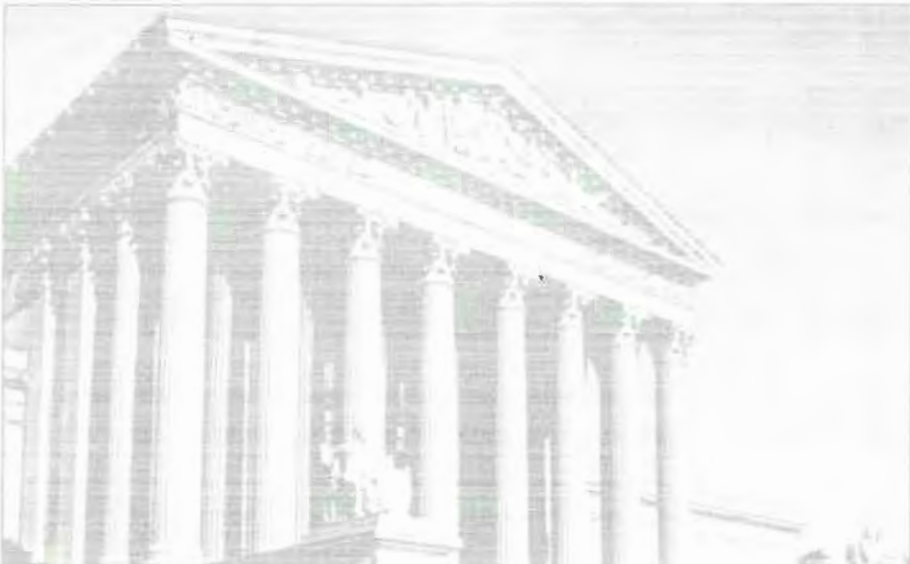
North East Journal of Legal Studies



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ARTICLES

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Information for Contributors

The *North East Journal of Legal Studies* is a double blind refereed journal, published once a year. Its purpose is to encourage scholarly research in legal studies and pedagogy related thereto.

Articles may be submitted simultaneously to this journal and others with the understanding that the author(s) will notify this journal if the article is to published elsewhere. We will not publish an article that will be published in another journal.

Papers should relate to the field of Business Law (including recognized topics within Business Law and the Legal Environment of Business) or to Legal Studies Education.

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Articles offered for inclusion in the next issue of the journal shall be submitted to the editor by June 30, 2001.

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Submissions must include a check for $50.00 payable to North East Academy of Legal Studies in Business. If the article is not published, $25.00 will be returned.

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1. Submissions are to be single-spaced. Skip lines between paragraphs and between section title and paragraphs. Right-hand justification is required.
2. 12 point Times New Roman or an exact equivalent font must be used.
3. Number pages in pencil on the back in the lower right-hand corner. Do not number the front of the pages.
4. Two of the copies submitted must have all references to the author's identity and affiliation eliminated.
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INNOCENCE IN THE EYES OF THE INTERNAL REVENUE SERVICE *

by

Martin H. Zern **

I. INTRODUCTION

It is common knowledge that the standard of proof for conviction of a crime is guilt beyond a reasonable doubt, and that anyone charged with a crime is presumed innocent. Moreover, the burden of proving such guilt rests on the government, and those indicted are not required to testify. When the government charges a person with an understatement of tax, however, the presumption is generally just the opposite. In most tax controversies, the government presumptively is assumed to be correct. In other words, the taxpayer is presumed *guilty* of owing additional taxes where the government alleges so, and the taxpayer generally has the burden of proving otherwise.[1] Accordingly, where a tax deficiency imposed by the Internal Revenue Service ("IRS") is litigated, the taxpayer cannot simply hunker down as in a criminal case and, in effect, declare to the government *go prove it*.[2]

In most cases, filing a joint return saves taxes for a married couple. That is the good news. The bad news is that the signatories to a joint return are jointly and severally liable for the accuracy of the return, for the full tax liability, and for any interest or penalty relating to the return.[3] Such liability extends not only to the tax shown on the return that was filed, but also to any tax that should have been but was not reported on the return. Because of the presumption of correctness that applies to understatements of tax asserted by the government, a spouse signing a joint return is placed in a particularly difficult position. Basically, each spouse becomes responsible for the tax transgressions of the other. Here, the marriage vow *for better or for worse* is apropos. Joint responsibility is applicable regardless of which spouse is responsible for income omitted or for false or exaggerated deductions taken, and notwithstanding the fact that one spouse may be less informed about the contents of the return.[4]

A review of the numerous litigated cases involving joint liability reveals that it is usually the wife (or ex-wife as the case may be), for whom signing jointly was in retrospect a mistake. Most often, the husband assumes control over the couple's financial decision making and preparation of their tax return. In numerous situations, the wife signs the return blindly or with only a cursory

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review. Unfortunately, the day of reckoning frequently occurs after a separation or divorce, which is often caused by the husband's misfortune, financial or otherwise. Although the husband is equally responsible for any understatement of tax, he may be deceased, financially destitute or have left town and be difficult for the IRS to find. Consequently, the wife becomes the easier source of collection and ends up being assessed by the IRS for the entire understatement of tax, plus interest and penalties. Although a possible escape route is for the wife to file for bankruptcy, she may have too much income or assets to qualify for bankruptcy protection, or she may not meet the requirement that the tax obligation be more than three years old.[5] In order to avoid being responsible for the tax sins of the other spouse, one could file as a *married person filing separately*. Although filing this way is generally more costly, it may be advisable where one spouse is aware of the dishonesty of the other spouse, and especially where there is marital strife and separation or divorce is in the winds.

Because of the perceived unfairness in certain cases of the joint and several liability rule when a joint return is filed, the Internal Revenue Code has long contained the possibility of relief for someone who met the standard of being an *innocent spouse*.[6] Numerous horror stories began to surface, however, concerning how the existing rules provided inadequate protection to spouses in situations where fairness dictated that there should be relief from joint and several liability. Consequently, Congress recognized that the existing rules should be softened.[7] As the rules stood, innocent spouse relief was available only in the most egregious cases where the understatement of tax was large and the tax position taken was *grossly* erroneous. Accordingly, in 1998, Congress enacted a new section of the Internal Revenue Code that makes innocent spouse relief easier to obtain, and expunged the prior innocent spouse rules.[8] The new law is effective for any tax liability arising after its effective date, July 22, 1998. The purpose of this article is to explicate the new rules. Accordingly, the old rules will be referred to only where deemed appropriate for purposes of contrast.[9]

It was reported in the New York Times that the IRS expected 3,000 claims for relief after enactment of the new law, but instead has received over 45,000 claims, with hundreds more being received each week. More than 90% of the new claims are from women. Apparently, many divorce lawyers are routinely filing innocent spouse relief claims along with the filing of divorce papers as a means of protecting their client or as a bargaining chip against a spouse in danger of an audit. Because it has been inundated with so many claims, the IRS reportedly has assigned 500 auditors to deal with the situation, which is more than 3% of its auditing force.[10]

To provide guidance to taxpayers on how to seek relief under certain provisions of the new law, specifically those dealing with equitable relief, the IRS, in January, 2000, issued a new revenue procedure.[11] This article will also consider this new procedure.

II. STATUTORY ANALYSIS

The new law allows general relief from liability for all joint filers if certain conditions, as enumerated below, are met. In addition to seeking general relief, joint filers who are divorced, widowed, legally separated or not living together may choose to limit their liability under a new allocation procedure that operates as if *separate returns* had been filed. The option of limiting liability may be sought in tandem with a request for general relief where the granting of general relief is uncertain, which most often will be the case. Where general relief seems clearly unavailable, a joint filer who qualifies may proceed only under the option of limiting liability. If a joint filer does not meet the requirements for general or limited relief, there is a backup method under which the IRS may grant relief if it is *inequitable* to hold the individual liable. As just mentioned, a new revenue procedure provides guidance on seeking equitable relief. A request to be relieved from liability under any of the foregoing procedures must be timely made, as explained below. Finally, a joint filer is given permission to petition the United States Tax Court, and the Court is given jurisdiction, to determine appropriate relief where the joint filer's election for innocent spouse relief is denied by the IRS.

A. RELIEF APPLICABLE TO ALL JOINT FILERS

The basic conditions that must be met for general relief from liability are that:

(i) a joint return has been made for the taxable year,

(ii) there is an understatement[12] of tax attributable to an erroneous item of one of the parties to the return,[13]

(iii) the party seeking relief demonstrates that when the return was signed, she[14] did not know, and had no reason to know, of such understatement,

(iv) under all the facts and circumstances, it would be inequitable to hold the party seeking relief liable for the tax attributable to such understatement, and

(v) the party seeking relief *elects* the benefits of the new law within a certain time limit.[15] The procedure for electing relief will be discussed later in this article.

If all of the foregoing requirements are met, the person seeking relief will be completely relieved of liability for tax (including interest, penalties and other amounts) to the extent the liability is attributable to the understatement of tax on account of the erroneous item.[16]

1. Time Limits

Relief must be sought within two years after the IRS has begun collection efforts.[17] In this regard, the two-year period first begins when the IRS gives the spouse notice that it will attempt to collect the joint liability from her.[18] For example, a wage garnishment or notice of intent to levy against the property of a spouse would constitute collection efforts. However, the mailing of a notice of deficiency and demand for payment to the last known address of a spouse addressed to both spouses would not constitute a collection effort.[19] The implication, however, is that a mailing of a notice of intent to levy to a spouse at her last known address would constitute proper notice of collection. Accordingly, in divorce or separation situations, practitioners should consider advising a client to file a protective election for relief, especially where there is suspicion that the client's spouse has been cheating on the couple's tax return. As noted, the election must be filed within two years of notice of collection efforts. A potential pitfall is that a collection notice will not be received within the requisite two-year period where a spouse has moved from the last known address recorded by the IRS.

The IRS has made available Form 8857, Request for Innocent Spouse Relief, together with instructions, to facilitate requests for relief. Accordingly, it is this form that should be filed when a taxpayer becomes aware of a tax liability that she believes is the obligation of her spouse (or ex-spouse). Awareness of a joint liability may arise upon examination of a return or upon the receipt of a notice from the IRS. In any event, the spouse requesting relief should file the form no later than two years after the first attempt by the IRS to collect the tax from her. The form should be accompanied by a statement detailing the reasons why the taxpayer feels she qualifies for relief, using the best information available to her.[20] Care should be taken to properly complete Form 8857 since the IRS has noted that between March of 1999 and March of 2000, it could not timely process approximately 21% of such forms due to taxpayer errors or omissions.[21]

2. Joint Return Determination

Whether a joint return has been filed depends on the intent of the parties. Clearly, the act of signing must be voluntary. Thus, a spouse who signs a joint return under duress may be relieved of liability for any understatement of tax. For example, a signature ordered by a divorce court has been held to be involuntary,[22] as well as one signed to accommodate the wishes of a dying spouse.[23] Whether there is sufficient duress to obviate a joint return depends on the particular facts and circumstances, and there are a number of litigated cases concerning this issue. Moreover, the failure of one spouse to sign the return does not rule out the existence of a joint return, especially where the non-signing spouse does not object to the filing of the return and does not file a separate return. Thus, if a husband, for example, signs his wife's name, she would have the burden of proving that her signature was unauthorized. If joint returns had been filed in the past, this would tend to show that a joint return was intended.[24] If it can be shown that a joint return was filed under sufficient duress, the spouse so signing is not subject to joint and several liability, and the innocent spouse rules have no applicability.

3. Apportionment of Relief

Under prior law, it was unclear whether a court could grant partial innocent spouse relief where, for instance, the spouse knew some of the gory details of her husband's tax chicanery, but not all of them. The Ninth Circuit Court of Appeals allowed partial relief where the spouse did not know, and had no reason to know, the magnitude of the understatement, even though the spouse may have known of some understatement.[25] The new law adopts the underlying rationale of this case. Consequently, if a joint filer knew or had reason to know of an understatement, but did not know or had no reason to know of its full extent, she may be relieved of liability on an apportioned basis – i.e., to the extent the liability is attributable to that part of the understatement of which she did not know and had no reason to know.[26] For example, when a wife signs a joint return she may be aware that her husband omitted a certain amount of income, but did not know and had no reason to know of other income omissions. Accordingly, she may be relieved of liability for additional taxes to the extent the additional taxes are attributable to omitted income of which she had no knowledge and had no reason to know about.

