" and "source nations"; that is, where the corporate entity was owned (residence) and where it sourced its profits (source). The rules were designed to enhance the taxing rights of those who were based in the residence nations. These rules were also applied to the arrangements for taxing wealthy individuals. Wealthy individuals from both rich and poor nations began to place their wealth in foreign bank accounts in order to avoid the reach of their national governments.[11]

While international tax rules may be unequal, they usually do not authorize tax abuse; however, they do create opportunities for tax abuse. While tax secrecy has always been around, in the last half century it has been frequently facilitated by a network of offshore financial centers, more popularly known as "tax havens." Tax havens are legal jurisdictions offering a combination of extreme secrecy, limited regulation and low tax rates for foreign corporations and individuals. These tax havens have been achieved with bank secrecy laws designed to prevent the sharing of information about bank clients with national authorities.[12]

The use of tax havens is basically a beggar-thy-neighbor strategy. In tax havens, financial institutions achieve economic gain by offering services to foreign capital and the do so by

undermining tax laws elsewhere around the globe. The largest recipients of offshore financial wealth are Switzerland, the United States, Luxembourg and Singapore. Table 1 reveals the top 40 nations in the Financial Secrecy Index.[13]

Table 1: Top 40 Nations in the Financial Secrecy Index[14]

Rank	Jurisdiction	Rank	Jurisdiction
1	Switzerland	21	Canada
2	USA	22	Macao
3	Cayman Islands	23	United Kingdom
4	Hong Kong	24	Cyprus
5	Singapore	25	France
6	Luxembourg	26	Ireland
7	Germany	27	Kenya
8	Taiwan	28	China
9	United Arab Emirates	29	Russia
10	Guernsey	30	Turkey
11	Lebanon	31	Malaysia
12	Panama	32	India
13	Japan	33	South Korea
14	Netherlands	34	Israel
15	Thailand	35	Austria
16	British Virgin Islands	36	Bermuda
17	Bahrain	37	Saudi Arabia
18	Jersey	38	Liberia
19	Bahamas	38	Marshall Islands
20	Malta	40	Philippines

While it is generally well known that Switzerland is a major tax haven – and has been for quite some time – not as many are aware that the USA is ranked second right after Switzerland when it comes to financial secrecy. In the U.S., the largest recipient of offshore financial wealth is New York; however, Delaware is the easiest place globally to create a secretive corporate entity. It is not surprising that many global entities will register a secretive corporation with Delaware and

then deposit their funds in New York banks, where the funds will be kept secret.[15]

It should be noted Switzerland may be the largest destination for global financial wealth in terms of bank accounts. A lot of wealth is also transferred to tax havens in the form of stocks and bonds and tangible assets such as art, jewelry, precious gems and other luxury goods that are difficult to track.[16] This makes the loss of potential tax revenue even more potent.

The numbers associated with the transfer of wealth to tax havens is large. One research estimate is that $8 trillion of personal financial wealth is held in tax havens and this number is considered to be very conservative[17] (Zucman 2014). This estimate does not include tangible assets such as art, jewelry or other movable property. Other estimates of total global wealth held in tax havens are $32 trillion and implies that about 20% of total global wealth is held in tax havens.[18]

Meanwhile, the percentage of total global wealth transferred to tax havens is higher for Africa. The estimate is that Africans hold $500 billion in offshore financial wealth, which amounts to 30% of all financial wealth held by Africans and once again, this is a conservative estimate. The fact that there is mounting evidence of massive sums of foreign wealth transferring into global property markets, often through shell companies, makes this higher percentage more plausible.[19]

So how much tax revenue is lost by African governments? There are studies that assume that about 80% to 95% of offshore wealth remains unreported to governments, which means that financial returns such as capital gains, dividends and interest go untaxed by national governments. Estimates are that African governments lose about $15 billion to

$45 billion annually in tax revenues.[20] This has led to a globalization-induced tax revenue loss.

IV. CONSEQUENCES OF THE GLOBALIZATION-INDUCED TAX REVENUE LOSS

The globalization-induced tax revenue loss (GTRL) permanently reduces the revenue supply from longstanding sources, such as tariffs and income taxes.[21] As expected, the first big shock for developing nations occurred in the 1990s, immediately after initial trade reforms and World Trade Organization accession. On average, trade increased by 24 percent while trade tax revenues fell by 40 percent between 1990 and 2010.[22]

This GTRL poses serious challenges for developing nations. In addition to losing important tax revenue sources, overall revenue levels in developing nations have always been suboptimal. They have hovered around 22% of gross domestic product compared with 33% of developed nations. This has led developing nations to implement deficit spending policies, which have decreased the quality of public goods and services.[23] The United Nations Conference on Trade and Development estimates that achieving the Sustainable Development Goals requires developing nations to raise their current tax/gross domestic product ratios by close to 4 percentage points.[24]

Nations such as the Philippines, Nicaragua and India have made great progress in global market expansion but minimal improvements in tax revenue.[25] In particular, undeclared revenue is costing India billions of dollars. The informal Indian economy is very extensive and paid mostly in cash; therefore, it is difficult to tax. One report suggests that the

informal Indian economy is 23 percent of its gross domestic product for a total of over $270 billion.[26]

In order to recover some of the lost tax revenue, India launched tax amnesty schemes and a widely criticized "demonetization," where 500- and 1,000-rupee notes were removed from circulation with no warning, just to uncover this untaxed revenue.[27] According to the Indian government, under one amnesty program, nearly 700,000 people were contacted and offered immunity if they came forward and paid the appropriate taxes and penalty. Included among those who came forward were Mumbai street food vendors who declared almost $7.5 million in untaxed assets. Within 4 months of this amnesty, 64,275 declarations were made according to the Indian finance minister, Arun Jaitley. This amnesty unearthed $9.5 billion in undeclared income but this isn't much considering the size of the informal Indian economy.[28]

Then again, not all developing nations are suffering from the GTRL. Government revenue levels appear to be rising in a subset of developing nations that includes China, Tunisia and Morocco. This group of developing nations show improvements in trade and total revenue.[29] How are these developing nations doing this? Recovering from a GTRL requires the successful generation of domestic tax revenues so how are these developing nations doing that?

V. THE CHALLENGE OF DOMESTIC TAX BARGAINING

The GTRL, which struck the hardest in the 1990s, requires governments to immediately replenish their domestic treasuries. If free global trade can't increase the tax revenues of

many developing nations, then what can? The answer is domestic tax reform.

A lot of developing nations have been facing obstacles substituting their tariff (trade tax) revenues with domestic tax revenues. On average, low- and lower- middle-income nations lost 2.83% of gross domestic product in trade tax revenues while gaining only 2.4% of gross domestic product from domestic tax revenues. Overall, the marginal increases in domestic taxes in many developing nations have been unable to offset the loss of trade tax revenues over time.[30]

When it comes to tax revenue policy, today's developing nations are facing an entirely different set of circumstances than their predecessors did. Today's developed nations faced a different state of affairs when they abandoned trade taxes in the 19th century. These developed nations had greater latitude to implement tax reforms both domestically and globally. They adopted tax reforms in response to their own domestic calculations, rather than to external pressures from other nations. Today's developed nations had strong state capacity, a more advanced tax bureaucracy and an abundant supply of public goods; therefore, domestic tax bargaining was more expedient for them.[31]

Another distinction is that today's developed nations had strong capacity to tax before they became democracies. In pre-modern Europe, the powerful authorities imposed and enforced tax compliance before the establishment of representative institutions. The authoritarian capacity to tax existed prior to effective tax bargaining in developed nations. This is different from today's developing nations that are trying to democratize and impose domestic taxes all in the face of inefficient state capacity.[32]

In political science, a generally accepted premise is that leaders are incentivized to remain in power.[33] The difference across regimes depends on how adept leaders are at retaining power while pursuing goals, such as implementing unpopular tax reforms in the face of globalization. Democratic leaders depend on voters.[34] Non-democratic leaders basically need to satisfy a small group of loyal resource-providers, which they do with tax breaks and exemptions. Of course, nondemocratic leaders must also prevent the general population from rebelling against the needed tax reforms.[35]

VI. THE UNDERMINING OF DEMOCRACY

In general, leaders have two main strategies for overcoming the public's resistance to taxes: (1) quasi-voluntary compliance; and (2) coercion.[36] Taxpayers are more likely to pay taxes when they are confident in their leaders and believe that the tax system is fair. The taxpaying public is confident in their leaders when the leaders deliver their promised benefits such as solid infrastructure and public goods. Simply put, taxpayers support higher taxes when they receive competent government services. It is quasi-voluntary compliance because the choice to comply is backed up by enforcement and/or the expectation that others will also comply.[37]

When leaders can't provide competent government services, the taxpayers are less likely to pay taxes; therefore, quasi-voluntary compliance becomes more difficult to achieve. When leaders can't collect taxes through quasi-voluntary compliance, they may have to resort to coercion, which undermines democracy.[38]

There are two basic nondemocracies: (1) liberal authoritarian regimes and (2) conservative authoritarian

regimes.[39] Dictators in liberal regimes usually coopt opposing groups by offering some social benefits in exchange for higher taxes. Dictators in conservative regimes usually don't cooperate with the opposition and engage in coercion to prevent rebellion.[40]

When taxpayers feel that a new tax policy is no longer in their favor, quasi-voluntary compliance unravels.[41] During the recession of the early 1990s, many governments simultaneously levied new taxes on businesses. But with more global competition and tax havens, businesses were well positioned to demand tax cuts. Businesses with fewer resources in particular demanded tax decreases in order to stay afloat.[42]

When a nation has fewer resources to bargain with, quasi-voluntary compliance tends to unravel immediately. During a 2013 nationwide protest in Brazil, 26-year old Jairo Domingos said, "They don't invest in education, they don't invest in infrastructure, and they keep putting makeup on the city to show to the world that we can host the World Cup and Olympics," referring to the 2014 World Cup and 2016 Olympic Games. "We work four months of the year just to pay taxes and we get nothing in return."[43] When citizens have low confidence in their government, collecting much-needed domestic tax revenue becomes an extreme challenge.

When a nation needs more tax revenue after a revenue shock and quasi-voluntary compliance is a challenge, an alternative means of collecting tax revenue would be through state coercion.[44] Coercion can be implemented through specific forms such as passing tax laws by executive decree, harsh penalties for tax evaders and collectors and even the use of arbitrary and extreme punishments.[45] For example, tax collectors have been executed in China for accepting bribes in exchange for tax evasion.[46]

Empirical analysis suggests that authoritarian nations are more effective than democratic nations in raising domestic revenue after trade tax liberalization.[47] Bastiaens and Rudra (2018) examined the changes in trade tax revenues and domestic tax revenues in 133 developing nations between 1990 and 2012.[48] The results are summarized in Table 2:

Table 2: Effect of Declining Trade Tax Revenue on Domestic Tax Revenue[49]

Type of Government	***Empirical Results***	***Interpretation***
Democracies	Decrease in trade tax revenue leads to decrease in domestic tax revenue	Unsuccessful domestic tax revenue reform as citizens resist higher domestic taxes
Nondemocracies	Decrease in trade tax revenue leads to increase in domestic tax revenue	Successful domestic tax reform generates higher tax revenue as governments overcome citizens' resistance to higher domestic taxes

Compared to democracies, nondemocracies show consistent improvement in collecting goods and service tax revenues after trade taxes are liberalized.[50] When trade taxes are reduced or even eliminated, democracies face an uphill battle when it comes to replacing the lost trade tax revenues with the collection of more domestic tax revenues. This can destabilize democracies, particularly in developing nations.[51]

Nondemocracies in developing nations have two advantages when it comes to governance. One, they can impose unwanted reform on the population and enforce it by severe punishment.[52] Two, they don't need to win the confidence of the entire population; they only have to win and maintain the confidence of a small group of loyalists by providing loopholes,

subsidies or other exceptions to the law. Furthermore, nondemocracies can buy support from external groups as well.[53]

Democracies in developing nations are limited in dealing with taxpayers who resist higher taxes, especially when those taxpayers don't believe that the democratic governments will use the tax money in an effective way. Democratic governments can't use fear and coercion to impose tax reform on the population and catering to internal as well as external elite groups will only make things worse.[54] When the citizens of democracies have low confidence in their governments, they are more likely to rebel against these governments and this rebellion could range from tax evasion to protesting and ultimately, to the removal of the democratic leaders.[55]

VII. CONCLUSION

While academics have been arguing that tax revenue is the foundation for a democratic society, little attention has been given to how global tax policies affect democracies around the world. More research is needed to examine how global tax liberalization affects the domestic tax collection systems in sovereign nations, particularly those with developing economies.