4. Knowledge

The language *did not know, and had no reason to know* has been carried forward from the prior innocent spouse rules. Under the prior rules, the most heavily litigated of the elements that a spouse seeking innocent spouse relief had to prove, and the most judicially unsettled, was the requirement that when she signed the return she did not know and had no reason to know of the understatement. Since the new law carries over verbatim the same standard of knowledge, the case law dealing with this aspect of innocent spouse relief should still have value as precedent. Under prior law, the courts uniformly held that mere knowledge of the underlying transaction that produced *omitted income* was sufficient to deny innocent spouse relief.[27] However, the courts had split on whether mere knowledge of the underlying transaction was sufficient to deny innocent spouse relief for *deduction*, *credit* or *tax basis* items.[28] Where actual knowledge was not evident, the general rule, which was difficult in application, was whether under the particular facts and circumstances a *reasonably prudent* taxpayer should have deduced that her spouse had been cheating.[29]

Quite often the result turned on the sophistication and financial acumen of the spouse seeking relief. For example, where a spouse was a housewife and unemployed former secretary with a high school education "possessing only a rudimentary grasp of the simplest tax principles," and did not participate in her husband's affairs, she was granted relief.[30] On the contrary, a highly paid, college educated spouse, a vice president of a national retailer, as well as a joint investor with her husband, was denied relief *as a matter of law*, although she may not have specifically understood the tax consequences of her husband's tax shelter investments.[31]

B. RELIEF FOR TAXPAYERS DIVORCED, WIDOWED, SEPARATED OR LIVING APART

In addition to an election to seek general relief, or as an alternative thereto, a joint filer who meets prescribed conditions, as enumerated below, may *elect* to limit liability for an understatement of tax to the portion of the understatement allocable to such electing individual.[32] However, the individual seeking such relief has the burden of proving the amount of the understatement allocable to her.[33] The possibility of electing to limit liability did not exist under the old law. If the conditions to limit liability are not met, apportioned liability may still be possible as discussed under part II.A.3. of this article, above.

In general, if the conditions to limit liability are met, items are to be allocated between spouses as if they had filed *separate returns*.[34] When separate returns are filed, items of income are apportioned based on the source of the income. Business and investment income (including capital gains) are allocated based on each spouse's proportionate ownership of the business and investments. If the business or investments are owned equally, the income therefrom will generally be allocated equally unless there is *clear and convincing* evidence to support a different allocation.[35] Business deductions are expected to follow the ownership of the business, and personal deductions will be allocated equally unless it is shown that a different allocation is appropriate.[36] For example, a charitable deduction that would normally be allocated equally may be allocated to the husband if is clearly shown that the property donated was his separate property. Thus, any deficiency assessed on account of a valuation overstatement would be allocated entirely to the husband.[37] Income tax withholding is allocated to the spouse from whom it is withheld and estimated tax payments are to be allocated to the spouse who made the payments. If the estimated payments are made jointly, then an equal allocation is the rule, in the absence of evidence supporting a different allocation.[38] Although items are generally to be allocated according to the rules of allocation where separate returns are filed by a married couple, the IRS may provide for some other method of allocation where it can show that another method is appropriate due to the *fraud* of one or both of the spouses.[39] Also, the IRS is granted authority to issue regulations providing for methods of allocation.[40]

The key conditions that must be met in order to secure relief under the election to limit liability are:

(i) at the time of the election, the individual seeking relief is no longer married to, or is legally separated from the person who was the co-signatory on the return,[41] or

(ii) the individual was not a member of the same household as the co-signatory on the return at any time during the12-month period preceding the filing of the election.

The provision to limit liability would come into play where, for example, the tax deficiency related to unreported income of the husband and the couple were divorced, legally separated, had lived apart for 12 months or the husband was deceased. In such case, the deficiency would be the sole responsibility of the husband or ex-husband (or his estate). If, on the other hand, the deficiency relates to items of both spouses, the deficiency is allocated between them.

<u>Example</u>: A deficiency is assessed against both spouses on account of \$70,000 unreported income of the husband and a disallowance of \$30,000 of miscellaneous deductions allocable to the wife. If no longer married, separated or living apart, either may elect limited liability. Liability to an electing party would be limited to 70% of the deficiency in the case of the husband and 30% in the case of the wife. This would be the result even if some of the miscellaneous deductions had been disallowed under the 2% offset rule. Limited liability is available only if a proper election is filed. A failure to make an election means that a spouse is liable for the full deficiency.[42]

If a deficiency arises due to the disallowance of a deduction or a credit, the amount of a tax deficiency allocable to a spouse is limited to the amount of income allocated to the spouse that was offset by the deduction, or to the amount of tax allocated to the spouse that was offset by the credit.

<u>Example</u>: On a joint return, the husband has wage income of \$100,000 and the wife has self-employment income of \$30,000. A deduction of \$20,000 allocable to the husband is disallowed, resulting in a tax deficiency of \$5,600. Since, the deficiency is attributable solely to the husband, and he has sufficient income to offset the disallowed deduction, he is responsible for the entire deficiency. The wife has no liability regardless of the ability of the IRS to collect from the husband.

However, if the husband had income of only \$15,000, there would be insufficient income to absorb the \$20,000 disallowed. Here, the shortfall of \$5,000 would be deemed to have offset income of the wife. Accordingly, the deficiency of \$5,600 would be allocated ¾ to the husband, or \$4,200 (\$15,000/\$20,000 x \$5,600) and ¼ to the wife, or \$1,400 (\$5,000/\$20,000 x \$5,600).[43]

If a deficiency is attributable to the disallowance of a credit against the tax, or is attributable to any tax other than the income tax or alternative minimum tax, the deficiency attributable to such credit or other tax is considered first.[44]

<u>Example</u>: There is an overall tax deficiency of \$10,000, consisting of \$2,800 of self-employment tax and \$7,200 of income tax. The income tax deficiency is attributable to \$20,000 of self-employment income unreported by the husband and a disallowed itemized deduction of \$5,000 allocable to the wife. The \$2,800 of self-employment tax is first allocated to the husband. The \$7,200

of income tax deficiency is allocate 80% ($20,000/$25,000) to the husband and 20% ($5,000/$25,000) to the wife.[45]

The right to limit liability as if separate returns were filed is available only where there is a *tax deficiency* -- that is, where the IRS claims that additional taxes are owed.[46] Consequently, this option is not available to obtain a refund of amounts already paid.[47] Moreover, the option to limit liability is not available where there is a tax shown on the return, but has not been paid since technically the amount shown as owed is not a deficiency. In this case, however, there is the possibility of equitable relief in an appropriate situation. The possibility of equitable relief is discussed later in this article.

1. Time for Making Election

An election to limit liability must be timely made. In this regard, the election must be made within the same time frame that is imposed for an election to request complete relief – i.e., within two years after the IRS has begun collection efforts against the person seeking relief.[48] As previously noted, a protective election should be considered where there is a matrimonial dispute, and Form 8857 is available to facilitate an election.

2. Actual Knowledge of Falsification Prevents Election

Congress was concerned, however, that some persons might attempt to use the election to limit liability inappropriately. Accordingly, the new law contains a provision that denies limited liability relief to an individual so seeking it who, at the time of the signing of the return, had *actual knowledge* of any item giving rise to a deficiency (or a portion thereof) that was not allocable to such individual. Here the burden of proving actual knowledge is placed on the IRS.[49] This should be contrasted with the standard, *did not know, and had no reason to know*, the burden of proving which is placed on the taxpayer. Apparently, the government was unwilling to let a spouse elect to limit liability where that spouse actually knew of the falsifications of the other spouse when she signed the return. However, the proof submitted by the government would apparently have to be substantial since actual knowledge is *not to be inferred* based on indications that the electing spouse had a reason to know.[50]

Example: A joint return is filed reflecting wage income of $150,000 allocable to the wife and $30,000 of self-employment income allocable to the husband. The IRS assesses a deficiency based upon $20,000 of unreported self-employment income of the husband resulting in a tax deficiency of $9,000. The IRS clearly proves that the wife knew of $5,000 of the husband's unreported income, but is unable to prove that she knew of the remaining $15,000. Here, the husband would, of course, be responsible for the entire tax deficiency. The wife would be responsible only for a deficiency based upon $5,000 of unreported income. The IRS thus could collect the deficiency based upon $5,000 from either spouse, but could collect the remainder of the deficiency only from the husband.[51]

3. Signing Under Duress with Actual Knowledge

Although a joint return is signed with actual knowledge of an understatement (or a portion thereof), the joint filer with such actual knowledge may nevertheless elect to limit liability if she can establish that the return was signed under duress.[52] Apparently, there was testimony before Congress that some spouses signed tax returns under duress, including physical duress.[53] However, joint filers that still wants to secure the benefits of limited liability on the basis that they were coerced into signing have the burden of proving the circumstances of the coercion.[54]

4. Transfers of Property to Avoid Tax

Congress also was concerned that the election to limit liability might in certain cases be inappropriately used. Accordingly, the new law contains provisions that come into play where a *disqualified asset* is transferred with a principal purpose to avoid tax or the payment of tax.[55] If such a transfer takes place, the portion of the tax deficiency for which an electing spouse would otherwise be responsible is increased by the value of the disqualified asset transferred to that spouse.[56] A disqualified asset is basically defined as any property or right to property where the principal purpose of its transfer was tax avoidance.[57] In this regard, there is a rebuttable presumption of tax avoidance where property is transferred within the one-year period preceding the date the IRS sends a proposed notice of deficiency notifying the taxpayer of his or her rights to administrative review by the IRS Office of Appeals.[58] This presumption against the taxpayer will not apply, however, to a transfer made within the foregoing one-year period where the transfer is pursuant to a court decree of divorce or maintenance, or a written instrument (e.g., a marital agreement) incident to such decree. Also, the presumption may be rebutted if the taxpayer electing to limit liability can demonstrate that the transfer did not have tax avoidance as its principal purpose.[59]

5. Other Restrictions on Election to Apportion Liability

An item otherwise allocable to a spouse under separate return allocation concepts, is required to be allocated to the other spouse filing the joint return to the extent the item gave rise to a tax benefit on the joint return to such other spouse.[60] Also, if an item is disallowed in its entirety solely because a separate return is filed, the disallowed item is disregarded and the item must be computed as if a joint return had been filed and then allocated between the spouses accordingly.[61] A similar rule is to apply for purposes of computing taxable social security.[62] Consequently, a base amount and an adjusted base amount will be allowed in the determination of the taxable portion of the social security without regard to the rule restricting the base amount for married taxpayers filing separately.[63] Finally, a child's tax liability included on a joint return is disregarded in computing separate liability, and is then to be allocated appropriately between the spouses.[64]

III. NOTICE REQUIREMENTS

Congress wanted to assure that taxpayers filing joint returns are properly notified of their rights to elect relief under the new law. Accordingly, notice is to appear in IRS Publication 1, dealing with taxpayer rights, and in collection-related notices sent to taxpayers.[65] Also, wherever practicable, the IRS is required to send any notice relating to a joint return separately to each individual filing the joint return.[66] Further, the Tax Court is to establish rules that provide the individual filing a joint return but not electing to seek relief under the new law with adequate notice and an opportunity to become a party to the Tax Court proceeding.[67] Finally, the IRS is required to issue regulations providing for an individual who has filed a joint return to have notice of, and an opportunity to participate in, any administrative proceeding with respect to an election to seek innocent spouse relief by the other individual filing the joint return.[68]

IV. TAX COURT REVIEW

If the IRS denies an individual's request for general relief or a request to limit liability, the individual is given the right to petition the Tax Court to determine the appropriate relief available to the individual.[69]

A. FILING THE PETITION

A petition to the Tax Court must be made within a 90-day period beginning when the IRS mails, by certified or registered mail, a notice to such individual of the IRS's determination of the relief available to the individual, if any. However, an individual may file the petition at any time within 6 months after filing an election seeking relief and before the close of the aforesaid 90-day period.[70] Accordingly, the taxpayer need not wait until receiving a determination from the IRS, and can petition the Tax Court immediately after filing an election seeking relief. As noted, an election seeking relief is made on Form 8857.

B. COLLECTION ACTIVITIES SUSPENDED

Apart from situations where a taxpayer is about to leave the United States, remove assets therefrom, about to conceal herself or her property, or collecting the tax would be jeopardized by delay,[71] the IRS is prohibited from levying or proceeding in court to collect any assessment until the expiration of the 90-day period, or if a petition has been filed with the Tax Court, until a decision of the Tax Court has become final. However, the IRS may require a bond to stay collection.[72]

C. ENJOINDER OF COLLECTION ACTIVITIES

Despite restrictions on lawsuits initiated to obtain a restraining order against the IRS on assessment or collection,[73] where the IRS attempts collection activities within the restricted time period just noted, a proceeding to enjoin collection activities against the IRS may be brought in any proper court, including the Tax Court. However, the Tax Court is given jurisdiction to enjoin collection only where a petition to the Court has been timely filed, and then only to the extent of the amount of the assessment with respect to which the taxpayer is seeking innocent spouse relief.[74]

D. SUSPENSION OF STATUTE OF LIMITATIONS

During the period of time the IRS is prohibited from collecting by levy or by court proceeding, as a result of the filing of a petition in Tax Court, the statute of limitations on collection of an assessment is suspended, and for 60 days thereafter.

E. REFUNDS CAN BE ORDERED BY TAX COURT

The Tax Court is a forum to get a hearing without first paying additional taxes assessed by the IRS. Consequently, a taxpayer seeking a refund of taxes already paid had to proceed in a United States District Court or the United States Court of Federal Claims. Now, however, with certain exceptions, the Tax Court is authorized to grant refunds to the extent applicable to the new innocent spouse rules.[75]

F. RES JUDICATA

A taxpayer may have participated in a Tax Court proceeding with respect to a particular taxable year, but made no claim for innocent spouse relief. If that is the case, the taxpayer cannot come back into Tax Court and attempt to adjudicate the issues all over again under the pretext of now seeking innocent spouse relief. The decision of the Tax Court will be conclusive as to matters determined, except with respect to the qualification of such taxpayer for innocent spouse relief that was not at issue in the prior proceeding. Nevertheless, a spouse will be precluded from seeking innocent spouse relief in a Tax Court proceeding if she participated *meaningfully* in a prior Tax Court proceeding, even if no claim for innocent spouse relief was raised in the prior proceeding.[76]

G. TRANSFER OF JURISDICTION

If a suit for refund is initiated by either party filing a joint return, the Tax Court loses jurisdiction to the extent jurisdiction is acquired by a District Court or the United States Court of Federal Claims over the taxable years that are the subject of the suit for refund. The court acquiring jurisdiction will then have jurisdiction over the petition filed in Tax Court seeking innocent spouse relief. Accordingly, the court in which the refund claim is filed would then determine whether a spouse is entitled to innocent spouse relief in considering the refund claim.

V. EQUITABLE RELIEF

By the terms of the new law, in order to qualify for relief under both the general relief and limited liability provisions, there must be either a proposed or assessed *deficiency* – i.e. an understatement of tax. Accordingly, relief under these provisions is not available where the tax return was correct and showed an amount as owing, but such amount had not been paid. The reason is that the failure to pay a tax liability that is accurately reported on a return is technically not an understatement of tax. In order to cover this situation, and possibly other situations where relief is not available under either the general relief or limited liability provisions, Congress gave the IRS authority to relieve a taxpayer of liability for *any unpaid tax* or *any deficiency*, or any portion of either, and the taxpayer is able to demonstrate that, under all of the facts and circumstances, it would be *inequitable* to hold her liable.[77]

According to the Conference Report on the new law, equitable relief should be "available to a spouse that does not know, and had no reason to know, that funds intended for the payment of tax were instead taken by the other spouse for such other spouse's benefit." The Conference Report goes on to provide that the IRS use its authority to grant equitable relief "where, taking into account all the facts and circumstances, it is inequitable to hold an individual liable for all or a part of any unpaid tax or deficiency arising from a joint return. The conferees intend that relief be available where there is both an understatement and an underpayment of tax."[78] Equitable relief may be granted only by the IRS since the Tax Court is given authority to review only denials of general relief or limited liability relief.[79] However, in a recent case, the Tax Court concluded that it had jurisdiction to review a request for equitable relief where the taxpayer made the required election and timely filed a petition with the Tax Court. The Tax Court rejected the IRS's argument that the court lacked jurisdiction to grant equitable relief "because the granting of equitable relief is discretionary."[80]

Since the requirements that must be met for obtaining equitable relief were not clear, the IRS issued some interim guidance shortly after enactment of the new law.[81] The interim rules have now been superseded by a permanent revenue procedure, as mentioned earlier. The new revenue procedure sets forth (i) general eligibility rules that must be met for equitable relief, (ii) circumstances under which equitable relief will *ordinarily* be granted (only available for taxes shown on a return and unpaid), and (iii) circumstances under which general relief will be granted where the taxpayer does not qualify under clause ii, and where under all the facts and circumstances it would be inequitable to hold the taxpayer responsible. This clause covers both unpaid liability shown on return and a deficiency. However, equitable relief is available for a deficiency only if the

taxpayer does not qualify for general or limited liability relief. This possibility, which is extremely limited, will be further explained below.

A. GENERAL ELIGIBILITY RULES

The threshold conditions that must all be met for equitable relief are:

1. A joint return was filed for the taxable year by the party seeking relief with respect to such year,
2. Neither general relief nor limited liability relief is available,
3. Relief is applied for within two years after the IRS's first collection efforts after July 22, 1998,
4. The liability remains unpaid (apparently, this includes both an unpaid amount shown on a return and an understatement of tax),
5. There was no fraudulent transfer of assets between the spouses signing the joint return,
6. There were no disqualified assets transferred to the spouse requesting relief by the spouse not requesting relief (if such assets were transferred, equitable relief is available only to the extent that the liability exceeds the value of the disqualified assets), and
7. The requesting spouse did not file the return with fraudulent intent.

B. CONDITIONS UNDER WHICH EQUITABLE RELIEF WILL ORDINARILY BE GIVEN

This option is available only where a liability reported on a joint return is unpaid. According to the revenue procedure, relief will *ordinarily* be granted if *all* of the following conditions are met:

1. At the time equitable relief is requested, the spouse asking for relief is no longer married to, is legally separated from, or has not been a member of the same household as the spouse not requesting relief at any time during the 12-month period preceding the date relief was requested.
2. At the time the return was signed, the spouse asking for relief had no knowledge or reason to know that the tax shown as due on the return would not be paid. In this regard, the taxpayer asking for relief must establish that it was reasonable for her to believe that her spouse would pay the reported liability. Partial relief is possible where the requesting spouse can only establish that she had no knowledge or reason to know that the her spouse would pay only part of the reported liability.
3. The spouse asking for relief can show that she will suffer economic hardship if relief is not granted.[82]

Relief under this provision is subject to certain limitations: (a) If the return has been adjusted to reflect an understatement, relief will be available only to the extent of the liability shown on the return prior to adjustment, and (b) relief will only be available to the extent the unpaid liability is allocable to the spouse not requesting relief.

C. OTHER CIRCUMSTANCES WHERE EQUITABLE RELIEF MAY BE GRANTED

A spouse may not meet the requirements where relief would ordinarily be given. She may not, for example, be divorced, legally separated or living apart from her husband, or there is an understatement of tax (deficiency). As noted, the situation where relief would ordinarily be given is applicable only where there is a liability reported on a return that is unpaid. Nevertheless, equitable relief may be available if based upon all the facts and circumstances, it would be inequitable to hold the requesting spouse liable for all or a part of the unpaid liability or deficiency. Here, the revenue procedure presents a list of positive and negative factors that the IRS will take into account, and weigh, in determining whether full or partial equitable relief should be granted. No single factor is determinative and the factors listed are not necessarily all that the IRS will consider.

Factors weighing in favor of relief are:

1. The requesting spouse is divorced, legally separated or living apart from the non-requesting spouse.
2. The requesting spouse would suffer economic hardship if relief is not granted.
3. The requesting spouse was abused by the non-requesting spouse, but not sufficiently for the abuse to amount to duress. If the abuse is so severe as to amount to duress, a joint return will not be considered as filed.
4. The requesting spouse did not know and had no reason to know that the liability reported on the return would not be paid, and in the case of a deficiency, did not know and had no reason to know of the items giving rise to the deficiency.
5. The non-requesting spouse had a legal obligation, pursuant to a divorce decree or marital agreement to pay the outstanding obligation. However, this factor will not be considered if the requesting spouse knew at the time the decree was entered or the marital agreement signed that the amount would not be paid.
6. The liability from which relief is requested was solely attributable to the non-requesting spouse.

Factors weighing against relief are:

1. The unpaid liability or item that gave rise to the deficiency is attributable to the requesting spouse.
2. The requesting spouse knew or had reason to know of the item giving rise to the deficiency, or that the reported liability would be unpaid at the time she signed the return. According to the revenue procedure, this is an *extremely strong factor* weighing against relief. However, it may be appropriate in *limited situations* to grant relief where the requesting spouse knew or had reason to know that the liability would not be paid, and in *very limited situations* where the requesting spouse knew or had reason to know of an item giving rise to a deficiency.
3. The requesting spouse has benefited, beyond normal support, from the unpaid liability or items giving rise to the deficiency.[83]
4. The requesting spouse will not suffer economic hardship if relief is not granted.
5. The requesting spouse has not made a good faith effort to comply with the tax laws for years following the year or years for which relief is requested.
6. The requesting spouse has a legal obligation to pay the liability pursuant to a divorce decree or martial agreement.

A spouse does not qualify for general relief if she knew or had reason to know of an understatement at the time she signed the return. Also, if a spouse had *actual knowledge* of an understatement at the time she signed the return, she does not qualify to limit liability. The failure to qualify under either of those two provisions, however, opens the door to equitable relief under very limited circumstances. For example, if a spouse in fact knows of falsifications, but is abused, it seems possible that she might have an escape hatch under the equitable relief provision. Also, under the same rationale, an abused spouse who knew that a liability shown on a return would not be paid may qualify for equitable relief. Other possible situations might include dementia or mental illness. In such cases, a person may know something, but otherwise may not have the cognizance to fully understand the implications.

A request for equitable relief must be timely filed and Form 8857 may be used for this purpose. If a person has filed for general relief or to limit liability, and it is determined by the IRS that no relief or only partial relief is available, the IRS will consider whether equitable relief is available for the portion of the liability for which general or limited liability relief is not granted. A subsequent filing of another Form 8857 is not necessary. The new revenue procedure became effective on January 18, 2000.

VI. CONCLUSION

The prior rules for obtaining innocent spouse relief were quite complex. As can be seen, the new rules are likewise complex. However, the new rules are clearly more favorable to taxpayers. For instance, the possibility of limiting liability under a separate return concept is new, as is the possibility of apportioned liability. The new rules are less restrictive in numerous other respects and should grant relief in situations where relief was not available under the old law. As of the date of the writing of this article, no temporary or permanent regulations have been issued on the new law. Due to the complexity of the new law, and that a determination one way or the other will often revolve around the particular facts and circumstances, taxpayers seeking innocent spouse relief would be well advised to retain competent counsel. As the new law ages, and cases start to come down from the courts, practitioners will have more background material with which to advise clients. As is the case with any new law, it takes time for clarification and parameters to be established.

The new innocent spouse rules, and other pro-taxpayer rules, came about as a result of the considerable criticism leveled against the IRS in recent years. In this context, the IRS has been trying to change its image and has been advertising itself as new and friendlier. Hopefully, the IRS will be friendly in granting innocent spouse relief under the new rules, and especially in exercising its discretion in granting equitable relief. For those who have dealt with IRS collection personnel, however, a raised eyebrow is in order.