Recent research suggests that when trade taxes (tariffs) are liberalized, nondemocracies do a better job than democracies do of replacing the lost trade tax revenues with domestic tax revenues. Since democracies can't easily coerce the population into accepting the imposition of more taxes, they may be undermined by the loss of trade tax revenues, especially when the population has low confidence in their democratic leaders.

The so-called global tax policies have largely been created by the richer and more powerful nations so eliminating global trade taxes favors the wealthier nations at the expense of

the poorer nations. Before implementing a global tax policy, the global creators should consider how the policy will affect the democracies in developing nations. Any global tax policy that places democracies in danger should not be implemented because when democracies are in danger, global stability could wind up in danger as well.

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[38] *Id.*
[39] Jennifer Gandhi, POLITICAL INSTITUTIONS UNDER DICTATORSHIP. New York: Cambridge University Press (2008); Jennifer Gandhi and Adam Przeworski, *Cooperation, Cooptation, and Rebellion under Dictatorships*, 18(2) ECONOMICS AND POLITICS, 1-26 (2006).
[40] *Id.*
[41] Margaret Levi and Audrey Sacks, *Legitimating Beliefs: Sources and Indicators*, 3(4) REGULATION AND GOVERNANCE, 311-333 (2009).
[42] *Id.*
[43] Simon Romero and William Neuman, *Sweeping Protests in Brazil Pull In an Array of Grievances*, NEW YORK TIMES, June 20, 2013.
[44] Levi, *supra*, note 35.
[45] *Id.*
[46] Wang Jingqiong, *Two Former Officials Executed*, CHINA DAILY, July 30, 2011.
[47] Ida Bastiaens and Nita Rudra, DEMOCRACIES IN PERIL: TAXATION AND REDISTRIBUTION IN GLOBALIZING ECONOMIES. Cambridge: Cambridge University Press (2018).
[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *Id.*
[52] *Id.*
[53] *Id.*
[54] *Id.*
[55] *Id.*

ALMONDS AND CONFUSION IN THE DAIRY INDUSTRY: IF ALMONDS AND WATER EQUAL MILK, DO ALMONDS EQUAL DAIRY?

by

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Sales of dairy milk decreased by roughly 15 percent over the five-year period between 2012 and 2017.[1] Meanwhile, sales of non-dairy food products such as almond milk, yogurt, ice cream and plant-based meat alternatives continue to gain market share.[2] As an example, in 2018 plant-based milk sales were 1.6 billion dollars which is a nine percent increase over the prior year.[3] During that same time period, sales of cow's milk were down 6 percent.[4] The focus of this paper is a discussion of the war the dairy industry is waging against non-dairy alternatives. However, it is important to note that there are other, more substantial factors affecting dairy sales.

I. REASONS FOR DECREASE IN DAIRY SALES

The decrease in dairy sales is due to many factors. These factors include an oversupply of milk which leads to falling milk prices.[5] For example, milk prices have declined from $26 per hundred pounds to less than $17 per pound over the last five years.[6] Another factor impacting dairy sales is the almost 30 percent decline in milk consumption since the 1970s.[7] Statistics show that each successive generation consumes less milk.[8]

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Erratic trade policies such as retaliatory tariffs and lack of passage of a new North American trade deal have also contributed to the decline in dairy sales.

When President Trump introduced tariffs on foreign steel imports in order to help the U.S. manufacturing sector, other countries, including Mexico, Canada, Europe and China implemented retaliatory tariffs on American goods.[9] Tariffs imposed by Mexico and China included tariffs on certain dairy products.[10] Mexico imposed a 25 percent tariff on dairy products[11,12] and China imposed tariffs on milk and cream ranging from 35 to 40 percent.[13] In general, retaliatory tariffs increase the cost of importing the products which leads to less demand by the foreign consumer. In turn, income for the dairy farmer can be negatively impacted.[14]

In the past, international markets accounted for approximately 20 percent of the dairy industry's market.[15] But trade wars have harmed many of these business relationships. Trade wars have also pushed the dairy industry into a longer than normal downward business cycle. Historically, that cycle lasts for three years, but trade wars have expanded that cycle to five straight years.[16]

Immigration policies have also made it difficult for farmers, including dairy farmers, to get reliable workers.[17] Changes in state and federal funding subsidies for dairy farmers have also affected revenues.[18] Finally, as mentioned earlier, competition from non-dairy alternatives to cow's milk also plays a small role in the decrease in revenue for dairy farms. Non-dairy alternatives account for about 1.8 billion dollars of the total milk market while cow's milk represents about 12 billion dollars of that market.[19]

II. BATTLES OVER NON-DAIRY ALTERNATIVES TO COW'S MILK

A non-exclusive list of non-dairy alternatives to cow's milk include almond, coconut, soy, pea, oat and hemp milks.[20] The dairy industry has argued that these plant-based alternatives should not be called "milk."[21] A National Milk Federation spokesperson stated "you don't got milk if it comes from a nut or a seed or a grain or a weed."[22] Some also argue that labeling these products as "milk" misleads consumers into thinking that the plant-based alternatives are nutritionally similar to dairy products.[23]

In *Gitson v. Trader Joe's Co.,*[24] plaintiffs purchased several products at Trader Joe's grocery including nonfat and low-fat yogurts as well as organic soymilk and organic chocolate soymilk. Plaintiffs alleged that several Trader Joe's products, including its soymilk product, were either misbranded or contained misleading labels. Specifically concerning the soymilk, the plaintiffs argued that they were misled because Trader Joe's labeled its "soy beverage" as "milk." However, plaintiffs contend that the soy beverage didn't meet the definition of milk contained in the Food, Drug and Cosmetic Act.[25] As such, plaintiffs argued that the Company's labeling violated the California Unfair Competition Law.[26]

The Court in *Gitson* looked to the Food, Drug and Cosmetic Act to determine whether the term "soymilk" could be considered false or misleading.[27] The U.S. Food and Drug Administration (FDA) issued guidance in 2002 on the types of health claims that can be made on food labels.[28] Since December 2002, the FDA has followed the FTC's "reasonable consumer standard" in determining whether a food labeling claim is misleading.[29] The reasonable consumer uses common sense and judgement.[30] According to the *Gitson* court, a reasonable

consumer (as well as a least sophisticated consumer[31]) doesn't think soymilk comes from a cow. As a result, the court held that calling the product "soymilk" was not misleading.

Next, plaintiffs argued that the word "soymilk" was misleading because by including the word "milk" in the title it implies that the product has a similar nutritional makeup as dairy milk. The court dismissed this argument stating a reasonable consumer would not assume the products had the same nutritional values. Moreover, "if the consumer cared about the nutritional content, she would consult the label."[32]

A few years before *Gitson* a U.S. District Court heard a similar case. In *Ang. v. Whitewave Foods Co.*,[33] plaintiffs argued that the manufacturers of Silk© brand soy and almond milks violated the standard of identity for milk. In other words, the products do not meet the FDA's definition for milk which states that milk "comes from the lacteal secretions of healthy cows."[34] But the court stated that the names accurately conveyed "the content of the beverages, while clearly distinguishing them from milk that is derived from dairy cows."[35] The court also determined that as a matter of law, plaintiffs' claims were implausible because a reasonable consumer would not see the word "soymilk" or "almond milk" and disregard the first part of the word and assume the products were dairy milk that came from cows.[36]

More recently, the Ninth Circuit similarly found that "almond milk" was not mislabeled simply because it has the term "milk" in its title.[37] Plaintiffs in *Painter v. Blue Diamond Growers*[38]argued that because almond milk is "nutritionally inferior" to dairy milk it should be labeled "imitation milk." The court states that in order to require the term "imitation," the product would have to involve substituting inferior ingredients for the ingredients in dairy milk. Almond milk, the court notes,

is not a "substitute" for dairy milk. Instead, according to the court, it's a separate and distinct food. The court gave a comparison to a case involving jam in order to illustrate the distinction.[39] In *62 Cases of Jam v. U.S.*,[40] a product substituted the fruit in fruit jam with pectin. The pectin or gelatin solution made the product an imitation of jam. Similarly, imitation vanilla can be used as a less expensive alternative for vanilla extract. The Blue Diamond court went on to address Painter's claim that almond milk is nutritionally inferior. The court concluded that a reasonable consumer would not be misled and would not assume that two distinct products have the same nutritional content.[41] Like the court stated in *Gitson*, the consumer can simply read the label.[42]

There have been hundreds of class action lawsuits filed against food and beverage manufacturers and Cary Silverman discusses them in an article about the reasonable consumer.[43] For example, Silverman asks whether workers on their lunch break are duped into believe that Subway's "Footlong" sandwiches are precisely twelve inches long. Or, "do consumers buy glazed 'raspberry filled' or 'blueberry cake' donuts for the cancer-fighting benefits of real fruit?"[44]

Some writers suggest that if non-dairy product names are misleading, then many other products would have to change their name too. For example, milk of magnesia, cocoa butter, cream of wheat and peanut butter would all need to change their names.[45] Although one distinction is that milk of magnesia and cocoa are not generally found in the dairy aisle while non-dairy and dairy milks and butters are usually found near each other in the dairy aisle, most people understand the distinction between milk from a cow and other non-dairy alternatives. As a matter of fact, the common definition of "milk" includes more than the product produced by lactating cows. According to the *Cambridge Dictionary*, milk is (1) the white liquid produced by

cows, goats and sheep… Milk is also defined as (2) the white liquid produced by women and other female mammals as food for their young and finally, the definition includes (3) *the white liquid produced by some plants and trees such as coconut milk (emphasis supplied).*[46]

III. THE HEALTH-CONSCIOUS MOVEMENT TOWARDS MORE WHOLE, PLANT- BASED FOODS

In her law review comment, *Incentivizing Transparency: Agricultural Benefit Corporations to Improve Consumer Trust*, Kathryn Smith notes that denying non-dairy products the label "milk" would only serve to confuse customers at this point. Many health-conscious consumers of non-dairy products specifically choose to purchase almond or soy or oat or coconut milk and are well-aware of what they are purchasing.[47] The author notes that the concern should be focused on issues such as hormone and non-hormone treated milk. This is an area where the milk products do not have the same nutritional content, yet the different products are not clearly labeled as such.[48]

In another law review article about the neuroscience of nutrition, the author talks about the relationship between food, health and the impact diet can have on cognitive decline for lawyers. Diets such as the Mediterranean, and whole foods plant-based diets help to prevent depression and Alzheimer's disease.[49] The article discusses research involving whole foods, plant-based diets and points out that lawyers who follow a diet rich in plant-based whole foods lower the risk of cognitive decline while diets higher in processed foods increase the risk of cognitive decline.[50] It is such health and nutrition research that has led to an increase in the number of consumers making healthier food choices. People are seeking out information and choosing to replace meat and dairy with vegetables, fruits beans

and whole grains.[51] It is for these perceived health benefits that many consumers choose to purchase plant-based dairy alternatives such as almond or soymilk.[52]