ENDNOTES

[1] Tax Court Rule 142 generally places the burden of proof on the taxpayer. An IRS notice of deficiency is presumptively correct and the burden is on the taxpayer to prove otherwise (Welch v. Helvering, 299 U.S. 111 (1933)). In addition to rebutting the presumption, the taxpayer must show the merits of his or her position by a preponderance of the evidence (Danville Plywood Corp. v Comm'r, 16 Cl. Ct. 584, 1989 U.S. Cl.Ct. LEXIS 47 (1989).

[2] There are a number of Internal Revenue Code sections that expressly place the burden of proof on the government. Some examples, but not an all inclusive listing, are fraud (I.R.C. §§ 7422(e) and 7454(a)), transferee liability (I.R.C. § 6902(a)), unreasonable accumulation of earnings and profits (I.R.C. § 534), disallowance of illegal bribes, kickbacks and other payments (I.R.C. §162(c)(1)), and income tax preparer's penalty (I.R.C. § 7427). All references herein to "I.R.C." are to the Internal Revenue Code of 1986, as amended. In addition, the IRS Restructuring and Reform Act of 1998 (Pub. L. 105-206, 112 Stat. 742) added a new section, I.R.C. § 7491, that shifts the burden of proof in court proceedings where an issue of fact is in dispute. The conditions that must be met in order to shift the burden of proof are quite technical and beyond the scope of this paper. The new code section may turn out to be of little or no advantage to taxpayers -- despite being billed by the government as a major pro-taxpayer advantage -- due to the tough standards that must be met to shift the burden of proof, the uncertainty of their application and additional costs that might be incurred.

[3] I.R.C. § 6013(d)(3) (2000).

[4] Sonnenborn v. Comm'r, 57 T.C. 373, 381 (1971).

[5] Federal bankruptcy law permits a discharge for federal, state or local taxes, if a return was filed, due more than three years before filing a bankruptcy petition, unless fraud or willful evasion is shown. 11 U.S.C. § 523(a)(7)(b) (2000). If a return is filed late, taxes more than three years old may be discharged provided the late return is filed more than two years before the filing of the bankruptcy petition. No discharge is permitted for any tax required to be collected or withheld. 11 U.S.C. §§ 523(a)(1)(A) & 507(a)(7)(C). *See also* United States v. Sotelo Et Ux, 436 U.S. 268 (1978).

[6] I.R.C. § 6013(e). This section was enacted in 1971 (Pub. L. No. 91-679, 84 Stat. 2063).

[7] According to testimony presented before Congress, innocent spouse relief was only "theoretically" available because it was extremely difficult for the standards for such relief to be met. "In fact there are some 50,000 women, generally ex-spouses, who are caught up in this 100-percent responsibility for a tax return." Senate Floor Debate for Amendment No. 2369 (144 CONG. REC. 56, S4473 (1998)).

[8] I.R.C. § 6015. Added by Internal Revenue Service Restructuring and Reform Act of 1998 (Pub. L. 105-206, 112 Stat. 742). The Act removed the prior code section dealing with innocent spouse relief, I.R.C. § 6013(e).

[9] For a detailed analysis of the prior rules, *see* Martin H. Zern, *The Innocent Spouse: Apppeals Courts Endorse Pro-Taxpayer Standard*, Journal of Legal Studies in Business, Volume 5, Number 2 (1997).

[10] David Cay Johnston, *With Law Change, Innocent Spouse Claims Flood IRS*, New York Times, 12-29-99, p.1.

[11] Rev. Proc. 2000-15, 2000-5 I.R.B. 447, 2000 IRB LEXIS 17. The new procedure is effective on January 18, 2000 and supercedes Notice 98-61, 1998-51 I.R.B. 13 (1998).

[12] The new law defers to I.R.C. § 6662(d)(2)(A) for a definition of *understatement* (I.R.C. § 6015(b)(3)). The former section defines an *understatement* as the excess of the amount of the tax required to be shown on a return for the taxable year over the amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211(b)(2)).

[13] Under the prior law, there was relief only if the understatement of tax was attributable to a *grossly* erroneous item. A grossly erroneous item was defined as *any* item of gross income of a spouse which was omitted from gross income, and any claim for a deduction, credit or tax basis by a spouse for which there is no basis in fact or law. The taxpayer seeking relief had the difficult burden of proving that the item had no basis in fact or law. Also there was a threshold that denied relief unless the understatement of tax exceeded the greater of $500 or a specified percentage of the innocent spouse's adjusted gross income for the most recent taxable year. The new law eliminates all of the thresholds and provides that the understatement be attributable only to an erroneous item, and not a grossly erroneous item. Thus, the taxpayer seeking releif no longer has to show that the deduction, etc., had no basis in fact or law.

[14] To avoid awkward references to *he or she* or *him or her*, pronoun references will be to *she* or *her* since it is predominantly the wife (or ex-wife) who is seeking innocent spouse relief.

[15] I.R.C. § 6015 (b)(1) (2000).

[16] The election applies to all unpaid taxes under subtitle A of the Internal Revenue Code including the income tax and the self-employment tax. S. REP. NO. 105-174, 105th Congress, 2d Sess. (1998).

[17] I.R.C. § 6015 (b)(1)(E) (2000).

[18] There is a transitional rule applicable where collection efforts began prior to the effective date of the new law (July 22, 1998). In such case, the two-year period does not expire until two years after collection efforts that have occurred after such effective date. H.R. CONF. REP. NO. 105-599, 105th Congress, 2d Sess. (1998).

[19] S. REP. NO. 105-174, 105th Congress, 2d Sess. (1998).

[20] *See* General Instructions to Form 8857.

[21] In a recent Electronic Dispatch, the IRS identified the most frequent reasons why it could not timely process 15,500 of the 73,777 Forms 8857 submitted to it between March of 1999 and March of 2000: (1) the collection statute of limitations has already expired, (2) the taxpayer was an "injured spouse" and should have filed Form 8379 (Injured Spouse Claim and Allocation) instead, (3) the requesting spouse did not file a joint federal tax return for the year relief was requested, (4) incomplete information was submitted and the requesting spouse did not respond to IRS requests for additional data, and (5) the year for which relief was requested was not properly identified.

[22] Anderson v. Commissioner, T.C. Memo. 1984-82 (1984).

[23] Hickey v. Commissioner, T.C. Memo. 1955-149 (1955).

[24] Evans v. Commissioner, T.C. Memo. 1982-700 (1982).

[25] Wiksell v. Commissioner, 90 F.3d 1459 (9th Cir. 1997).

[26] I.R.C. § 6015(b)(2) (2000).

[27] *See* Hayman v. Comm'r, 992 F.2d 1256 (2d Cir. 1993); Erdahl v. Comm'r, 930 F.2d 585 (8th Cir. 1991).

[28] *See* Stevens v. Comm'r, 872 F.2d 1499 (11th Cir. 1989) (pro government decision). *Cf* Price v. Comm'r, 887 F.2d 959 (9th Cir. 1989), Erdahl v. Comm'r, 930 F.2d 585 (8th Cir. 1991) and Friedman v. Comm'r, 53 F.3d 523 (2d Cir. 1995) (pro taxpayer decisions).

[29] Price v. Comm'r, 887 F.2d 959 (9th Cir. 1989).

[30] Friedman v. Comm'r, 53 F.3d 523 (2d Cir. 1995). *Also see* Erdahl v. Comm'r, 930 F.2d 585 (8th Cir. 1991).

[31] Hayman v. Comm'r, 992 F.2d 1256 (2d Cir. 1993).

[32] I.R.C. § 6015(c) (2000).

[33] I.R.C. § 6015(c)(2) (2000).

[34] I.R.C. § 6015(d)(3)(A) (2000).

[35] S. REP. NO. 105-174, 105th Congress, 2d Sess. (1998).

[36] *Id.*

[37] *Id.*

[38] *Id.*

[39] I.R.C. § 6015(d)(3)(C) (2000).

[40] I.R.C. § 6015(g)(1) (2000).

[41] A person is considered no longer married if widowed. H.R. CONF. REP. NO. 105-599, 105th Congress, 2d Sess. (1998).

[42] H.R. CONF. REP. NO. 105-599, 105th Congress, 2d Sess. (1998).

[43] *Id.*

[44] I.R.C. § 6015(d)(2) (2000).

[45] H.R. CONF. REP. NO. 105-599, 105th Congress, 2d Sess. (1998).

[46] I.R.C. § 6015(c)(1) (2000).

[47] *See* General Instructions to Form 8857.

[48] I.R.C. § 6015(c)(3)(B) (2000).

[49] I.R.C. § 6015(c)(3)(C) (2000).

[50] S. REP. NO. 105-174, 105th Congress, 2d Sess. (1998).

[51] *Id.*

[52] I.R.C. § 6015(c)(3)(C) (2000).

[53] Senate Floor Debate for Amendment No. 2369 (144 CONG. REC. 56, S4473 (1998)).

[54] *Id.*

[55] I.R.C. § 6015(c)(4) (2000).

[56] I.R.C. § 6015(c)(4)(A) (2000).

[57] I.R.C. § 6015(c)(4)(B)(i) (2000).

[58] I.R.C. § 6015(c)(4)(B)(ii)(I) (2000).

[59] I.R.C. § 6015(c)(4)(B)(ii)(II) (2000).

[60] I.R.C. § 6015(d)(3)(B) (2000). There was no example in the Congressional Committee Reports as to how this rule operates. An example, however, might be the recovery by a divorced spouse in a negligence action of medical expenses she incurred that were previously deducted on a joint return. Since her husband received an equal tax benefit by the deduction, the income to be picked

up as a result of the recovery of the tax benefit arguably should be allocated partly to her ex-husband.

[61] For example, provisions requiring the filing of a joint return in order to claim a credit, such as the dependent care credit, credit for the elderly and permanently disabled, adoption credit, Hope and learning credit, and earned income credit would not apply in computing separate tax liability. The deduction for interest on an education loan would be an example of a rule disallowing a deduction that would not apply. S. REP. NO. 105-174, 105th Congress, 2d Sess. (1998).

[62] I.R.C. § 6015(d)(4) (2000).

[63] S. REP. NO. 105-174, 105th Congress, 2d Sess. (1998).

[64] I.R.C. § 6015(d)(5) (2000).

[65] Act Sec. 3501(b), Pub. L. 105-206, 112 Stat. 742.

[66] Act Sec. 3501(d), Pub. L. 105-206, 112 Stat. 742.

[67] I.R.C. § 6015(e)(4) (2000). In this regard, *see* Thomas Corson, 114 T.C. No. 24 (2000), where the Court held that a nonelecting spouse should have the opportunity to litigate a decision by the IRS to grant relief from joint and several liability to the electing spouse.

[68] I.R.C. § 6015(g)(2) (2000).

[69] I.R.C. § 6015(e) (2000).

[70] I.R.C. § 6015(e)(1)(A) (2000

[71] I.R.C. §§ 6851 and 6861 (2000).

[72] I.R.C. § 6015(e)(1)(B)(i) (2000).

[73] I.R.C. § 7421 (2000).

[74] I.R.C. § 6015(e)(1)(B)(ii) (2000).

[75] I.R.C. § 6015(e)(3)(A) (2000).

[76] I.R.C. § 6015(e)(3)(B) (2000).

[77] I.R.C. § 6015(f) (2000).

[78] H.R. CONF. REP. NO. 105-599, 105th Congress, 2d Sess. (1998).

[79] I.R.C. §§ 6015(e) and 6015(f) (2000).

[80] Fernandez v. Comm'r, 114 T.C. No. 21 (2000).

[81] Notice 98-61, 1998-51 I.R.B. 13 (1998).

[82] The revenue procedure refers to Treasury Regulation § 301.6343-1(b)(4) for rules delineating economic hardship.

[83] According to the Internal Revenue Manual, the term "benefit" is something beyond ordinary support. Accordingly, a spouse would benefit if omitted income sustained a higher living standard than would be possible without the omitted income. The Manual goes into specifics, such as gifts of jewelry and furs, and goes on to list situations where the spouse, perhaps obviously, does not benefit. For example, the Manual states that a spouse would not benefit if the other spouse used the omitted income for: supporting an extramarital affair, gambling, benefiting third person, purchasing assets not held jointly or for joint benefit and maintaining a separate bank account or otherwise accumulating caches of money without the spouse's knowledge. Internal Revenue Manual 45 (11) (20).

POLITICAL DEBATES ON PUBLIC TELEVISION: THE FORBES CASE

by

Robert Wiener*

I. Introduction

Televised political debates, especially in races for higher office, are common in the United States. Debates are not constitutionally required,[1] but voters expect to see candidates tested against each other.[2] Technology has changed the way political campaigns are conducted with television playing an ever more important role. If a televised debate take place, who has a right to participate? If a private television station or organization[3] sponsors the debate, it is governed only by legislation.[4] However, if the debate is sponsored by a public television station, the United States Constitution, specifically the freedom of speech clause of the First Amendment, may apply.[5] The case of Arkansas Educational Television Commission v. Ralph P. Forbes confronts this issue.

II. The Story

Ralph Forbes, a self-proclaimed Christian Supremacist, member of the American Nazi Party, and speaker at Klan rallies, collected the signatures of more than 2,000 voters from an Arkansas congressional district in 1992.[6] He thereby qualified to be on the ballot for his run as an independent candidate for a seat in the House of Representatives as an independent candidate. The five-station Arkansas Educational Television Network (AETN), owned by the Arkansas Educational Television Commission (AETC), sponsored a series of one-hour candidates debates, but only invited the Democratic and Republican candidates to participate. Forbes asked to be included, but was refused.[7] AETC based its decisions on its judgment that be was not a "viable" candidate or "newsworthy".[8] Forbes sued the AETC, but the District Court Decided against him[9] and he did not participate in the debate.

In the election, Forhes won 2.5 percent of the vote. The winning margin was 3 percent.[10] Forbes appealed the District Court decision and, in August 1996, the Court of Appeals for the Eighth Circuit found for Forbes on First Amendment grounds.[11] The United States Supreme Court decided the case in 1998.[12]

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II. Freedom of Speech

The United States Constitution governs when state state action is involved.[13] A public television station is a state actor, so the constitution applies here. Forhes and the AETC argued the case on First Amendment grounds.

Several freedom of speech issues are raised by this case. Why protect speech? Is freedom of speech absolute? If not, how much legal protection does free speech get? Is all speech treated alike or are some kinds of speech entitled to greater protection? If so, how much?

Concerning political debates, do all candidates for political office have a legal right to be included in all political debates for that office? What if the candidate has qualified to be on the ballot? Are only the two major parties entitled to debate? Do the politics of the candidates matter? Do the preliminary polls, that is, the projected support at election time matter? Does money raised by a candidate matter? If minority candidates are kept out of debates does that constitute unconstitutional censorship? If a candidate's viewpoints are considered reprehensible do they have less of a right to speak? What if a third party candidate is ahead in the polls of one of the two major party candidates?[14] Does the forum matter, that is, if the debate is in print, radio, television, or the Internet?

Does the issue of political debates on public television also concern freedom of the press? The freedom of speech clause of the First Amendment states that "Congress shall make no law ... abridging the freedom of speech...."[15] But the First Amendment also has a freedom of the press component, "Congress shall make no law ... abridging the freedom ... of the press..."?[16] Does the press have a protected freedom to hold debates between candidates of its choice? Is that freedom more restricted if the press is public? Is television "the press"? If there a conflict between the candidate's freedom of speech and the press's freedom of the press[17] how is it resolved? These are questions that the Supreme Court chose not to discuss. Rather, it spoke exclusively in freedom of speech terms, both for the candidate and the public television station.

III. First Amendment Theory

To better understand this case, it is helpful to first consider the philosophy and history of the First Amendment.

A. Absolutist vs. Codified English Law

The freedom of speech clause of the First Amendment reads "Congress sball make no law ... abridging the freedom of speech...."[18] On the face of it, it is unambiguous. Some have suggested that its appropriate reading is absolutist, that Congress shall make no such law. This interpretation would forbid any governmental restriction on speech. Then what of the passing of government military secrets to an enemy?[19] Or the use of the words of another without permission?[20] And is this clause limited congressional acts or is it extended to other legislative bodies and the executive and judicial branches? What of common law actions for defamation? Or shouting "Fire!" falsely in a crowded theater?[21] An absolutist reading would have results both too broad in terms of the speech allowed and too narrow in terms of the political institutions covered.

An alternative reading is to understand the First Amendment as a codification of the English law of its time of the First Amendment.[22] If so, only previous restraints by the government would be prohibited.[23] However, the Supreme Court has decided that post-publication penalties are banned by the First Amendment.[24]

B. Why Protect Speech?

As is true of its companion amendments in the Bill of Rights, the open texture of the words of the First Amendment lends itself to interpretation. Although the point is still debated, the prevailing jurisprudence of constitutional interpretation applauds the opportunity for the Constitution to develop over time,[25] rather than being restricted to the original intent of its authors.[26]

Therefore, to determine the meaning of the First Amendment, courts have asked the question, "Why protect speech?" What is the objective of freedom of speech? If we know our objective, they suggest, we will better know how to get there. In recent cases, courts have considered two theories.

Under the instrumental theory presented by Alexander Meikeljohn, government restriction of speech is seen as interference with the free flow of information preventing the public from making informed democratic choices.[27] This interpretation focuses on the listener's right to listen. This is the theory reflected in the opinions of Justices Holmes and Brandeis promoting a free market in ideas. As the court stated it more recently, "It is of particular importance that candidates have the opportunity to make their views known so that the electorate may intelligently evaluate the candidates' personal qualities and their positions on vital public issues before choosing among them on election day."[28]

The dignitary theory advanced by Tom Emerson considers self-expression to be an essential component of human dignity.[29] This theory focuses on the speaker's right to speak, that is, on the speaker's freedom of speech, rather than the listener's freedom to listen.

The instrumental theory is the more commonly used approacb in First Amendment cases, but little is made of traditional freedom of speech theory in the Forbes case. The dignitary theory is not directly discussed and neither the majority nor the dissent consider Forbes's right to speak. There is some concern in the dissent as to Forbe's right to speak compared to other candidates who are permitted to participate in debates. But this is a relative right to speak rather than a constitutional freedom of

speech. The instrumental theory seems to underlie Justice Stevens's concern in "government censorship and propaganda."[30]

IV. Freedom of Speech Cases

A. Holmes-Brandeis

A Supreme Court approach to interpretation and application of the freedom of speech clause has developed in a series of opinions by Holmes and Brandeis. This line of analysis began as dissenting opinions in the 1920s and was later adopted by the Supreme Court.[31] It is premised on the understanding that freedom of speech is not absolute, but may be restricted by the government. However, government may not censor political speech merely because it disagrees with a speaker's viewpoint.[32] This is capitalist economic theory applied to constitutional political theory – Holmes's notion of "free trade in ideas."[33]

Government may restrict the content of speech, but only if it has a high interest in the speech.[34] This state interest must be compelling. For the state to act on its compelling interest there must also be an extremely close causal connection between the speech and the anticipated harm[35] such that state action is necessary. Even then, that state action must be drawn as narrowly as possible, the least restrictive alternative, so as not to restrict permitted speech. In other words, government censorship is not constitutional if a less limiting action is possible. This judicial content based analysis of abridging of freedom of speech by a court is called strict scrutiny.[36]

B. Content Analysis

The Supreme Court has made a distinction between content-based and content-neutral governmental restrictions on freedom of speech. If the content of governmental regulations of the time, place, manner of speech is neutral, for example parade permit statutes,[37] it will receive a somewhat more relaxed scrutiny.[38]

Applying First Amendment content analysis to Turner Broadcasting television case,[39] the Supreme Court decided by a 5-4 majority that a content neutral regulation requiring cable companies to carry public television stations, "may treat categories of speakers differently without being labeled content-based as long as little risk exists that the regulation will be used to control what the speakers say."[40] The distinction between content neutral and content based regulations is crucial to the outcome of a case. Content based regulations are mucb more likely to be found unconstitutional.

C. Forum Classification

The Supreme Court has developed a hierarchy of protection of speech from governmental restrictions based on the nature of the forum. Those forums which are considered more traditionally open to public debate receive a higher degree of judicial scrutiny. Forum classification was adopted over the objections of Justice Brennan who would have granted strict scrutiny protection from state action to all protected speech regardless of the forum.[41]

The Court classifies a forum, in order of decreasing constitutional speecb protection, as (1) a traditional public forum, (2) a limited public forum, or (3) a non-public forum.

1. Traditional public forum

A traditional public forum is a place where the public would be traditionally welcome to speak. In a traditional public forum abridgment of speech is permitted only if it is necessary to serve a compelling state interest and if the restriction is narrowly drawn to achieve that end. This is a strict scrutiny test. Courts will scrutinize closely the governmental restriction of speech and declare it constitutional only if it meets this test. In other words, government officials have very limited discretion to restrain the expression of ideas in traditionally public forums.

Even so, if the strict scrutiny test is passed, the state may so act. In the case of Davis v. Massachusetts[42] the United States Supreme Court followed a Massachusetts case opinion by Holmes.[43] A speaker on the Boston Commons was arrested for speaking without a permit. Holmes argued for absolute governmental power in this case. "[F]or the legislature absolutely or conditionally to forbid public speaking in a highway or public park is no more an infringement of the rights of a member of the public than for the owner of a private house to forbid it in his house."[44] In the past century, the judicial trend has been to increase the protection given to speakers. Since the Davis case, traditional public forum First Amendment protection has been provided to streets, parks, and other public places held by government.[45]

2. Limited public forum

Limited public forum is a term applied to typically non-public places which serve as public forums for limited times or for selected classes of persons.[46] For those limited times or persons, courts apply the traditional public forum test.[47] At other times or for persons not within the selected class, they are treated as non-public forums. Limited public forums include the opening of university facilities to student groups[48] and a municipal theater made available for theater productions.[49]

3. Non-public forum

A non-public forum is neither a traditional nor a limited public forum; that is, neither tradition nor designation makes it a forum for public communication.[50] Public property is not a public forum simply because it is governmental.[51] An example of a non-public forum is a public school mail system even if made available to a community organization.[52]

Speech in a non-public forum is still constitutionally protected, but to a mucb lesser degree. A rational basis or reasonableness test is used bere under whicb the state may regulate speecb as long as that regulation is reasonable and not merely content based censorship, an effort to suppress views opposed by public officials.[53] Judicial review in these cases is much more relaxed and courts typically defer to the state.

3. Application of Forum Classification

Forum designation is often outcome determinative. Governmental restrictions in traditional public forums are much more likely to be found unconstitutional than similar restrictions in non-traditional public forums. Once the forum is classified, the legal question is whether the appropriate standard has been properly applied.

V. Forbes Case

A. Choosing Up Sides

The Forbes case excited many to weigh in with *amicus curiae* briefs. The side choosing has resulted in some strange bedfellows. On the side of Ralph Forbes are the Greens/Green Party USA,[54] Perot '96,[55] Eugene McCarthy, the American Civil Liberties Union, and the Brennan Center for Justice.[56] The Rutherford Institute paid for Forbes's counsel.[57] On the side of AETC were the United States Justice Department, the Federal Communications Commission, the Commission on Presidential Debates,[58] the Corporation for Public Broadcasting, the Association of America's Public Television Stations, 20 states, and New York City.

B. Forum Classification

What is the appropriate forum classification for public television sponsored candidates' debates? The Eighth Circuit Court of Appeals in this case decided that it was a public forum.[59] The Eleventh Circuit, in a similar case, determined that, because it "was stated in order for candidates to express their views on campaign issues," it was "a limited-purpose public forum."[60] The Justice Department brief claimed that "Sponsorship by a state actor does not convert a news program into a public forum."[61] Kelly Shackelford, Forbes's counsel, argued "If a government-sponsored and -planned debate is not a limited public forum, one can only wonder what is."[62]

The Supreme Court recognized the important threshold nature of this question. "[I]t is instructive to ask whether public forum principles apply to the case at all."[63] The court began to discuss the public forum doctrine, but very shortly it was discussing the sui generis nature of journalism in general and television broadcasting in particular and became uninterested in forum classification. "In the case of television broadcasting, however, broad rights of access for outside speakers would be antithetical, as a general rule, to the discretion that stations and their editorial staff must exercise to fulfill their journalistic purpose and statutory obligations."[64] The court emphasized the need for deferring to the editorial discretion of broadcasters without really considering the constitution.[65] This seems to be a case of begging the question. The majority engaged in scrutiny far less than strict before it had even determined the type of forum involved and, therefore, the appropriate level of scrutiny.