IV. LONG STANDING GOVERNMENT SUPPORT OF THE DAIRY INDUSTRY

Despite the research findings supporting whole foods, plant-based diets, state and federal governments strongly and continuously support the powerful dairy industry.[53] At the federal level, examples of government protection for the dairy industry include promoting milk through federal nutrition assistance programs such as food stamps and school lunch programs. For example, federal assistance in providing milk to school children began in June 1940 with a federally subsidized program in low income Chicago neighborhoods.[54] The program expanded to several other cities. The way the program operated was dairies submitted bids to the U.S. Department of Agriculture (USDA). Schools collected one cent per half pint and paid it directly to the dairies. The difference between the one cent paid to the dairy farmer by the school and the cost of the milk was paid to the dairies by the USDA on a monthly basis.[55] Eventually, in 1946, the milk for the school children program became part of the National School Lunch Program.[56] After several years, milk consumption began to wane. To encourage the consumption of milk among school children, the 83rd Congress authorized the government to reimburse schools for milk served over and above the usual amount consumed. Reimbursement was at the rate of 4 cents per half pint over and above what was normally consumed.[57] Eligibility was broadened to include child care centers, nursery schools, summer camps and other nonprofits that provided care for children.[58] The program has required that milk be offered in order to receive federal reimbursement for meals.[59] Federally subsidized school meals account for 7.6 percent of total fluid

milk sales.[60] On the other hand, at least one study found that "people who drank three glasses of milk a day had a higher risk of dying over 20 years than those who drank one glass per day."[61] There is a growing recognition among doctors that high dairy intake can increase risks of heart disease, cancer, and weight gain according to a recent *Bloomberg Businessweek* article.[62] The requirement mandating milk as part of the school lunch program exists despite the fact the majority of Native, Asian and African Americans are lactose intolerant[63] and despite the growing evidence that dairy may not be as healthy as traditionally thought.[64]

Research findings suggest benefits to eating whole food, plant-based diets that do not use animal products, but the dairy industry[65]as well as some state and federal legislators, continue to challenge plant-based foods.[66] Tammy Baldwin, Senator from the dairy-rich state of Wisconsin, introduced the "*Defending Against Imitation Replacements of Yogurt, Milk and Cheese to Promote Regular Intake of Dairy Everyday Act*" (The Dairy Pride Act) in 2017 and reintroduced the bill on March 14, 2019.[67] The Bill would require that the FDA enforce the legal definition of milk and prohibit plant-based alternatives from using terms such as milk, cheese and yogurt.[68]

A similar measure was introduced as a legislative resolution in Nebraska.[69] The resolution urges the U.S. Government to establish and enforce labeling rules for plant-based "imitation milk" that is truthful, not misleading and that differentiates between dairy products and non-dairy beverages.

On March 21, 2017 Michael Dykes, the CEO of the International Dairy Foods Association (IDFA), testified before the House Agriculture Committee about *the Dairy Pride Act*. During his testimony, Dykes indicated that he no longer supported the bill. He stated that the labeling issue "is probably

an issue that needs to be resolved in the marketplace," and also stated that "the FDA has not concluded these [labels] are misleading and there have been court challenges and the courts have not concluded that they have been misleading."[70]

V. NUTRITION LABELS, HORMONES, AND FREE SPEECH

When it comes to discussing health benefits of foods, the FDAs labeling laws seem outdated and are nonresponsive to consumer demand.[71] Hormone treated cow's milk is a good example. If a consumer wants to know whether the milk she is drinking contains hormones, FDA regulations make it difficult to find out the truth.[72] The FDA's Guidance states that there is "no significant difference between milk from treated and untreated cows." The Agency therefore asserts that is does not have authority to require special labeling for hormone-treated milk.[73] In addition, the Agency also believes that since there is some naturally occurring bST (hormones) in cow's milk, labeling even untreated milk as hormone free would be untruthful.[74] The state of Vermont passed a law requiring hormone containing milk to state so on the label.[75] However, the dairy industry challenged the requirement on compelled speech grounds, arguing that the statute infringed on their right not to speak. The Second Circuit agreed with the challengers and the Vermont statute was ruled unconstitutional.[76]

Instead of the dairy industry raising free speech issues, some writers have suggested that plant-based alternative producers may raise free speech challenges if they are required to stop using the term milk or are required to use words such as "imitation."[77] In comments submitted to the FDA, the Institute for Justice stated that a labeling ban "would confuse consumers, harm small businesses across the country, and raise serious First Amendment concerns."[78] In support of its First Amendment

argument, the Institute referenced the *Ocheesee Creamery v. Putnam* case.

In *Ocheesee*, plaintiff is a small dairy creamery located in Florida. It sells all-natural dairy products including cream and skim milk. The cream is made according to industry standard by skimming the cream off the top of the milk. The leftover product is sold as skim milk. One of the side effects of the skimming process is that it removes almost all the vitamin A naturally present in whole milk. This is because vitamin A is fat-soluble, so it is removed along with the cream. Because the Creamery prides itself on selling only all-natural products without additives, it refused to replace the vitamin A. Its product contains no ingredients other than skim milk. Florida law prohibits the sale of skim milk that does not replace the vitamin A lost during skimming. Because the creamery sells all-natural products, it refused. The state of Florida told Creamery that it could either put the vitamin A in or label its product "imitation skim milk," or "milk product."

The court applied the four-point test of *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n,*[79] to determine if the state's regulation of Creamery's commercial advertising was proper. Here, the court found that Creamery's use of the word "skim milk" to describe its milk was not inherently misleading. In applying the remaining prongs of *Central Hudson*, the court found that the State had a substantial interest in establishing nutritional standards for milk. It also assumed that the restriction directly advanced the states interest. However, the court ruled that the regulation was more extensive than necessary and there were less restrictive ways of regulating the product. For example, the state could have allowed use of the term skim milk with a disclaimer stating that the product lacked vitamin A.

Similar to the *Ocheesee* case, the FDA in the case of plant-based milk products can permit consumers to compare the nutrient labels to ascertain the nutrition of the dairy versus non-dairy products. Moreover, use of the term "milk" would likely not cause confusion as buyers understand that almond milk is made from almonds and not from a lactating cow. As the court in *Ang* noted, under [that] logic, a reasonable consumer might also believe that veggie bacon contains pork, that flourless chocolate cake contains flour, or that e-books are made out of paper.[80]

VI. COMPETITION AND MARGARINE WARS

The dairy industry's challenge against competitors is nothing new. As far back as 1886, margarine manufacturers faced similar challenges from the dairy industry through passage of the Oleomargarine Act of 1886.[81] Under the so-called "margarine wars" campaigns at both the state and federal levels fought to either outright prevent butter substitutes or to regulate the substitutes, sometimes to the point of extinction.

People v Marx,[82]challenged New York state's outright ban on the sale of margarine. The law carried a very high penalty, especially for 1885. In New York State, selling margarine carried a penalty of one year in jail, a $ 1,000 fine, or both for each offense. However, the court held that the law was unconstitutional because the law was really prohibiting the sale of any butter substitute. The law's aim was to protect the dairy industry rather than protect consumers from fraud or deceit.[83]

In *Powell v. Pennsylvania,*[84] the state legislature passed a law banning the manufacture or sale of any product designed to take the place of butter or cheese unless the product was made from milk or cream. In contrast to the earlier New York case, Pennsylvania used its police powers to determine that the sale or

intent to sell margarine is fraudulent because it is designed to take the place of butter. Moreover, the state determined that margarine is harmful to the health of its citizens. Because it was within the state's police powers to protect its citizens, the U.S. Supreme Court upheld the conviction.[85] By 1897, the U.S. Congress had recognized margarine as a healthy and nutritious product that could be an item of interstate commerce.[86] As a result, the court in *Schollenberger v. Pennsylvania*[87] held that the state could not use its police powers to prevent a dealer from bringing his margarine into Pennsylvania through interstate travels and selling it in Pennsylvania.[88]

In lieu of outright bans on the sale of margarine, there were drives at both the state and federal levels to regulate the color of margarine, such as prohibiting it from being yellow or mandating that it be colored pink.[89] Of course, most consumers wouldn't want to buy pink margarine, so the law would in reality severely diminish the company's business.[90] At the federal level, a prohibitive tax was imposed on yellow (or colored) margarine.[91] The law basically required that margarine "sold in interstate commerce" remain "natural" (white) in color.[92] Margarine manufacturers such as Fleishman's began adding a package of special fats that when squeezed by the consumer would give the margarine a yellow tinge.[93] Simultaneously, the dairy industry continued its assault on margarine manufacturers including publishing false and horrifying rumors about how margarine was produced.[94] It was not until the 1950's that war-on-margarine type laws were abolished and free and open competition was permitted.[95] Today, butter has a larger market share than margarine and more consumers prefer creamy butter to the margarine counterpart.[96]

VII. ALTERNATIVES FOR DAIRY FARMERS

Financial assistance should be available to help America's dairy farmers pursue alternatives including growing different crops including whole foods used in making dairy alternatives.[97] For example, in Finland the government assisted dairy farmers by helping them switch to berry farming.[98] As the world faces environmental and sustainability issues, governments should assist farmers in creating alternatives. Methane gas digesters that allow dairy farmers to capture methane gas and use it to generate electricity is one example that helps the environment and produces an alternate source of revenue for our farmers.[99]

VIII. CONCLUSION

Dairy market revenues are declining, in part due to consumers turning to plant-based alternatives. Waging war over the use of the word "milk" by manufacturers of non-dairy alternatives is misplaced. Courts have repeatedly held that the reasonable consumer is not misled by the term almond or soymilk. Consumers do not believe the non-dairy alternative comes from a cow. Similarly, courts have found that the argument about the differing nutritional values does not cause consumer confusion. Consumers interested in the nutritional content will read the nutrition label. It seems that more focus should be spent on the deeper issues affecting dairy farmers including lack of trade agreements, lack of subsidies and lack of assistance in helping dairy farmers pursue alternatives including growing different crops including whole foods used in making dairy alternatives.

[1] *U.S. Non-Dairy Milk Sales Grow 61% Over the Last 5 Years*, MINTEL REPORT, (June 4, 2018), https://www.mintel.com/press-centre/food-and-drink/us-non-dairy-milk-sales-grow-61-over-the-last-five-years.

[2] Janet Forgrieve, *Plant-Based Food Sales Continue To Grow By Double Digits, Fueled By Shift In Grocery Store Placement*, FORBES (July 16, 2019, 9:00 am), https://www.forbes.com/sites/janetforgrieve/2019/07/16/plant-based-food-sales-pick-up-the-pace-as-product-placement-shifts/#1b2eae314f75.

[3] Nellie Bowles, *Got Milk? Or Was That Really a Plant Beverage?*, N.Y. TIMES (August 31, 2018), https://www.nytimes.com/2018/08/31/business/milk-nut-juice-plant-beverage-label.html.

[4] Deena Shanker, *Plant Based Foods Are Finding an Omnivorous Customer Base: Almond Milk and Veggie Burgers Aren't Just for Hippies Anymore*, BLOOMBERG (July 30, 2018, 5:00 am), https://www.bloomberg.com/news/articles/2018-07-30/plant-based-foods-are-finding-an-omnivorous-customer-base (last accessed February 21, 2019).

[5] Alan Rappeport, *Stung by Trump's Trade Wars, Wisconsin's Milk Farmers Face Extinction*, N.Y. TIMES (April 26, 2019), https://www.nytimes.com/2019/04/26/us/politics/trump-trade-war-wisconsin-dairy.html. (wherein the author notes that large corporate farms and more efficient milking processes have led to an oversupply of milk). *See also*, Heather Haddon, *Got Milk? Too Much Of It Say U.S. Dairy Farmers*, MARKET WATCH (May 21, 2017 4:07 pm), https://www.marketwatch.com/story/got-milk-too-much-of-it-say-us-dairy-farmers-2017-05-21 (the author discusses a downswing in foreign imports of dairy products combined with an increase in the value of the dollar (causing U.S. imports to be more expensive and less competitive) as other causes for the oversupply of milk).

[6] Rappeport, *Stung by Trump's Trade Wars, Wisconsin's Milk Farmers Face Extinction* (noting an almost 30% decline in the price of milk over the last five years).

[7]Stewart, Hayden, Diansheng Dong, and Andrea Carlson, *Why Are Americans Consuming Less Fluid Milk? A Look at Generational Differences in Intake Frequency*, ERR-149, U.S. Department of Agriculture, Economic Research Service (May 2013), https://www.ers.usda.gov/webdocs/publications/45073/37651_err149.pdf?v=41423. (discussing how Americans are not consuming as much milk.

Since the 1940s, each generation has consumed less milk. The authors report that since the 1970s consumption of milk has decreased from .96 to .91 cup equivalents, or almost a 38% decrease).

[8] *Id*.

[9] Anita Regmi, *Retaliatory Tariffs and U.S. Agriculture*, R 45903, CONGRESSIONAL RESEARCH SERVICE REPORT, 9 (September 13, 2019), https://fas.org/sgp/crs/misc/R45903.pdf.

[10] *Id*.

[11] *Id*. at 10

[12] The United States removed the tariffs on U.S. steel imports from Mexico and Canada on May 17, 2019 in order to facilitate the passage of the new NAFTA — known as the U.S. Mexico Canada Agreement (USMCA). In turn, those countries removed tariffs on U.S. products including dairy. *Id*. at 11.

[13] USDA Foreign Agricultural Service, Gun Report, CH 19051, *China Announces Increases to Additional Tariffs*, 8-9, (August 28, 2019).

[14] Congressional Research Report, *supra* note 7, at 3.

[15] *Farmer's in Distress* Before the Conn. Gen. Assembly Rural Caucus, 2019 Leg., 2019 Sess. (Conn. 2019) (Statement of Joan Nichols, Executive Director, Connecticut Farm Bureau) (on file with the author).

[16] *Id*.

[17] *Reviewing the State of the Dairy Economy* Before the U.S. H. Comm. on Agric., Subcomm. on Livestock and Foreign Agric., 116th Cong. (2019). (Statement of Mike McMahon, Dairy Farmer EZ Acres, LLC). (noting that "local labor doesn't want to work on a dairy. A 2017 Texas A&M study found that 79% of the U.S. milk supply is harvested by Hispanic workers. Agriculture needs a way to secure American workforce that is willing, able and legal. I realize that immigration from top is a difficult topic, but agriculture's need for immigrant labor is undeniable."), *available at* https://www.dairyherd.com/article/farmers-discuss-state-dairy-economy-washington.

[18] *See, e.g.*, Nichols *supra* note 13 (In Connecticut for example, dairy farmers receive some funding from the Community Investment Act Dairy Fund. However, on several occasions the funds were raided and used to shore up the state general fund to meet other state obligations. At the federal level, the government established a program to relieve some of the pressure dairy farmers face due to the trade wars. However, farmers received pennies on the dollar ("$370,560 to replace $5,800,000 in market disruption")).

[19]Amelia Lucas, *5 Charts That Show How Milk Sales Changed and Made It Tough For Dean Foods To Avert Bankruptcy*, CNBC (November 13, 2019

3:00 pm), https://www.cnbc.com/2019/11/13/5-charts-that-show-how-milk-sales-have-changed.html.
[20] Jaclyn London, *The Best Milk Alternatives To Pour In Your Coffee, Cereal, And Smoothies, According To A Dietitian*, GOOD HOUSEKEEPING (September 18, 2019), https://www.goodhousekeeping.com/health/diet-nutrition/g27128821/best-milk-alternative-substitutes/.
[21] Bowles, *Got Milk? supra* note 3.
[22] *Id*.
[23] Anahad O'Connor, *Got Almond Milk? Dairy Farms Protest Milk Label on Nondairy Drinks*, N.Y. TIMES (February 13, 2017), https://www.nytimes.com/2017/02/13/well/eat/got-almond-milk-dairy-farms-protest-milk-label-on-nondairy-drinks.html.
[24]*Gitson v. Trader Joe's Co*., No. 13-cv-01333-VC, 2015 U.S. Dist. LEXIS 170401 (N.D. Cal. 2015).
[25]21 C.F.R. § 131.110 (a) (2001) defines "milk" as the lacteal secretion, practically free from colostrum, obtained by the complete milking of one or more healthy cows.
[26] Plaintiffs cannot sue directly under the Food, Drug and Cosmetics Act because it does not create a private right of action. *Gitson* at 2.
[27] 21 U.S.C. § 343(a) (2012) defines false or misleading.
[28] U.S. Food & Drug Admin., *Guidance: Interim Procedures For Qualified Health Claims In The Labeling Of Conventional Human Food And Human Dietary Supplements*, Docket No. 2013-S-0610 (FDA July 2003), *available at* https://www.fda.gov/regulatory-information/search-fda-guidance-documents/guidance-industry-interim-procedures-qualified-health-claims-labeling-conventional-human-food-and.
[29] Timothy Ernst, *Advertising Food Products: Understanding the Regulatory Mix*, A.B.A. BUS. L. TODAY, May/June 2009, https://apps.americanbar.org/buslaw/blt/2009-05-06/ernst.shtml.
[30] *U.S. v 88 Cases*, 187 F. 2d. 967, 971 (3d. Cir. 1951). *See also*, *Guidance for Industry: Qualified Health Claims in the Labeling of Conventional Foods and Dietary Supplements*, 67 Fed. Reg. 78,002, 78,004 (December 20, 2002), (where the FDA discusses how courts have applied differing standards including the ignorant and unthinking consumer standard as well as the reasonable consumer standard. The FDA, *citing U.S. v. 88 Cases*, states that the reasonable consumer standard more accurately reflects its viewpoint).
[31] *Id*. (Sometimes referred to as "the ignorant, the unthinking, and the credulous'' consumer. See, e.g., United States v. ElO-Pathic Pharmacy, 192 F.2d 62, 75 (9th Cir. 1951)).
[32] *Gitson supra* note 21, at 5.

[33] *Ang. v. Whitewave Foods Co*., No. 13-cv-1953, 2013, U.S. Dist. LEXIS 173185 (N.D. Cal. Dec. 10, 2013).
[34] 21 C.F.R. § 131.110 (a).
[35]*Ang*. at 12.
[36] *Id*. at 13.
[37] *Painter v. Blue Diamond Growers*, No. 17-55901, 2018 U.S. App. LEXIS 35939 (9th Cir. 2018).
[38] *Id*.
[39] *62 Cases of Jam v. U.S.*, 340 U.S. 593, 600 (1951).
[40] *Id*.
[41] *Blue Diamond* at 4.
[42] *Gitson supra* note 21, at 5.
[43] Silverman**,** *In Search of The Reasonable Consumer: When Courts Find Food Class Action Litigation Goes Too Far,* 86 U. CIN. L. REV. 1 (2018).
[44] *Id*.
[45] *See*, *e.g.* O'Connor, *supra* note 20.
[46] The Cambridge Dictionary, CAMBRIDGE UNIVERSITY PRESS (2019), *available at* https://dictionary.cambridge.org/dictionary/english/milk.
[47] 55 SAN DIEGO L. REV. 888, 905 (2018).
[48] *Id*.
[49] Debra Austin, *Food for Thought: The Neuroscience of Nutrition to Fuel Cognitive Performance*, 95 OR. L. REV. 425 (2017).
[50] Id. at 498.
[51] R. Wes Harrison, *U.S. Consumers' Demand for Healthy, Nutritious Foods*, LA. AGRIC. MAG. (December 3, 2013), https://www.lsuagcenter.com/portals/communications/publications/agmag/archive/2013/fall/us-consumers-demand-for-healthy-nutritious-foods.
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[53] Christopher Wolf and Glynn Tonsor, *Dairy Farmer Policy Preferences, 38* J. Agric. & Resource Econ., No. 2 (2013).
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[55] *Id*.
[56] *Id*.
[57] P.L. 690, 83rd Cong., 68 Stat. 900 (August 28, 1954).

[58] P.L. 752, 84th Cong., 70 Stat. 596 (July 20, 1956).
[59] *See*, Matilde Cohen, *Milk and the Constitution*, 40 HARV. J. L. & GENDER 115, 155 (2017).
[60] Peter Robinson and Lydia Mulvany, *Big Dairy is About to Flood America's School Lunches with Milk*, BLOOMBERG BUSINESSWEEK (January 9, 2019), https://www.bloomberg.com/news/features/2019-01-09/big-dairy-is-about-to-flood-america-s-school-lunches-with-milk.
[61] *Id*.
[62] *Id*.
[63] Cohen, *supra* note 56, at 119. (noting that The National Dairy Council recognizes that between 80 to 100 percent of Native Americans, Asian Americans and African Americans are lactose intolerant. As well, over 50 percent of Hispanics are also lactose intolerant).
[64] *Id*.
[65] and, in some cases government agencies themselves.
[66] *See, e.g.*, Dairy Pride Act, S. 130, 115th Cong. (2017), *reintroduced as* S. 792, 116th Cong. (2019).
[67] *Id*.
[68] *Id*.
[69] Neb. L. Res. 13, 160th Leg., 1st Sess. (2019), *available at* https://nebraskalegislature.gov/FloorDocs/106/PDF/Intro/LR13.pdf.
[70] Michele Simon, *Dairy Lobbying Group Backs Down on "Dairy Pride" Act*, Plant Based Foods Association (March 22, 2017), https://plantbasedfoods.org/dairy-lobbying-group-backs-dairy-pride-act/.
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[72] *Id*.
[73] *Id*.
[74] *Id*.
[75] VT. STAT. ANN. tit. 6, § 2754(c) (repealed 1998).
[76] *Int'l Dairy Foods Ass'n v. Amestoy*, 92 F.3d 67, 69-70 (2d Cir. 1996)(holding Vermont's statute requiring notification and labeling unconstitutional).
[77] *See, e.g.*, Nick Sibilla, *FDA Crackdown on calling Almond Milk "Milk" Could Violate the First Amendment*, FORBES (January 31, 2019), https://www.forbes.com/sites/nicksibilla/2019/01/31/fda-crackdown-on-

calling-almond-milk-milk-could-violate-the-first-amendment/#4d160f8f7b70.

[78] https://ij.org/press-release/ij-to-fda-milk-doesnt-have-to-come-from-cows-to-be-called-milk/.

[79] 447 U.S. 557, 563–64, 100 S. Ct. 2343, 2350 (1980) (describing the four-part test wherein speech cannot be misleading or unlawful. In addition, the government must have a substantial interest, the regulation must advance that interest and the regulation must be narrowly tailored).

[80] *Ang* at 14.

[81] Oleomargarine Act of 1886 (32 Stat. 194), as amended by Act of May 9, 1902 (R.S. § 3224).

[82] 99 N.Y. 377 (1885).

[83] *Id*.

[84] 127 U.S. 678 (1887).

[85] *Id*. at 684.

[86] *Schollenberger v. Pennsylvania*, 171 U.S. 1 (1897).

[87] *Id.*

[88] *Id*.

[89] *See, e.g., Collins v. New Hampshire*, 171 U.S. 30 (May 23, 1898) (a state law prohibiting the sale of margarine unless it was pink in color was declared prohibitory and therefore unconstitutional).

[90] See, Geoffrey Miller, *Public Choice at the Dawn of the Special Interest State: The Story of Butter and Margarine*, 77 CALIF. L. REV. 83, 84 (1989).

[91]Federal Oleomargarine Act of 1902, 57 P.L. 110, 32 Stat. 193, 57 Cong. Sess. 1, Ch. 784 (subjecting margarine manufacturers to the jurisdiction of every state in which it sells margarine and imposing a tax on all sales including a penalty for any margarine colored yellow).

[92] *Id*.

[93]Ethan Trex, *The Surprisingly Interesting History of Margarine*, MENTAL FLOSS, (August 31, 2010), https://mentalfloss.com/article/25638/surprisingly-interesting-history-margarine. (There was no reason why the manufacturer couldn't simultaneously sell consumers margarine and yellow dye. When you bought a block or tube of margarine, you also got a packet of food coloring that could be kneaded into the margarine by hand).

[94]Margarine was described as containing a compound of diseased or putrid beef, dead horses, dead hogs, dead or mad dogs and drowned sheep. There were also reports that claimed workers lost toenails because of the margarine manufacturing process. *See*, Miller, *supra* note 90, at 115. *See, also*, Adam Young, *The War on Margarine*, Foundation for Economic Education (June 1, 2002) *citing* Celia Bergoffen, "*Margarine Wars*,"

AUDACITY: THE MAGAZINE OF BUSINESS EXPERIENCE (Summer 1995) p. 55, https://fee.org/articles/the-war-on-margarine/.

[95] In some heavy dairy industry states restrictive margarine laws lasted into the 1960's, with the dairy-rich state of Wisconsin not repealing restrictions until 1967. *See*, Adam Young, *The War on Margarine*.