Not surprisingly, the court eventually decided that the political debate on public television was a non-public forum.[66] Once this forum classification was made the end was in sight.

The notion that television is not a traditional public forum seems to result from the adoption of a narrow definition of tradition. The public square or town hall may have been the traditional forum for political debate at the time of the drafting of the First Amendment and the Lincoln-Douglas debates[67]. But our political tradition evolves and many years have passed since the televised Kennedy-Nixon debates.[68] Today, I believe, we would much more expect a televised debate for a congressional seat that than a non-broadcast debate in a "traditional" public space. If we don't grant the highest constitutional protection to political speech broadcast on our public airways through the auspices of a governmental agency, I fear for the protection of all speech.

The dissent took a step back from forum classification suggesting a more general issue, "whether AETC defined the contours of the debate forum with sufficient specificity to justify the exclusion of a ballot-qualified candidate."[69] Although the dissent seemed unhappy with forum analysis,[70] it did suggest that televised political debates are most like parade permits.[71] That would seem to imply limited-public forum analysis as with Ward.[72]

C. Public and Private Media

If it is all television, broadcast in the same way, why shouldn't public and private television be judged by the same standards?[73] Isn't this case best understood as one of applying journalistic standards[74] protected by the media's First Amendment freedom of speech?[75]

The Eighth Circuit did make a distinction between private and public television. Constitutional protection is not available unless there is state action. "[A] crucial fact here is that the people making this judgment were not ordinary journalists: they were employees of the government. The First Amendment exists to protect individuals, not government."[76] "A journalist employed by the government is still a government employee."[77] And, as the Forbes's brief argues, "if the broadcasters are state actors, the First Amendment precludes them from having unfettered journalistic discretion."[78]

The Supreme Court largely ignored this distinction, treating all broadcasters, public and private, alike.[79] By blurring such a distinction, the Court ignored the primacy of the Constitution.[80] Apparently it feared the slippery slope argument of unbridled speech, for it seemed unable to distinguish debate between political candidates from other forms of speech.[81]

The dissent expressed concern protection of public television presented "the risk of government censorship and propaganda in a way that protection of privately owned broadcasters does not."[82]

D. Speaker Selection

If speaker selection is restricted by the Constitution, what are the rules? How do public media decide who has a right to speak when?

1. Traditional Candidate Test

How important is our traditional two-party political system in this case? Should the candidates of the Democratic and Republican parties automatically participate in candidate debates and not others? After all, what chance do they have to win?[83] Or, as Perot '96 argued, is it true that "The whole point of a political campaign period is to allow candidates – through popular appeals, organizing, and debates – to change public opinion", not "self-perpetuating rule by Republicans and Democrats"?[84] The dissent found value in diversity of opinion quoting an earlier case that "political figures outside the two major parties have been fertile sources of new ideas and new programs; many of their challenges to the status quo have in time made their was into the political mainstream."[85]

2. Good Faith Test

Good faith has played a role in other constitutional law cases.[86] Should we rely on the good faith of the editor to determine our freedom of speech? The Court of Appeals argued that the good faith of the AETC is not sufficient.[87] The question should not be one of faith, but of action.

3. Content-Based Test

Alternatively, should we use the Turner Broadcasting content-based test, that is, content-based selection is unconstitutional, but selection on other grounds may not be? AETC agrees that "viewpoint discrimination" is unconstitutional[88] and there was no smoking gun in evidence rejecting Forbes because of his views, but how do we distinguish between keeping candidates out of a debate and keeping minority views from being heard?[89] How do we know whether candidate selection for a debate is content-based? This standard seems far to vague for even the Supreme Court to consider.

4. Rational Basis Test

We are left with a rational basis test as our final alternative. But if a rational basis test is used, on what basis can a rational decision be made? AETC's counsel argued for a test of whether a candidate was "newsworthy" enough to "best serve the interests of its viewers."[90] The AETC also argued for the "political viability" test. But the AETC seems to have really used the traditional candidate approach because it staged entire debates between majority candidates even when the outcome of the election was hardly in doubt.[91] Perhaps the majority parties should not be so sanguine about the results of this case for their candidate may not always be politically viable. The Court of Appeals argued that a decision in favor of Forbes is correct even if we assume the continuation of a predominantly two-party system. "If Mr. Forbes can be excluded today, a Republican or Democrat who is believed to have no chance of success could be excluded tomorrow."[92] "Political viability is a tricky concept. We should leave it to the voters at the polls, and to the professional judgment of nongovernmental journalists."[93] Furthermore, the Eighth Circuit observed that Ralph Forbes had, in fact, earned a plurality of the votes in the 1990 Arkansas Republican primary for lieutenant governor.[94]

The Eighth Circuit said that "The question of political viability is, indeed so subjective, so arguable, so susceptible of variation in individual opinion, as to provide no secure basis for the exercise of governmental power consistent with the First Amendment."[95]

Both the majority and the dissent in this case apparently felt that the rational basis/political viability test is the appropriate test. Where they differed, is in their analysis of the application of the test; that is, whether, in this case, an objective standard was used by AETC staff.[96] As characterized by Justice Stevens, the AETC decision was an "entirely subjective, ad hoc [judgment],"[97] whereas what was required was "narrow, objective, and definite standards."[98]

E. Competing Freedom of Speech Claims

Another argument raised here against Forbes is that of competing freedom of speech claims. If one speaker gets more freedom of speech, another speaker necessarily gets less. And if there are too speakers no one has an opportunity to engage in meaningful speech. In other words, does granting freedom of speech to all deny freedom of speech to all?

AETC claimed that its decision to exclude Forbes resulted in more speech for the only candidates with a chance of winning.[99] As argued by its counsel, Richard Marks in his brief, "If every candidate had a constitutional right to appear in a debate on public television, then public broadcasters would be flooded with requests for access".[100] The result would be a "cacophony" and no voice would be clearly heard.

The Eighth Circuit did not absolutely protect the right of minority candidates to be heard, but it questioned the exclusion of a candidate on the grounds used.[101] Forbes's counsel asserted that the "effect of AETC's approach is to exclude minority voices and viewpoints."[102] It argued for many voices quoting Judge Learned Hand that "right conclusions are more likely to be gathered out of a multitude of tongues, than through any kind of authoritative selection."[103]

The Supreme Court, concerned at the number of candidates on some ballots, was persuaded by AETC argument, even adopting the "cacophony" argument.[104] In fact, the court took it even a step further presenting the specter of absolute silence if the public broadcaster chose that a debate wasn't worth the bother.[105]

I believe that at best this is an example of an easy case making bad law. The perceived evil, too little speech for some, usually the majority candidates, gives more value to the speech of some candidates than other candidates. Perhaps unequal valuation of speech makes sense in some cases, to enable the voter to make a decision based on the speech of a limited number of candidates.[106] And I believe that the fear of dead air because of too many candidates is a bogey man. Even if this might happen in some case, this is not the feared hard case. There were only three candidates on the ballot for this office and televised debates of three candidates have been held for three presidential candidates[107] and for many more candidates in presidential primaries.[108]

The court's concerns as to having too many speakers in a debate in which no one is really heard could be answered either by the dissent's argument that objective standards simply be established in advance of the selection of debate participants. In practice, this anticipated problem would probably be resolved through legislation making access to the ballot increasingly difficult. That raises its own constitutional issues, but they have apparently been resolved.

Such an interpretation would preserve principle that not everyone has access to public media.[109] It might also result in movement to further limit access to the ballot by increasing the signature requirements for candidacy on the ballot. But decisions on those potential cases will be left to another day.

Does the broadcaster have freedom of speech claims as well? The court asserted that "[w]hen a public broadcaster exercises editorial discretion in the selection and presentation of its programming, it engages in speech activity"[110] which apparently is seen as at least as deserving of First Amendment protection as the political speech of a candidates' debate.[111] The court's starting point is one of lack of access to the public press. "[I]n most cases, the First Amendment of its own force does not compel public broadcasters to allow third parties access to their programming."[112] Candidate debates are then presented as "the narrow exception to the rule" that "public broadcasting as a general matter does not lend itself to scrutiny under the forum doctrine."[113] At first it seems pretty innocuous – at least debates get some scrutiny. However, by putting debates in the category of the exception to the rule, Forbes had to play catch-up to prove his exceptional status, rather than having burden on AETC justify its limitation of speech.

The dissent also accepts broad journalistic discretion, just not quite as broad as the majority. Its primary concern is that here there is "nearly limitless discretion."[114] It appears that just a little less discretion would have been fine.

The court, by finding freedom of speech claims for majority candidates and broadcasters denied freedom of speech to the only two parties who really needed it, Forbes and the voters.

F. Effects of Decision

What does the Supreme Court decision mean for political debates on public television?[115] Perhaps it does mean that public television would be more likely to sponsor political debates.[116] They'll certainly be able to ignore marginal candidates such as Forbes. They will avoid the fear that if the Court of Appeals ruling had been followed, it might have been extended to public television news programs.[117] The concern of the Supreme Court seems to have been that to recognize a constitutionally protected right to freedom of speech by minority party candidates is to embark on a slippery slope that may have repercussions far beyond candidate debates.[118]

If the court had kept its eyes on the ball and decided the case before it on its merits, rather than being distracted by possible ramifications of its decision, it would have done a better job. A judicially acceptable selection standard could have been used to choose participating candidates. Or public television might restrict itself to covering "bona fide news events,"[119] perhaps including broadcasts of privately sponsored political debates.[120]

VI. Conclusion

The United States Supreme Court decision was not a foregone conclusion. As Justice Kennedy stated in his opinion, the court granted a *writ of certiorari* for this case, not only because of its constitutional and practical significance, but also because of a split in the Circuit Courts of Appeal. The Eleventh Circuit had decided for a public television commission, the Georgia Public Telecommunications Commission[121] on similar facts.

This decision does danger to the fabric of constitutional law in general and the First Amendment in particular. As discussed above, it blurs the line between public and private action, as the dissent notes[122] and cheapens the value of freedom of speech by deciding that everyone has it, but the more powerful just have more of it.

But the most disappointing aspect of this case is the dissenting opinion. Even if the dissenting opinion[123] had been adopted by the majority of the court, the impact of this case on constitutional law would not have been significantly different. The dissenters disagreed more on the application of the constitutional principles[124] than on what the basic appropriate principles are.[125] The result of this particular case would have been different, but the bar of constitutional judicial review would have been set only a little bit higher.[126]

The dissent here accepts that the forum is non-public and apparently uses the weakest form of judicial review available in these cases, the rational basis test. Their question is more of whether the standards that would have been applied to a private television station have been met, rather than whether the standards for public television stations governed by the United States Constitution should be stronger.[127]

This shortcoming is most apparent in Justice Stevens's misquoting of the Court of Appeals opinion. Whereas Richard S. Arnold, Chief Judge of the Eighth Circuit, made a sweeping statement rejecting a "political viability" test as constitutional under the First Amendment,[128] Justice Stevens referred to the statement as referring only to "the staff's appraisal of 'political viability.'"[129] This misuse of Judge Arnold's opinion is the equivalent of plagiarism in that both involve false attributions. The distinction between Judge Arnold's words and Justice Stevens's words is crucial. It is the difference between testing each individual candidate who has qualified for a place on the election day ballot under the relevant legislation of the political unit for political viability and rejecting such a test completely. The dissent, sadly, opted for the case-by-case approach.[130]

What is perhaps most strange is that, after this decision, federal legislation governing political debates sponsored by private broadcasters may well protect a minority candidate's freedom of speech better than the First Amendment. If this meant that speech is receiving super-constitutional rights by legislation, that would be one thing, but it seems to me that, instead, the protection afforded against governmental restrictions is weakening.

If I am right, then the tide of constitutional protection of freedom of speech has curiously turned, with the protection of commercial speech strengthening and the protection of political speech weakening. We must be careful not to primarily identify ourselves as a capitalist economy rather than a democratic republic.