[96] Mary Beth Quirk, *Spreads Are Dead: No One Likes Eating Margarine Anymore*, CONSUMER REPORTS (July 20, 2017), https://www.consumerreports.org/consumerist/spreads-are-dead-no-one-likes-eating-margarine-anymore/.

[97] *See, e.g*. Jeff Herman, *Saving U.S. Dietary Advice From Conflicts of Interest*, 65 FOOD &DRUG L.J. 285, 293 (2010) (wherein the author points out that in Finland, the Government recognized that dairy farmers might suffer when people adopted healthy lifestyles and changed their dietary habits by reducing saturated fats, especially from dairy sources. The government therefore helped many farmers switch from dairy farming to berry farming. Between 1969 and 1995, mortality rate from heart disease fell 65.9% in Finland).

[98] *Id*.

[99] Dairy cows produce methane gas and utility companies need renewable gas sources for energy. Building a system to deliver the gas while giving dairies credit for reducing emissions is one example of environmental strategies being pursued. *Pipelines for Dairy Waste Digesters The Next Logical Step*, NORTHWEST RENEWABLE NEWS (December 31, 2008), https://nwrenewablenews.wordpress.com/2008/12/31/pipelines-for-dairy-waste-digesters-the-next-logical-step/.

IS NEW TECHNOLOGY JEOPARDIZING OUR CONSTITUTIONAL RIGHT TO PRIVACY?

by

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I. INTRODUCTION

The Fourth Amendment to the Constitution of the United States prohibits unreasonable searches and seizures, stating that people have the right to be secure in their persons, houses, papers, and effects. It further requires that any search warrant be judicially sanctioned and supported by probable cause.[1] Over the past few decades the U.S. Supreme Court has ruled that many "searches" were not actually "searches"; therefore, they are not subject to the constitutional protections of the Fourth Amendment. Due to extensive advances in technology, there is increasing concern about privacy. This article will examine the relevant Supreme Court rulings that have protected and alternately restricted Fourth Amendment privacy rights, as well as analyze the Court's most recent decisions regarding this matter.

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II. OLMSTEAD v. UNITED STATES

Olmstead v. United States[2] is one of the earliest cases in which the Supreme Court analyzed whether the use of new technology to obtain incriminating evidence violated a defendant's Fourth Amendment rights. In *Olmstead,* federal agents wiretapped private telephone conversations without judicial approval.[3] This 1928 case concerned several petitioners who were convicted of conspiracy.[4] The information that led to the discovery of the conspiracy was largely obtained by federal officers who were able to intercept messages on the conspirators' telephones. No laws were violated in installing the wiretapping equipment, as the officers did not trespass upon either the homes or the offices of the defendants; instead, the equipment was placed in the streets near the houses and in the basement of a large office building.[5] The wiretapping went on for several months, and the records revealed significant details of the conspiracy.[6]

The majority opinion in *Olmstead* states that the Fourth Amendment, in part, intends to prevent the use of governmental force to search and seize an individual’s personal property and effects. "The amendment does not forbid what was done here. There was no searching. There was no seizure. The evidence was secured by the use of the sense of hearing and that only. There was no entry of the houses or offices of the defendants."[7] The opinion further suggests that because the wires that were tapped were not a part of either the petitioners’ houses or offices, they were not subject to the protections of the Fourth Amendment.[8] The majority concluded that there had been no official search and seizure of the person, his papers, or tangible material effects, and no actual physical invasion of property.[9] Since there was no physical intrusion or seizure of private property, the Court ruled

that the wiretapping did not amount to a search or seizure within the meaning of the Fourth Amendment.[10]

What makes *Olmstead* an important and often-quoted decision is not the opinion of the majority, but the famous dissent by Justice Louis Brandeis. Justice Brandeis attacks the majority's "trespass doctrine" and refusal to expand Fourth Amendment protections to telephone conversations.[11] He states that when the Fourth Amendment was adopted, “force and violence” were the only means by which the government could compel self-incrimination.[12] Thus, the protections offered were necessarily limited to address only imaginable forms of such force and violence.[13] He further contends that, due to technological advances, the government can invade privacy in more subtle ways, and there is no reason to think that the rate of such technological advances will slow down. Brandeis found it unimaginable that the Constitution affords no protection against such invasions of individual security.[14]

Brandeis further argues that the protections guaranteed by the Fourth Amendment are broad in scope. The framers of the Constitution sought "to protect Americans in their beliefs, their thoughts, their emotions, and their sensations."[15] It is for this reason that they established, as against the government, the "right to be let alone" as "the most comprehensive of rights and the right most valued by civilized men."[16] To protect that right, every unjustifiable intrusion by the government upon the privacy of the individual, whatever the means employed, must be deemed a violation of the Fourth Amendment.[17] Government officials must be subject to the same rules of conduct that we expect of every citizen. In his rousing dissent Justice Brandeis proved to be a visionary. Nearly forty years later, in its 1967 landmark decision in *Katz v. United States*,[18] the Supreme Court overruled *Olmstead* and similar decisions, and embraced Brandeis' view of protected privacy.

III. KATZ v. UNITED STATES

In *Katz v. United States*[19] the defendant, Charles Katz, was involved in interstate gambling, which is illegal under federal law. To avoid detection and prison, he used public telephone booths to conduct his business.[20] The Federal Bureau of Investigation became aware of his activities and moved quickly to collect evidence. The FBI identified the three phone booths Katz used on a regular basis and worked with the telephone company to take one out of service.[21] The other booths were bugged, and agents were stationed outside Katz's nearby apartment. Based upon the recorded conversations the FBI arrested Katz and charged him with an eight-count indictment.[22]

Katz's claim that the FBI's surveillance of the phone booths was unconstitutional directly conflicted with decades of Supreme Court precedent, most notably *Olmstead*.[23] Fortunately for Katz, he found a more receptive judiciary, and the Court's 7-1 majority overturned the "trespass doctrine" that was established by the Court in *Olmstead*. The majority held that the Fourth Amendment "protects people, not places" and is not dependent on intrusion into physical spaces. The Court also held that the Fourth Amendment applies to oral statements just as it does to tangible objects.

> . . . a person in a telephone booth may rely upon the protection of the Fourth Amendment. One who occupies it, shuts the door behind him, and pays the toll that permits him to place a call is surely entitled to assume that the words he utters into the mouthpiece will not be broadcast to the world. To read the Constitution more narrowly is to ignore the vital role that the public telephone has come to play in private communication.[24]

In a separate concurrence, Justice John Marshall Harlan, Jr. fleshed out a test for identifying a "reasonable expectation of privacy," one that is both subjectively understood by the individual and objectively recognized by society at large. He wrote:

> As the Court's opinion states, "the Fourth Amendment protects people, not places." The question, however, is what protection it affords to those people. Generally, as here, the answer to that question requires reference to a "place." My understanding of the rule that has emerged from prior decisions is that there is a twofold requirement, first that a person has exhibited an actual (subjective) expectation of privacy and, second, that the expectation be one that society is prepared to recognize as "reasonable." Thus, a man's home is, for most purposes, a place where he expects privacy, but objects, activities, or statements that he exposes to the "plain view" of outsiders are not "protected" because no intention to keep them to himself has been exhibited. On the other hand, conversations in the open would not be protected against being overheard, for the expectation of privacy under the circumstances would be unreasonable.[25]

Within a year, the Supreme Court started to use Justice Harlan's "reasonable expectation of privacy" test as the standard in its Fourth Amendment jurisprudence.[26] Within a decade, Harlan's test became so familiar that the Court officially recognized it as the essence of the *Katz* decision.[27] While *Katz* expanded the Fourth Amendment protection against "unreasonable searches and seizures" to cover electronic wiretaps, the long arm of *Katz* reaches into recent debates

over GPS tracking and mass data collection.[29] Indeed, in an age of increasing digital technology, the principle that the Fourth Amendment "protects people, not places" is more consequential than ever.

IV. UNITED STATES v. JONES

In *United States v. Jones*,[30] decided in 2012, respondent Jones owned and operated a nightclub and came under suspicion of narcotics trafficking. Based on information gathered through various investigative techniques, police were granted a warrant authorizing use of a GPS tracking device on a Jeep of which Jones was the exclusive driver, however, the police failed to comply with the warrant's deadline.[31] Officials nevertheless installed the device on the undercarriage of the Jeep and used it to track the vehicle's movements.[32] By satellite, the device established the vehicle's location within 50 to 100 feet and communicated the location by cell phone to a government computer, relaying more than 2,000 pages of data over a 28-day period. The District Court suppressed the GPS data obtained while the vehicle was parked at Jones' residence, but held the remaining data was admissible because Jones had no reasonable expectation of privacy while the vehicle was on public streets.[33] The government obtained an indictment against Jones that included charges of conspiracy to distribute cocaine.[34]

Jones was ultimately convicted, but the D.C. Circuit Court reversed the conviction, holding the admission of evidence obtained by the warrantless use of the GPS device violated the Fourth Amendment.[35] Upon review, the Supreme Court held unanimously that this was a "search" under the Fourth Amendment, although they were split as to the fundamental reasons behind that conclusion.[36] Justice Antonin Scalia wrote the opinion for the majority, holding that by

physically installing the GPS device on the defendant's car, the police had committed a trespass against Jones' "personal effects" and this constituted a search.[37] While he stated that *Katz* supplemented rather than replaced the trespassory test for whether a search has occurred, Scalia focused on trespass concerns versus the "reasonable expectation of privacy" standard developed in *Katz.*[38] Justice Scalia argued that the government's physical intrusion on Jones's car, a personal "effect", would clearly be a search within the original meaning of the Fourth Amendment; the police had physically encroached on a protected area to gather information.[39]

Justice Samuel Alito, joined by Justices Ginsburg, Breyer, and Kagan, concurred in the judgment, but disagreed with the majority that any technical trespass that results in the gathering of evidence amounts to search, and asserted that the case should have been analyzed under the *Katz* standard.

> This case requires us to apply the Fourth Amendment's prohibition of unreasonable searches and seizures to a 21st-century surveillance technique, the use of a Global Positioning System (GPS) device to monitor a vehicle's movements for an extended period of time. Ironically, the Court has chosen to decide this case based on 18th-century tort law. By attaching a small GPS device to the underside of the vehicle that respondent drove, the law enforcement officers in this case engaged in conduct that might have provided grounds in 1791 for a suit for trespass to chattels. And for this reason, the Court concludes, the installation and use of the GPS device constituted a search.

> This holding, in my judgment, is unwise. It strains the language of the Fourth Amendment; it has little if any support in current Fourth Amendment case law; and it is highly artificial.
>
> I would analyze the question presented in this case by asking whether respondent's reasonable expectations of privacy were violated by the long-term monitoring of the movements of the vehicle he drove.[40]

Justice Alito stated that because GPS technology is relatively easy and cheap, it overcomes traditional practical constraints on close surveillance and concluded that, in this case, its use violated society's expectation that law enforcement would monitor all of an individual's movements in his or her car for a 4-week period. While relatively short-term monitoring of an individual's movements on public streets may be reasonable, "the use of longer-term GPS monitoring in investigations of most offenses impinges on expectations of privacy."[41]

While Justice Sonia Sotomayor joined in the Court's majority opinion and agreed that *Katz* supplemented rather than replaced the trespassory test for whether a search has occurred, she wrote a separate concurring opinion. She concurred with Justice Alito that most long-term GPS monitoring would violate *Katz* but noted that even short-term monitoring may violate an individual's reasonable expectation of privacy because of the unique nature of GPS surveillance.[42]

V. THIRD PARY DOCTRINE

Advances in technology have also caused the Court to reexamine the "third-party" doctrine. Under this doctrine,

individuals have no constitutional right to privacy in information that others lawfully have; the government may search that data without a warrant or probable cause. The third-party doctrine largely traces its roots to *United States v. Miller*.[43] In this 1976 case, the government suspected Miller of tax evasion, and subpoenaed his banks, seeking several months of canceled checks, deposit slips, and monthly statements. The Court rejected a Fourth Amendment challenge to the records collection on two grounds. For one, Miller could "assert neither ownership nor possession"[44] of the documents; they were "business records of the banks."[45] For another, the nature of those records confirmed Miller's limited expectation of privacy, because the checks were "not confidential communications but negotiable instruments to be used in commercial transactions,"[46] and the bank statements contained information "exposed to [bank] employees in the ordinary course of business."[47] The Court concluded that Miller had taken a risk in revealing his affairs to a third party; therefore, that information could be conveyed by the third party to the government.

Three years later, in *Smith v. Maryland*,[48] decided in 1979, the Court applied the same principles in the context of information conveyed to a telephone company. In *Smith*, the telephone company, at police request, installed at its central offices a pen register to record all numbers dialed from the telephone located at the petitioner's home. The police did not get a warrant or court order before having the pen register installed. Since the pen register was installed on telephone company property, the petitioner could not claim that his "property" was invaded or that police intruded into a "constitutionally protected area." While there was no trespass, the petitioner claimed that the State infringed upon the "legitimate expectation of privacy" that he had in the telephone numbers he dialed from his home telephone.[49]

The Supreme Court held that installing a pen register is not a search because the "petitioner voluntarily conveyed numerical information to the telephone company." Since the defendant had disclosed the dialed numbers to the telephone company so that it could connect his calls, his expectation of privacy regarding the numbers he dialed was not reasonable.[50] All telephone users realize that they must "convey" phone numbers to the telephone company, since it is through telephone company switching equipment that their calls are completed. All subscribers also realize that the phone company has the ability to make permanent records of the numbers they dial, so this information cannot be considered private.[51] As a result, the government is typically free to obtain such information from the third party without triggering Fourth Amendment protections.[52] The *Smith* decision left pen registers completely outside constitutional protection, and made it clear that if there were to be any privacy protection, it would have to be enacted by Congress as statutory law.

VI. STORED COMMUNICATIONS ACT

The Stored Communications Act[53] of 1986 is a law that addresses voluntary and compelled disclosure of "stored wire and electronic communications and transactional records" held by third-party internet service providers (ISPs). Internet users generally entrust the security of online information to ISPs; therefore, many Fourth Amendment cases have held that users relinquish any expectation of privacy in this information. While the Fourth Amendment requires a search warrant and probable cause to search one's home,[54] under the third-party doctrine only a subpoena and prior notice are needed to subject an ISP to disclose the contents of an email or of files stored on a server.[55] This is a much lower hurdle to overcome than probable cause. The Stored Communications Act (SCA) creates Fourth

Amendment-like privacy protection for email and other digital communications stored on the internet.[56] It limits the ability of the government to compel an ISP to turn over content information and non-content information, such as logs and email envelope information.[57] In addition, it limits the ability of commercial ISPs to reveal content information to nongovernment entities.[58]

The SCA targets two types of online service, "electronic communication services" and "remote computing services."[59] The statute defines an electronic communication service as "any service which provides to users thereof the ability to send or receive wire or electronic communications."[60] A remote computing service is defined as "the provision to the public of computer storage or processing services by means of an electronic communications system."[61] With respect to the government's ability to compel disclosure, the most significant distinction made by the SCA is that communications held in electronic communications services require a search warrant and probable cause, and those in remote computing services only require a subpoena or court order, with prior notice.[62] This distinction seems artificial and, due to historical and projected technological growth, Congressional legislative reform of the SCA appears necessary. The Supreme Court addressed this issue in its 2018 decision in the *Carpenter* case.[63]

VII. CARPENTER v. UNITED STATES

In *Carpenter v. United States*,[64] decided in 2018, several individuals conspired and participated in armed robberies over a four-month period. Four of the robbers were captured and arrested, and one of those arrested confessed and turned over his phone, allowing FBI agents to review the calls made from his phone at the time of the robberies. Soon after, a judge, in

accordance with the Stored Communications Act,[65] granted the FBI's request to obtain "transactional records" from various wireless carriers for 16 different phone numbers for "[a]ll subscriber information, toll records and call detail records including listed and unlisted numbers dialed or otherwise transmitted to and from [the] target telephones . . . as well as cell site information for the target telephones at call origination and at call termination for incoming and outgoing calls[.]"[66] The government obtained a court order before gaining access to the information; while they did not have probable cause for a search warrant, prosecutors only had to show that they were seeking evidence relevant to a criminal investigation.[67] This was enough under the Stored Communications Act, which requires only "that there are reasonable grounds to believe that the contents of a wire or electronic communication, or the records or other information sought, are relevant and material to an ongoing criminal investigation."[68]

Using this information, the government was able to determine that Carpenter was within a two-mile radius of four robberies.[69] Carpenter was arrested, and a jury later convicted him on several counts of robbery, among other things.[70] Carpenter appealed and the Sixth Circuit, relying on the Supreme Court's decision in *Smith v. Maryland*,[71] affirmed, stating that only the content of a person's communication is protected by the Fourth Amendment.[72] The Court explained that "cell-site data, like mailing addresses, phone numbers, and IP addresses, are information that facilitate personal communications, rather than part of the content of those communications themselves."[73] Furthermore, the Court determined that the government did not obtain information from Carpenter, but the service provider's business records. Therefore, the government's collection of the service provider's business records did not constitute a "search" of Carpenter under

the Fourth Amendment, and a warrant was not required.[74] Carpenter appealed to the Supreme Court.

In a 5-4 decision the Supreme Court reversed. Chief Justice John Roberts wrote the opinion for the majority, holding that the acquisition of Carpenter's cell-site records was a Fourth Amendment search.[75] When a phone connects to a cell site, it generates time-stamped cell-site location information (CSLI) that is stored by wireless carriers for business purposes. Historical cell-site records give the government near-perfect surveillance and allow it to travel back in time to retrace a person's whereabouts. Roberts wrote that this sort of digital data, personal location information maintained by a third party, does not fit neatly under existing precedents. Instead, requests for cell-site records lie at the intersection of two lines of cases: those that address people's expectation of privacy in their physical location and movements, and those that distinguish between what people keep to themselves and what they share with others, known as the third-party doctrine.[76]

Chief Justice Roberts declined to apply the premise of the Court's majority opinion in *United States v. Jones*,[77] the GPS tracking case, which characterized the Fourth Amendment in terms of trespass upon property rights. Instead, he underscored the "reasonable expectation of privacy" concerns emphasized by five of the Justices in *Jones*.[78] Roberts noted that, "Since GPS monitoring of a vehicle tracks 'every movement' a person makes in that vehicle, the concurring Justices concluded that 'longer term GPS monitoring in investigations of most offenses impinges on expectations of privacy'."[79]

Roberts then addressed the third-party doctrine, stating that at the time earlier cases about bank and phone records were decided,

> . . .few could have imagined a society in which a phone goes wherever its owner goes, conveying to the wireless carrier not just dialed digits, but a detailed and comprehensive record of the person's movements. We decline to extend *Smith*[80] (bank records) and *Miller*[81] (phone records) to cover these novel circumstances.[82]

Roberts noted that there is a "world of difference between the limited types of personal information" addressed in precedent and the "exhaustive chronicle of location information casually collected by wireless carriers."[83] Location data is not truly "shared" because cell phones are an indispensable, pervasive part of daily life and they log location data without any affirmative act by the user.[84]

Chief Justice Roberts noted that this decision is narrow and does not address conventional surveillance tools, such as security cameras, other business records that might reveal location information, or collection techniques involving foreign affairs or national security. In the end, he returned to Justice Brandeis' famous dissent in *Olmstead*,[85] "[T]he Court is obligated, as '[s]ubtler and more far-reaching means of invading privacy have become available to the Government' to ensure that the 'progress of science' does not erode Fourth Amendment protections.[86]

VIII. CONCLUSION

The Fourth Amendment to the Constitution of the United States prohibits unreasonable searches and seizures, protecting one's personal information from public scrutiny. The Supreme Court in *Olmstead*[87] held that if there was no physical intrusion or seizure of private property, there was no search or

seizure within the meaning of the Fourth Amendment.[88] Justice Brandeis attacked the majority's "trespass doctrine" and their refusal to expand Fourth Amendment protections to telephone conversations, believing the Fourth Amendment guaranteed individuals "the right to be left alone." Nearly forty years later, in *Katz v. United States*,[89] the Supreme Court overruled *Olmstead* and similar decisions, and embraced Brandeis' view of protected privacy.

Katz expanded the Fourth Amendment protection against “unreasonable searches and seizures” to cover electronic wiretaps.[90] The majority held that the Fourth Amendment “protects people, not places”, is not dependent on intrusion into physical spaces, and applies to oral statements just as it does to tangible objects.[91] In a separate concurrence, Justice Harlan set forth the “reasonable expectation of privacy” test, which is now considered the essence of the *Katz* decision.[92]

In *Jones*[93] the Supreme Court examined whether the admission of evidence obtained by the warrantless use of a GPS tracking device violated the Fourth Amendment. While the Court unanimously held that this was a "search" under the Fourth Amendment, they were split as to the reasons behind that conclusion.[94] The majority returned to the old "trespass doctrine", holding that by physically installing the GPS device on the defendant's car, the police had committed a trespass against Jones' "personal effects" and this constituted a search.[95] However, the four concurring Justices asserted that the case should have been analyzed under the "reasonable expectation of privacy" standard developed in *Katz*.[96]

In both *Miller*[97] and *Smith*[98] the Court applied the "third party" doctrine, stating that information voluntarily conveyed to a third party cannot be considered private.[99] As a result, the government is typically free to obtain such information from the

third party without triggering Fourth Amendment protections.[100] While the third-party doctrine only requires a subpoena and prior notice to obtain information from a third party, the Stored Communications Act (SCA) creates Fourth Amendment-like privacy protection for email and other digital communications stored on the internet.[101] However, the SCA does not provide this level of protection for communications held in remote computing services.[102] The Supreme Court addressed this issue in *Carpenter v. United States*.[103]

In *Carpenter* the government did not have probable cause for a search warrant. However a judge, in accordance with the SCA, granted the FBI's request for a court order to obtain "transactional records" from various wireless carriers.[104] The Court held that the acquisition of Carpenter's cell-site records was a Fourth Amendment search and impinged on his "reasonable expectation of privacy."[105] The Court distinguished the limited types of personal information addressed in precedent from the "exhaustive chronicle of location information casually collected by wireless carriers."[106]

Our laws protect people from governmental intrusion in their daily lives. It has long been the task of the Supreme Court to balance the rights of individuals against the need of the government for information. This task has become exceedingly difficult due to technological advances as the progress of science has afforded law enforcement officials powerful new tools to carry out their important responsibilities. At the same time, these tools risk government encroachment of the sort that the Framers drafted the Fourth Amendment to prevent. The Supreme Court's refusal in *Carpenter*[107] to grant unrestricted access to a wireless carrier's database of physical location information is vitally important for privacy protection amid such extraordinary and rapidly advancing technology.

[1] U.S. CONST. amend. IV.
[2] *Olmstead v. United States*, 277 U.S. 438 (1928).
[3] *Id.* at 439-440.
[4] *Id.* at 438.
[5] *Id.* at 464.
[6] *Id*.
[7] *Id.* at 466.
[8] *Id.* at 457, 464, 466.
[9] *Id.* at 464-466.
[10] *Id.* at 466.
[11] *Id.* at 473-478 (Brandeis, J., dissenting).
[12] *Id.* at 473 (Brandeis, J., dissenting).
[13] *Id*.
[14] *Id.* at 474.(Brandeis, J., dissenting).
[15] *Id.* at 478. (Brandeis, J., dissenting).
[16] *Id.*
[17] *Id*.
[18] *Katz v. United States*, 389 U.S. 347 (1967).
[19] *Id.* at 348.
[20] *Id.*
[21] *Id.* at 348-349.
[22] *Id.* at 349.
[23] *Olmstead v. United States*, 277 U.S. 438 (1928).
[24] *Katz v. United States*, 389 U.S. 347, 351 (1967).
[25] *Id.* at 361 (Harlan, J., concurring).
[26] See *Mancusi v. DeForte*, 392 U.S. 364, 368 (1968), (applying the "reasonable expectation of privacy test" in the Court's majority decision).
[27] See *Kyllo v. United States*, 533 U.S. 27, 33 (2001) ("As Justice Harlan's oft-quoted concurrence described it, a Fourth Amendment search occurs when the government violates a subjective expectation of privacy that society recognizes as reasonable.")
[28] *Katz v. United States*, 389 U.S. 347, 351 (1967).
[29] See *United States v. Jones*, 565 U.S. 400 (2012), and *Carpenter v. United States*, No. 16-402, slip op. at 1 (U.S. Jun. 22, 2018).
[30] *United States v. Jones*, 565 U.S. 400 (2012).
[31] *Id.* at 401.
[32] *Id.*
[33] *Id.*
[34] *Id*.