As time passes, the wisdom of Justice Brennan becomes more and more clear. A simplification of the analysis of freedom of speech, strictly scrutinizing government censorship, would clarify rights and duties in a way that would preserve the importance of constitutional protection, especially of political speech, and avoid complicated forum classification followed by various forms of judicial review. But the Supreme Court seems determined to at least pay lip service to the perpetuation the forum categorization approach. In practice, it seems to have significantly limited those forums which may be labeled traditionally public, and thereby permitted further limitations on political speech.

The First Amendment is there to protect the freedom of speech of those whose freedom needs protecting. Candidates whose political viability is not in doubt need no protection. The media, public and private, will be eager to broadcast their words. It is the words of those whose voices are likely to otherwise go unheard that concern the constitution. Political debate is how ideas are tested. The First Amendment "has its fullest and most urgent application precisely to the conduct of campaigns for political office."[131] It is fundamental for democracy. To exclude minority candidates, is to silence the voices of those we are least likely to, and perhaps most need to, hear.

[1] "A state-owned broadcaster need not plan, sponsor, and conduct political debates …." Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *42 (1998) (Stevens, J., dissenting).

[2] When debates do not take place, for example in the 1994 New York State gubernatorial election between Mario Cuomo and George Pataki, people notice. No debate occurred because the Democratic incumbent, Mario Cuomo, insisted on allowing all candidates to participate, while the Republican candidate, George Pataki, insisted on a one-on-one debate. "Well hell, maybe we can get the wives to debate. Our election campaign, already close and nasty, is now officially wallowing in foolishness and dreck. We have two candidates who are afraid to stand up in the same room and face each other. As a result, the first gubernatorial debate takes place upstate tonight, featuring Mario Cuomo and four complete strangers. The whole thing is being televised on C-Span, so the entire nation can witness our humiliation. Candidates in every other state in the nation have no problem getting together for debates, people. There are states where the gubernatorial candidates have already faced off four, six, 10 times." Gail Collins, NEWSDAY, Oct. 14, 1994.

[3] Such as the League of Women Voters.

[4] Debates for federal office are governed, for example, by 47 U.S.C. Section 315. Stations or networks must conform to the Federal Communication Commission's equal time provisions.

[5] The Constitution is applicable to state and local public television through interpretation of the Fourteenth Amendment's due process clause. U.S. CONST. Amend. XIV. West Va. State Bd. of Educ. V. Barnette, 319 U.S. 624 (1943).

[6] The Third District, President Clinton's district. Apparently, Ralph Forbes is running for the same seat again this year, 1998. Elizabeth McFarland and Doug Thompson, *Lincoln, Boozman about even in cash on hand,* The ARKANSAS DEMOCRAT-GAZETTE, July 16, 1998, at ?.

[7] There was a debate on 22 October 1992 for the House of Representatives seat for which Forbes was a candidate.

[8] AETC decisions were made by its executive director, Susan Howarth, whose editorial judgment is statutorily independent from AETC's eight commissioners appointed by the governor of Arkansas.

[9] Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497, 500 (8th Cir. 1996).

[10] The Republican, Tim Hutchinson, won over the Democrat, John Van Winkle.

[11] Opinion written by Chief Judge Richard Arnold for a three-judge panel. Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497 (8th Cir. 1996).

[12] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102 (1998).

[13] U.S. CONST. Amend. XIV.

[14] Note Ross Perot's presence and absence in the debates for the presidency in 1992.

[15] U.S. CONST. Amend. I.

[16] U.S. CONST. Amend. I.

[17] Justice Stewart.

[18] U.S. CONST. Article I.

[19] Treason. U.S. CONST. Article III, Section 3.

[20] Copyright. U.S. CONST. Article I, Section 8.

[21] Oliver Wendell Holmes, Jr..

[22] 1789.

[23] "[T]he liberty of the press … consists in laying no *previous* restraints upon publications and not in freedom from censure for criminal matter when published." 4 Blackstone's Commentaries, 151.

[24] "[T]he prohibition of laws abridging the freedom of speech is not confined to previous restraints." Schenck v. United States, 249 U.S. 47, 51 (1919).

[25] Ronald Dworkin.

[26] Robert Bork.

[27] Meikeljohn, Alexander, Free Speech and Its Relationship to Self-Government (1948). Meikeljohn has been described as "The leading exponent of free speech as an aid to informed decision-making." Bentsen v. Coors Brewing Co., 512 U.S. 1203 (1994).

[28] CBS, Inc. v. FCC, 453 U.S. 367, 396 (1981). Note that by using the word "among" the Court anticipated more than two candidates.

[29] Emerson, Tom, The System of Free Expression (1970).

[30] "[D]eference to its [AETC's] interest in making ad hoc decisions about the political content of its programs necessarily increases the risk of government censorship and propaganda." Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *40 (1998) (Stevens, J., dissenting).

[31] E.g., Schenck v. United States, 249 U.S. 47 (1919); Abrams v. United States, 250 U.S. 616 (1919); Gitlow v. New York, 268 U.S. 652 (1925); West Virginia Bd. of Educ. v. Barnette, 319 U.S. 624 (1943).

[32] Note that the Supreme Court has since recognized a degree of constitutional protection for commercial speech as well, but the government may certainly restrict certain speech (e.g., Federal Trade Commission actions against false and misleading advertising).

[33] Dissenting, in Abrams v. United States, 250 U.S. 616, 630 (1919).

[34] Freedom of speech rights "are susceptible of restriction only to prevent grave and immediate danger to interests which the State may lawfully protect." West Va. State Bd. of Educ. v. Barnette, 319 U.S. 624, 639 (1943)

[35] For example, Justice Holmes's "clear and present danger" test, Schenck v. U.S. 249 U.S. 47 (1919).

[36] West Va. State Bd. of Educ. v. Barnette, 319 U.S. 624 (1943).

[37] Sometimes parade cases turn on whether the parade sponsor is public or private (e.g., the New York City St. Patrick's Day Parade) because if the sponsor is private constitutional protections are not triggered..

[38] Here the court considers if the restriction of substantive content is neutral and narrowly-tailored to achieve a significant government interest leaving the speaker an adequate alternative. Ward v. Rock Against Racism, 491 U.S. 781 (1989).

[39] Turner Broad. Sys., Inc. v. FCC, 512 U.S. 622 (1994).

[40] Turner Broad. Sys., Inc. v. FCC, 512 U.S. 622 (1994).

[41] Dissenting opinions in Lehman v. Shaker Heights, 418 U.S. 298 (1974); Greer v. Spock, 424 U.S. ( ); Jones v. , U.S. ( ).

[42] Davis v. Massachusetts, 167 U.S. 43 (1897).

[43] Massachusetts v. Davis, 162 Mass. 510 (1895).

[44] Massachusetts v. Davis, 162 Mass. 510, (1895).

[45] Hague v. Committee for Indus. Org., 307 U.S. 496 (1939) (open air meeting).

[46] "A public forum may be created for a limited purpose such as use by certain groups…." Perry Education Ass'n v. Perry Local Educators' Ass'n, 460 U.S. 37, n.7 (1983).

[47] Widmar v. Vincent, 454 U.S. 263 (1981); Cornelius v. NAACP Legal Defense & Educational Fund, 473 U.S. 788 (1985).

[48] Widmar v. Vincent, 454 U.S. 263 (1981).

[49] Southeastern Promotions, Ltd. v. Conrad, 420 U.S. 546 (1975).

[50] Perry Educ. Ass'n v. Perry Local Educators' Ass'n, 460 U.S. 37 (1983).

[51] The "First Amendment does not guarantee access to property simply because it is owned or controlled by the government." U.S. Postal Service v. Greenburgh Civic Ass'ns, 453 U.S. 114 (1981).

[52] Perry Educ. Ass'n v. Perry Local Educators' Ass'n, 460 U.S. 37 (1983).

[53] Perry Educ. Ass'n v. Perry Local Educators' Ass'n, 460 U.S. 37, 46 (1983); U.S. Postal Service v. Greenburgh Civic Ass'ns, 453 U.S. 114 (1981).

[54] Ralph Nader's party.

[55] The H. Ross Perot campaign, although included in the Commission on Presidential Debates sponsored presidential and vice-presidential debates in 1992, was excluded from their debates in 1996. Court action was unsuccessful and Perot '96 complained with the Federal Election Commission (still pending as of 06 October 1997 according to the Legal Times).

[56] At the New York University School of Law.

[57] Also the financial supporter of the Paula Jones in here case against President Clinton.

[58] Privately run.

[59] Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497 (8th Cir. 1996).

[60] Chandler v. Georgia Public Telecommunications Comm'n, 917 F.2d 486, (1990), cert. Denied, 502 U.S. 816 (1991).

[44] Massachusetts v. Davis, 162 Mass. 510, (1895).

[45] Hague v. Committee for Indus. Org., 307 U.S. 496 (1939) (open air meeting).

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[60] Chandler v. Georgia Public Telecommunications Comm'n, 917 F.2d 486, (1990), cert. Denied, 502 U.S. 816 (1991).

[61] Justice Department brief, filed by then Acting Solicitor General Walter Dellinger (May 1997). Deputy Solicitor General Lawrence G. Wallace, on behalf of the Federal Communications Commission, also argued orally that this was not a public forum. Richard D. Marks's Supreme Court oral argument. N.Y. TIMES, 9 October 1997, at A28.

[62] Forbes brief.

[63] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *12 (1998).

[64] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *12-13 (1998).

[65] "Public and private broadcasters alike are not only permitted, but indeed required, to exercise substantial editorial discretion in the selection and presentation of their programming." Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *13 (1998).

[66] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *19 (1998).

[67] Abraham Lincoln vs. Stephen Douglas, 1858 debates for Senator from Illinois. THE COLUMBIA ENCYCLOPEDIA 788 (Barbara A. Chernow & George A. Vallasi, 5th ed. 1993).

[68] John Kennedy vs. Richard Nixon, 1960 debates for President of the United States. THE COLUMBIA ENCYCLOPEDIA 1463 (Barbara A. Chernow & George A. Vallasi, 5th ed. 1993).

[69] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *41 (1998) (Stevens, J., dissenting).

[70] "The televised debate forum at issue in this case may not squarely fit within our public forum analysis." Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *46 (1998) (Stevens, J., dissenting).

[71] Surely the Constitution demands at least as much from the Government when it takes action that necessarily impacts democratic elections as when local officials issue parade permits." Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *35 (1998) (Stevens, J., dissenting).

[72] Ward v. Rock Against Racism, 491 U.S. 781 (1989).

[73] According to Judge Arnold, "We have no doubt that the decision as to political viability is exactly the kind of journalistic judgment routinely made by newspeople." Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497 (8th Cir. 1996).

[74] The federal Communications Act requires all stations, public and private, to exercise independent news judgment as a license condition. N.Y. TIMES, 09 October 1997, at A28.

[75] Marks argued for Howarth's freedom in exercising editorial judgment. AETC brief.

[76] Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497, 505 (8th Cir. 1996). Part of this passage was quoted approvingly by the dissent, but it failed to follow the thought to its logical conclusion. In fact it almost immediately turned its attention to a private broadcasting case. Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *35 (1998) (Stevens, J., dissenting).

[77] Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497 (8th Cir. 1996).

[78] Forbes brief.

[79] See n. above. The cases repeatedly cited as precedents involve private networks: the Columbia Broadcasting System in CBS, Inc. v. FCC, 453 U.S. 367 (1981) and the Turner Broadcasting System in Turner Broad. Sys., Inc. v. FCC, 512 U.S. 622 (1994).

[80] "As a general rule, the nature of editorial discretion counsels against subjecting broadcasters to claims of viewpoint discrimination." Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *13 (1998). This general rule referred is not a general constitutional rule. The rule seems to be a case of the Court taking notice of a general rule of journalism.

[81] "Much like a university selecting a commencement speaker, a public institution selecting speakers for a lecture series, or a public school prescribing its curriculum, a broadcaster by its nature will facilitate the expression of some viewpoints instead of others." Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *14 (1998). Here again, broadcasters, both public and non-public, are presented as the same.

[82] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *40 (1998) (Stevens, J., dissenting).