[35] *United States v. Jones*, 625 F. 3d 766 (D.C. Cir. 2010).
[36] *United States v. Jones*, 565 U.S. 400, 402 (2012).
[37] *Id.* at 403.
[38] *Id.* at 409-410.
[39] *Id.* at 404-405.
[40] *Id.* at 418-419. (Alito, J., concurring).
[41] *Id.* at 430-431. (Alito, J., concurring).
[42] *Id.* at 414-415. (Sotomayor, J., concurring).
[43] *United States v. Miller*, 425 U.S. 435 (1976).
[44] *Id.* at 443.
[45] *Id*.
[46] *Id*.
[47] *Id.*
[48] *Smith v. Maryland*, 442 U.S. 735 (1979).
[49] *Id.* at 741.
[50] *Id.* at 742.
[51] *Id.*
[52] *Id.* at 746.
[53] 18 U.S.C. Chapter 121 §§ 2701–2712.
[54] U.S. CONST. amend. IV.
[55] *United States v. Miller*, 425 U.S. 435, 443 (1976).
[56] 18 U.S.C. Chapter 121 § 2703.
[57] *Id*.
[58] *Id*.
[59] *Id*.
[60] *Id*.
[61] *Id.*
[62] *Id.*
[63] *Carpenter v. United States*, No. 16-402, slip op. at 1 (U.S. Jun. 22, 2018).
[64] *Id* at 2.
[65] 18 U.S.C. Chapter 121 §§ 2701–2712.
[66] *Carpenter v. United States*, No. 16-402, slip op. at 3 (U.S. Jun. 22, 2018).
[67] *Id*.
[68] 18 U. S. C. Chapter 121 §2703(d).
[69] *Carpenter v. United States*, No. 16-402, slip op. at 4 (U.S. Jun. 22, 2018).
[70] *Id*.
[71] *Smith v. Maryland*, 442 U.S. 735 (1979).
[72] *United States v. Carpenter*, 819 F.3d 880 (6th Cir. 2016).
[73] *Id.* at 885.
[74] *Id.*.
[75] *Carpenter v. United States*, No. 16-402, slip op. at 22 (U.S. Jun. 22, 2018).

[76] *Id* at 14-15.
[77] *United States v. Jones*, 565 U.S. 400 (2012).
[78] *Katz v. United States*, 389 U.S. 347, 418-419 (1967). Justice Alito's concurring opinion, joined by Justices Ginsberg, Breyer, and Kagan, arguing that *Katz's* "reasonable expectation of privacy" test governed the case, and denouncing the majority's disinterment of the trespass doctrine as outmoded and long overruled, and Justice Sotomayor's lone concurring opinion, joining the majority but also applying *Katz*.
[79] *Carpenter v. United States*, No. 16-402, slip op. at 16 (U.S. Jun. 22, 2018).
[80] *Smith v. Maryland*, 442 U.S. 735 (1979).
[81] *United States v. Miller*, 425 U.S. 435 (1976).
[82] *Carpenter v. United States*, No. 16-402, slip op. at 11 (U.S. Jun. 22, 2018).
[83] *Id*.
[84] *Id*.
[85] *Olmstead v. United States*, 277 U.S. 438 (1928).
[86] *Carpenter v. United States*, No. 16-402, slip op. at 22 (U.S. Jun. 22, 2018). Chief Justice Roberts quoting Justice Brandeis' dissent in *Olmstead*.
[87] *Olmstead v. United States*, 277 U.S. 438 (1928).
[88] *Id.* at 438.
[89] *Katz v. United States*, 389 U.S. 347 (1967).
[90] *Id.*
[91] *Id.* at 351.
[92] *Id.* at 361 (Harlan, J., concurring).
[93] *United States v. Jones*, 565 U.S. 400 (2012).
[94] *Id.* at 402.
[95] *Id.* at 401.
[96] *Id.* at 418-419. (Alito, J., concurring).
[97] *United States v. Miller*, 425 U.S. 435 (1976).
[98] *Smith v. Maryland*, 442 U.S. 735 (1979).
[99] *United States v. Miller*, 425, 443 U.S. 435 (1976); *Smith v. Maryland*, 442 U.S. 735, 742 (1979).
[100] *United States v. Miller*, 425, 443 U.S. 435 (1976); *Smith v. Maryland*, 442 U.S. 735, 746 (1979).
[101] 18 U.S.C. Chapter 121 § 2703.
[102] *Id.*
[103] *Carpenter v. United States*, No. 16-402, slip op. at 1 (U.S. Jun. 22, 2018).
[104] *Id.* at 3.
[105] *Id.* at 22.
[106] *Id.* at 15.

[107] *Id.*

TEACHING BUSINESS LAW STUDENTS THE BASICS OF CIVIL LEGAL ACTIONS THROUGH THE CASE OF THE SLEEPING YANKEE FAN

by

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INTRODUCTION

One of the great joys of teaching is the opportunity to develop new and creative ways in which to explain challenging legal material to students, particularly for a generation of students who embrace new and evolving technology. The pedagogical literature has a number of articles on the use of video media to help explain legal concepts in creative ways.[1] Perhaps one of the more challenging areas of the law to teach undergraduate business law students is civil procedure. There is a tendency to use famous canonical, albeit obtuse, cases to attempt to explain civil litigation practice and procedures.

It is a rare opportunity when students can study a legal action from start to finish so succinctly in one lesson by watching a video of the incident, which subsequently gave rise to the legal action, and read the judge's final Decision

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and Order in one class. The matter of *Andrew Robert Rector v. Major League Baseball Advanced Media, ESPN New York, et al.,*[2] colloquially referred to as The Sleeping Yankee Fan Case, is that exception. By using a YouTube video of the incident which is the subject of the litigation and reading aloud the subsequent Decision and Order of the case, educators can explain elements of the civil litigation process from inception to conclusion.

The lesson provides students with a basic understanding of civil litigation procedures, introduces legal vocabulary and concepts, and explains legal reasoning, particularly the IRAC (Issue, Rule, Analysis, and Conclusion) method. The exercise establishes a tone for the course that active participation is encouraged, expected, and that the class is a safe environment for participation. The exercise creates a shared common experience in which the class has a pedagogical touchstone case, which it can reference, and return to throughout the course.

EDUCATIONAL OBJECTIVES

The exercise has several learning objectives: (1) It allows students to become actively engaged in the case by personally viewing the initial incident and permits direct commentary from their observations. (2) It helps students understand client advocacy and the respective positions of the parties through role-playing by having the class divide into sections representing the plaintiff, defendants, and judge when taking turns reading aloud and analyzing Judge Julia Rodriguez's Decision and Order. (3) It provides a foundational understanding of civil procedure topics, such as jurisdiction and venue, by using the setting and proximity of Yankee Stadium to the Bronx County Courthouse. (4) It introduces students to a substantive area of the law, torts,

through the two legal causes of action, defamation and intentional infliction of emotional distress, and helps to explain the difference between, civil and criminal law, procedural and substantive law, and common and statutory law. (5) The exercise demonstrates the application of IRAC (Issue, Rule, Analysis, and Conclusion) method of legal analysis to the two causes of action. (6) And in one succinct lesson, the exercise demonstrates how civil litigation can be interesting, fun, and expensive to the parties involved.

CLASS EXERCISE

The exercise can be tailored to meet a variety of classroom settings. Depending on the context, character of the class, time constraints, and instructor experience, the instructor can simply assign the video and reading of the short six page Decision and Order as a homework assignment to be discussed at the next class in a flipped classroom format, or have the students role-play and sing as part of the exercise. Opportunities abound on how to approach the material.

Some students may be reluctant to embrace the exercise because it concerns sports, but the exercise is not about baseball. A baseball game is simply the context that gave rise to the legal action, although baseball does have its own set of rules which can provide an interesting metaphor for the exercise, which is about understanding and appreciating the rules of a game, in this case, the rules of civil procedure.

The following exercise described in this paper reflects a more comprehensive approach to the lesson and can be broken down into four parts: First, watching the video and soliciting student feedback; second, asking important and necessary questions before commencing a lawsuit; third,

role-playing through active classroom reading of the Decision and Order; and fourth, follow-up discussion.

The classroom instructor plays an important role in facilitating the process and setting the tone for the class. For the more adventurous instructors, in order to get the students motivated for the lesson and perhaps alleviate the malaise and boredom in the classroom, students can be asked to stand for the proverbial seventh inning stretch and sing "Take Me Out to the Ballgame." To make this more enjoyable, a YouTube video of a popular star leading and accompanying the class in song, such as Bill Murray at a Chicago Cubs' baseball game,[3] can be used. There are plenty of contemporary videos and artists singing the song available on the internet for use in the lesson.

Viewing the Incident – Let's go to the Video

Before watching the video, the instructor should discuss the context of the incident, but not mention the subsequent lawsuit or amount of relief requested because it might bias the students' perceptions. Simply state the facts that at a Major League Baseball game held at Yankee Stadium on Saturday, April 13, 2014 between the Boston Red Sox and the New York Yankees a fan was captured on television dozing in the stands during the game and ESPN sports' announcers took note, and then show the video. There are several versions of the video available on the internet for classroom viewing.[4] After watching the video, students can be asked their first impressions.

What the class does not know and will not know until it starts reading the Decision and Order is that the video and the sports announcers' comments went viral on the internet

and uncensored fan commentary on blogs proliferated about the incident. Rector, the plaintiff, brought legal action only against the sports announcers and their organizations, not the blogs, which is a key element of the judge's Decision and Order.

Commencing a Legal Action

After showing the video and asking the students their first impressions, the instructor should ask a legal question: Has Andrew Robert Rector, been wronged or injured? Or, more precisely: Does he have a legal cause of action against the announcers upon which relief can be granted by a court of law?

At this point, the instructor should explain the role of the attorney, legal representation and advocacy, and the questions that need to be asked to determine whether a legal action can be commenced. The instructor can create a scenario in which Rector seeks the advice of legal counsel as to whether he has a case against the announcers. The attorney advises him that in order to answer, she will need to ask additional questions. In addition, she will need to conduct legal research by consulting the Civil Practice Law and Rules (CPLR) of the State of New York, case law, and legal treatises to determine whether he has a legal cause of action for which relief can be granted in a court of law.

The instructor can ask the students some basic legal and civil procedure questions that an attorney might ask a client and begin to define and explain certain legal concepts. Some suggested questions might include, but not limited to:

> Was plaintiff injured or harmed by the announcers' actions?

> Does he have standing to sue the announcers?
> Under what legal theory or cause of action will he bring a legal action against the announcers?
> What type of relief from the court should he seek?
> Which court has jurisdiction to hear the case and in which venue will he bring his legal action?

The answer to the last questions on jurisdiction and venue can be answered by using a photo from the internet of Yankee Stadium juxtaposed against the Bronx County Courthouse. There are several photos of Yankee Stadium next to the Bronx County Courthouse.[5] This allows the students to understand the concept of venue. With the stadium and courthouse adjacent to each other and the courthouse being the actual courthouse in which the case was heard, venue becomes quite easy to explain. The instructor can take a moment to explain the various courts and their jurisdiction. For example, the court in which Rector, the plaintiff, filed his complaint, New York State Supreme Court, is a civil trial court which handles civil cases seeking relief over $25,000, of which plaintiff's legal action qualifies.

Once the class has established that Mr. Rector has standing and a legal cause of action, he can commence legal proceedings by filing a complaint, the class can then move on to reading the Decision and Order.

Reading the Decision and Order

Pleadings and other court documents are excellent tools for explaining the law to students. As physical documents that students can hold and read, they include information, such as the Index Number, that lends itself to explaining how the court systems work. Instructors should take the time to explain the headings, court, parties involved, judge and other features included in the document. The Decision and Order is a particularly useful tool because it has a list of the "Papers Submitted" by the parties in the matter which provides an opportunity to explain the costs associated with all the motions, affidavits, memorandums of law, and replies in the matter. Copies of the complaint and Decision and Order can be located on the internet.[6]

The Decision and Order explains the judge's ruling on defendants' Motion to Dismiss the case, so the judge summarizes the facts of the case, addresses plaintiff's two causes of action, defamation and the intentional infliction of emotional distress utilizing the IRAC method, and defendants' arguments in support of their motion.

After distributing the Decision and Order to the class, the instructor should divide the students into three groups representing the respective parties to the litigation. The three groups of students are the plaintiff's attorneys representing Andrew Robert Rector; the defendants' attorneys representing Dan Shulman, John Kruk, Major League Baseball Advanced Media, ESPN New York, and the New York Yankees; and the students who will preside in place of Judge Julia I. Rodriguez. Although not necessary, Power Point slides can be useful in introducing the respective parties, their images, company logos, etc. which are readily available on the internet.

For the remainder of the exercise, students from each group will read aloud to the class pertinent sections of the Decision and Order that reflect their role in the litigation. The students should imagine themselves as the attorneys for their respective clients or the judge and should advocate for their clients zealously, but respectfully. Either the instructor or students representing the judge can begin by reading a summation of the facts on page one of the Decision and Order.[7] After reading the summation of facts, the respective parties will take turns reading aloud.

Plaintiff's Attorneys:

A Power Point slide with a photo of the plaintiff can be introduced at this point. Even though the Decision and Order is written by the judge, it is written in such a way that plaintiff's and defendants' attorneys can read from respective parts of it outlining their arguments. For example, plaintiff's attorneys will begin on page 2 of the Decision and Order by taking turns reading "With respect to his defamation cause of action, Plaintiff alleges, *inter alia*, that:"[8] and the student continues to read the facts listed which support plaintiff's argument. The instructor should take a moment to translate *inter alia*, among other things, and discuss the use of Latin in the law.

Another student representing plaintiff's attorneys can continue reading on page two, "With respect to his cause of action for intentional infliction of emotional distress, plaintiff alleges, *inter alia*, that:"[9] and continues to read the facts listed which support plaintiff's argument.

And finally, a third student representing the plaintiff's attorneys can read on page three of the Decision and Order, "Plaintiff seeks $10 million in damages, including punitive

damages, to compensate him for..."[10] and continue to read the facts listed which support the argument and request for relief.

While the students are reading the two causes of action and relief requested, the instructor can pause the readings to explain and clarify the cause of actions, why such relief was requested, and the role of plaintiff's attorneys as advocates and their ethical responsibilities as attorneys to represent their clients zealously. Once the plaintiff's attorneys have completed reading their arguments, they can rest their case and the class can move on to the defendants' attorneys' request for Summary Judgement.

Defendants' Attorneys:

Defendants should then be introduced. The instructor can introduce the announcers Dan Shulman and John Kruk with a Power Point slide. In response to plaintiff's attorneys' arguments, the students representing the defendants' attorneys will then have their opportunity to ask the court to dismiss the case for lacking merit. Defendants' attorneys will have their chance by reading the Decision and Order on page three with the first student reading, "Defendants ESPN, New York Yankees, Shulman and Kruk (the "ESPN/Yankees") now move to dismiss the complaint, pursuant to CPLR 3211 (a)(1) and 3211(a)(7)."[11] The instructor can use a Power Point slide to list CPLR 3211 (a)(1) and (a)(7) and explain the purpose of a Motion to Dismiss.

A second student, reading for defendants' attorneys, will read on page three of the Decision and Order, "Under CPLR 3211(a)(1), a dismissal is warranted only if the documentary evidence submitted conclusively establishes a

defense to the asserted claims as a matter of law."[12] This may be a little complicated for an undergraduate to understand, but it provides an opportunity for the instructor to not only explain the statutory law, but also to distinguish between statutory law, the CPLR, and common law because the judge cites several cases in the Decision and Order when addressing the requirements to dismiss a case under CPLR 3211.

Judge's Reasoning and
Application of the IRAC Method of Legal Analysis:

After the students representing the plaintiff's and defendants' attorneys have had the opportunity to present their arguments, the class will then turn to the students representing the judge. The instructor should discuss the role of the judge in the case and ask the class questions such as how do judges decide cases? Do judges simply flip a coin or is there a method to deciding cases? What type of analysis is necessary to come to a just and reasonable decision? Most students do not understand how judges decide cases and may be inclined to believe they do so based on personal feelings, but it is important to understand that there is a systematic approach to deciding cases. The instructor should introduce and explain the IRAC method of legal analysis: Issue, Rule, Application and Analysis, and Conclusion. It is important to take the time to explain the four parts either through a PowerPoint slide or by providing students with a handout that explains the IRAC method of legal analysis.

As the students read the judge's reasoning using the IRAC method, the instructor can systematically address each question: What is the issue in the case? What is the rule regarding the legal issue? How does the judge apply

the law to the facts? And what is the judge's conclusion? The IRAC method can be used to address each of plaintiff's two causes of action, defamation and intentional infliction of emotional distress, and defendant's Motion for Summary Judgement.

The instructor should then introduce Judge Rodriguez with a Power Point slide of her photo. If available, and for fun, the instructor can provide the students representing the judge with a gavel which can be passed from student to student as they read the judge's Decision and Order.

The first student representing the judge will begin by reading the first cause of action in the Decision and Order at the top of page four, "To prove a claim for defamation, a plaintiff must show: (1) a false statement that is (2) published to a third party (3) without privilege or authorization, and that (4) causes harm."[13] The student will continue to read the supporting cases that cite the common law. The instructor can take this time to explain further the elements necessary to support a claim for defamation and common law versus statutory law.

The second student will read the facts as applied to the law in the Decision and Order on page five, "The CDs conclusively establish that none of the defendants made any of the statements attributed to them in the complaint. In fact, the Plaintiff's own submissions reflect that all of the statements alleged in the complaint were made by private individuals on websites not hosted or maintained by any of the defendants herein."[14] The instructor should ask the class why does it think the plaintiff did not bring a legal action against the internet fan blogs.

As the students read on behalf of the judge, there are certain elements of the opinion that should be emphasized. For example, when the students reading the facts applied to the law come to the sentence on page five, "Indeed, it is axiomatic that a defendant cannot be held liable for libelous or defamatory statement that it did not write or publish"[15] it is worth repeating the sentence again and other points of the text to emphasize and recognize important legal concepts and principles.

After the first cause of action has been addressed and each point of the IRAC method discussed, the students representing the judge should move on to the second cause of action and read from "II. Intentional Infliction of Emotional Distress," on page six, "To Survive a motion to dismiss a cause of action for the intentional infliction of emotional distress, plaintiff must allege "extreme and outrageous conduct intentionally or recklessly [which] causes severe emotional distress to another."[16] Then the instructor should address and discuss each point of the IRAC method as applied to the second cause of action.

Finally, the last student representing the judge can read on page six, "Based on the foregoing, the Defendant's respective motions to dismiss the Complaint are **granted** and the Complaint is hereby dismissed in its entirety."[17] The last student reading can then slam down the gavel. Rector is out!

Follow-up Discussion

Throughout the entire exercise, the instructor should be asking questions after each student has read a section of the Decision and Order to keep the students who are not reading engaged in the dialogue. The instructor can then solicit the

students' post-exercise impressions, discuss alternative scenarios, and reaffirm key elements and vocabulary of the civil litigation process. The Decision and Order is rife with grammatical errors and not very well written in some areas, which allows the instructor to discuss the imperfect nature of the legal process and point out that even judges make mistakes.

The case raises several issues worthy of follow-up. In addition to soliciting the students' feedback as to whether they agreed with the judge's reasoning and decision, there are additional questions that might be asked:

> Since the case received extensive publicity, is Rector now a "public figure" or still a "private" person in respects to any future claims of defamation?
> Knowing the case was such a long shot, why do you think the plaintiff brought the action against the defendants?
> Should the plaintiff be penalized for being unsuccessful?
> Can the plaintiff appeal the judge's decision?
> Should the plaintiff be allowed to appeal the judge's decision? And if so, why?
> Would defendants have been held liable if they had made comments similar to the fan blogs/websites on the internet?
> Is it legally acceptable to ridicule someone publicly for their weight, gender, or race?
> What if the plaintiff had been a child dozing in the stands instead of an adult?
> And finally, does the exculpatory clause on the back of baseball game ticket provide immunity for the defendants?

The question regarding the exculpatory clause on the back of a ticket is a perfect opportunity to begin to explore contract law

and the role of exculpatory clauses. The exculpatory clause on the back of a New York Yankee's baseball game ticket can be found on the web and made into a Power Point for the class.[18] To add additional levity, the instructor can introduce Mad Magazine's "The Sleeping Yankee Fan's Hall of Fame Plaque"[19] in which Rector is pictured as "The Yankee Stadium Snoozer" and lists his accomplishment of sleeping at Yankee Stadium.

CONCLUSION

There are many different pedagogical approaches to teaching the law and utilizing court documents and video which provide a more tangible experience for the students to appreciate the civil litigation process. At its most basic level, this lesson is designed to provide students with an understanding of the civil litigation process, an introduction to legal terms and concepts, and a demonstration of the use of the IRAC method of legal analysis. Having students actively participate and speak in front of their peers helps to establish a tone for the course that active participation is encouraged, expected, and that the class is a safe environment for participation. The payoff for the students is that they now have a shared common legal experience and touchstone case that they can refer to throughout the course when discussing new material.

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[1] McEvoy, Sharlene A., Teaching Legal Principles By Using the Movie "Treasure of Sierra Madre." North East Journal of Legal Studies, Vol. 37, Spring/Fall 2018 at p. 119. A Tale of Two Defense Attorneys: Using The Films "Jagged Edge" and "Suspect" To Teach Lessons In Ethics, Gender Roles And Trial Procedures In A Law Class. North East Journal of Legal Studies, Vol. 39, Fall 2019 at 59.

[2] Andrew Robert Rector v. Major League Baseball Advanced Media, ESPN New York, New York Yankees, Dan Shulman, John Kruk. DECISION and ORDER, No. 303630-2014 (N.Y. Sup. Bronx Co. 2014).
[3]Murray, Bill. "Take Me Out To The Ballgame." Wrigley Field during the Cubs' home opener. April 12, 2004. https://www.youtube.com/watch?v=yAOkVO_Pj7s
[4] A fan in the stands takes a snooze during the 4th inning of the Red Sox/Yankees game at Yankee Stadium. April, 13, 2014. youtube.com/watch?time_continue=20&v=1FDrcWTSczs
[5] One example of a photo of Yankee Stadium juxtaposed against the Bronx County Courthouse: https://www.flickr.com/photos/gary_dunaier/6946209812
Yankee Stadium, Bronx County Courthouse, which dominated the view of the Bronx skyline in the original stadium, now can only be seen from the left field stands taken by Gary Dunaier. April 17, 2012.
[6] The Smoking Gun. http://thesmokinggun.com/file/sleepy-fan-dismissal
[7] Andrew Robert Rector v. Major League Baseball Advanced Media,et al. at 1.
[8] *Id.* at 2.
[9] *Id.* at 2 and 3.
[10] *Id.* at 3.
[11] *Id.* at 3.
[12] *Id.* at 3.
[13] *Id.* at 4.
[14] *Id.* at 5.
[15] *Id.* at 5.
[16] *Id.* at 6.
[17] *Id.* at 6.
[18] New York Yankee Ticket Back Terms and Conditions https://www.mlb.com/yankees/tickets/ticket-back-terms-conditions
[19] Mad Magazine's, The Sleeping Yankee Hall of Fame Plaque https://www.madmagazine.com/blog/2014/07/09/the-sleeping-yankee-fans-hall-of-fame-plaque