[83] A third party candidate has never won a presidential election and has only infrequently won a substantial percentage of the vote. But Forbes himself won the most votes for Lietenant Governor of Arkansas in 1990 in the initial Republican primary and, "in 1958, in the Second Congressional District, a write-in candidate who equipped his supporters with stickers that could readily be applied to the ballot defeated the incumbent Democratic Member of Congress despite the fact that he began his campaign very shortly before the election." Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497, 505 (8th Cir. 1996).

[84] Perot '96 brief.

[85] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, * (1998) (Stevens, J., dissenting) quoting Anderson v. Celebrezze, 406 U.S. 780, 794 (1983).

[86] E.g., search and seizure cases under the Fourth Amendment.

[87] Judge Arnold wrote, "We also believe that the judgment in this case was made in good faith." Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497, (8th Cir. 1996).

[88] Richard D. Marks's Supreme Court oral argument. N.Y. TIMES, 09 October 1997, at A28. Some of the *amicus curiae* briefs went further. "The First Amendment does not constrain the editorial choices of state-entity public broadcasters licensed to operate under the Communications Act." Brief for FCC et al. as Amici Curiae 14.

[89] "Why isn't that a pretty darn good way substitute for viewpoint discrimination?" Justice David H. Souter questioning Marks during oral arguments. Richard D. Marks's Supreme Court oral argument. N.Y. TIMES, 09 October 1997, at A28.

[90] Richard D. Marks's Supreme Court oral argument. N.Y. TIMES, 09 October 1997, at A28.

[91] One of the major candidates included had even raised less money than Forbes. Dissent, Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *34 (1998).

[92] Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497 (8th Cir. 1996).

[93] Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497 (8th Cir. 1996).

[94] "It is worth noting that Mr. Forbes himself received the most votes in the preferential primary for the Republican nomination for lieutenant governor in 1990. (He was defeated in the run-off primary.) Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497 (8th Cir. 1996).

[95] Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497 (8th Cir. 1996).

[96] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *35 (1998) (Stevens, J., dissenting).

[97] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *41 (1998) (Stevens, J., dissenting).

[98] Shuttlesworth v. Birmingham, 394 U.S. 147 (1969)

[99] Susan Howarth's conclusions.

[100] ANET brief by Richard Marks, D.C. office of Houston's Vinson & Elkins.

[101] Judge Arnold argued that "a governmentally owned and controlled television station may not exclude a candidate, legally qualified under state law, from a debate organized by it on such a subjective ground as viability. To uphold such a defense would, in our view, place too much faith in the government." Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497 (8th Cir. 1996).

[102] Forbes brief.

[103] United States v. Associated Press, 52 F.Supp. 362 (S.D.N.Y. 1943).

[104] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *26-27 (1998). The court cited the number of candidates on some state ballots in the preceding presidential election.

[105] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *27 (1998).

[106] This argument shows little respect for the ability of candidates to be both clear and brief, and it shows little respect for the ability of voters to keep track of more than a few (two?) candidates. Of course, an alternative to reducing the amount of time to each candidate to 20 rather than 30 minutes, would be to lengthen the debate to 1 ½ hours. That would be an effective use of editorial discretion.

[107] In the 1992 election, George Bush, William Clinton, and Ross Perot debated.

[108] Although one of those debates (New Hampshire in 1984(?)) resulted in Ronald Reagan asserted his freedom to use the microphone.

[109] Note that just as anyone can solicit write-in votes, anyone can still get themselves a soapbox and speak in the public square.

[110] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *14 (1998).

[111] Interestingly, nowhere was the argument cast as one of freedom of the press.

[112] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *16 (1998).

[113] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *17 (1998).

[114] Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *35 (1998) (Stevens, J., dissenting).

[115] Many stations would be affected. Two-thirds of the nation's 350 public broadcast stations are licensed to state or local governments. N.Y. TIMES, 09 October 1997, at A28.

[116] Justice Department brief.

[117] "There is no obvious limiting principle that would afford minor candidates a constitutional right of access to televised debates but not, for example, to evening news broadcasts featuring interviews with the major candidates." We may then slide "to grant rights of television access not just to uninvited candidates, but to anyone with a view about a matter of public controversy." Justice Department brief.

[118] Dellinger compared a candidate debate to an "academic lecture series sponsored by state universities." Justice Department brief. Lawrence G. Wallace extended the argument to the implications for art exhibits at state-run museums. He also questioned whether a composer would be entitled to equal time after a public broadcast of the Metropolitan Opera. N.Y. TIMES, 09 October 1997, at A28.

[119] Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497 (8th Cir. 1996).

[120] It seems that the Eighth Circuit had no problem with public broadcasts of private events, for example, a candidates debate sponsored by the League of Women Voters. But why shouldn't it? Isn't the result, that the same candidates get to speak and the same candidates don't just the same? How is the distancing not like money laundering?

[121] Chandler v. Georgia Public Telecommunications Commission, 917 F.2d 486 (11th Cir. 1990).

[122] "In its discussion of the law, the Court understates the constitutional importance of the distinction between state ownership and private ownership of broadcast facilities." Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *31 (1998) (Stevens, J., dissenting).

[123] Dissent by Justice Stevens, with whom Justice Souter and Justice Ginsburg join, Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *30-50 (1998).

124 Stevens dissents from the "discussion of the facts" before he dissents from the "discussion of the law." Dissent, Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *31 (1998) (Stevens, J., dissenting).

125 "The Court has decided that a state-owned television network has no 'constitutional obligation to allow every candidate access to" political debates that it sponsors'... I do not challenge that decision." Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *30 (1998) (Stevens, J., dissenting).

126 The dissent notes that Forbes was not considered by AETC staff "a serious candidate as determined by the voters of Arkansas," Record, Letter to Carole Adornetto from Amy Oliver Barnes dated June 19, 1992, attached as Exh. 2 to Affidavit of Amy Oliver Barnes. The dissent goes on to make a great deal of the fact that he had "been a serious contender for the Republican nomination for Lieutenant Governor in both 1986 and, especially, in 1990 when he received 46.88% of the statewide vote in a three-way primary and received a majority vote in 15 of the 16 Third Congressional District counties. Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *32 (1998) (Stevens, J., dissenting). Since the margin Republican winner's victory in the 1992 Third Congressional District election was only 3.02%, the dissent feels that exclusion of Forbes from the debate "may have determined the outcome." Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *33 (1998) (Stevens, J., dissenting). This suggests that if Forbes did not have quite so strong a track record or if the race had not been so close, he would not have had a constitutional right to participate in the debate. It seems clear that most independent candidates do not have Forbes's political track record nor are most races so close. Therefore, under the dissent's analysis, most independent candidates would not have Forbes's constitutional rights. Furthermore, how is a broadcaster to predict how close a race will be months before it is run? This concern might result in the participation of more candidates in races in which the result is less certain.

127 Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *35 (1998) (Stevens, J., dissenting).

128 Forbes v. Arkansas Educ. Television Comm'n, 93 F.3d 497, 505 (8th Cir. 1996).

129 Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *35 (1998) (Stevens, J., dissenting).

130 For example, a dissent argument in favor of Forbes participating in the debate is that he raised more many than another, majority party, candidate who was invited. Arkansas Educ. Television Comm'n v. Forbes, 118 S. Ct. 1633, 1998 U.S. LEXIS 3102, *34 (1998) (Stevens, J., dissenting).

131 Monitor Patriot Co. v. Roy, 401 U.S. 265, 272 (1971).

COMMERCE VIA THE INTERNET: THE FUTURE OF DOING BUSINESS

by

Reginia Judge*

I. Introduction

The Internet has revolutionized the way business is conducted, and therefore it has become an invaluable tool of commerce. It provides for the convenience of purchasing goods at home and, therefore, allows customers to save valuable time and money. Consumers can easily bid on merchandise through on-line auctions, perform price comparisons, and even print postage. They also have the ability to engage in financial transactions and trade stock. Because of the World Wide Web, merchants have been able to establish business without storefronts and service customers throughout the country and around the world. 58 million people in the United States and Canada used the Internet in 1997, a 14% increase from 1996.[1] Ten million of those users purchased goods and services on-line.[2] Retailers, such as Amazon.com, reported revenues at an estimated 1.4 billion dollars in 1999 from business-to-consumer sales.[3] According to a recent report prepared by Penn State's Smeal College of Business Administration, U.S. Business-to-Business sales on the Internet are expected to reach $183 billion dollars in 2001.[4] This lucrative method of commerce has allowed business organizations to reap overwhelming profits.

Although many consumers are utilizing the Internet to make purchases and obtain information, there are still skeptics who have not ventured into cyberspace to take advantage of the services available. Often, concerns are focused on the protection of the right of privacy.[5] A 1998 poll published in Business Week indicated that 61% of those who do not use the Internet would be more likely to do so if they thought their personal information would be protected.[6] This article shall address the issues raised by the advent of electronic commerce such as privacy, security and consumer confidence. Also discussed will be the safeguards that can be utilized to address these concerns.

II. CONSUMER CONCERNS

A. CONFIDENTIALITY & SECURITY

The protection of ones privacy is a priority to those persons purchasing goods via the Net. The fear of transacting business over the Internet stems from the concern over the use and distribution of personal information that is often required to utilize some web sites. Moreover, the threat of security breaks when banking transactions and purchases are conducted electronically fosters the need for privacy.[7] Many

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people are reluctant to use this form of commerce because of the belief that unauthorized persons maybe able to invade computer systems and obtain personal information.[8] 89% of those questioned in one survey indicated their concern regarding privacy when conducting financial transactions. [9] To address this concern many web sites utilize encryption algorithms, which transform data into unreadable codes that require a decryption key in order to decipher the data. Thus the information is available only to those for whom it was intended.[10] Although technology is such that payments can be made through state-of-the art encryption algorithms, the confidentiality and security of systems utilized for e-commerce remains an issue. Despite sophisticated security measures, computer security breaches resulted in the theft of an estimated $300 million from U.S. banks in a two month time period in 1995.[11]

Internet users are also concerned that their use of the World Wide Web will result in the dissemination of their personal information. Many web sites require users to register or submit information such as name, age, street address and e-mail address before web site information may be viewed. The fear over the use of personal data prevented 70% of those polled by a Boston Consulting Group from registering at web sites.[12] An overwhelming number of consumers are more concerned about providing information over the Internet than over the phone or through the mail.[13] Finally, consumers don't want to be disturbed by the unsolicited e-mail or spam that is received as a result of registering or simple utilizing some sites.

B. FRAUD AND FALSE ADVERTISING

The level of consumer activity conducted on the Internet carries along with it the potential for extensive fraud and other crimes to occur. Internet crimes can be grouped into three categories: 1) computer crimes, 2) fraud, and 3) noncomputer crimes.[14] Fraud, or fraud in fact, is defined as concealing something and making false representations with an evil intent that causes injury to another.[15] Internet fraud usually involves stealing credit card numbers or transferring funds from an individual's account to the intruder's account.[16] One case that illustrates the use of the Internet to perpetrate false advertising and fraud is *People by Vacco v. Lipsitz,* 663 N.Y.S.2d 468 (1997). Defendant, Kenneth Lipsitz, using an array of unregistered business names such as Collegetown Magazine Subscription Service and Krazy Kevin's Magazine Club, sold magazine subscriptions via the Internet. The Defendant utilized an advertising campaign whereby he distributed unsolicited e-mail he created from fictitious customers that sang the praises of his services and unbeatable prices. The e-mail was sent to particular discussion groups or listservs. Armed with complaints of dozens of in and out of state customers, Dennis Vacco, the Attorney General for the State of New York, brought suit against Lipsitz for consumer fraud and engaging in deceptive and false practices via the World Wide Web. The State was able to obtain injunctive relief, restitution, as well as the leveling of monetary penalties against the Defendant for his actions.

Fraud creates concern over the reliability of many web sites, particularly with respect to on-line auctions. The National Consumer League reported that online auction complaints represented nearly 90% of all calls related to Internet commerce in 1999.[17] These complaints centered on customers not receiving what they bid on, or if they did receive the item purchased, it was damaged beyond use. In an effort to lessen these occurrences, some auction sites are performing comprehensive checks on sellers. Moreover, the sites are requiring that the sellers provide credit card numbers as a form of identification.[18]

III. INTERNET CRIMES AND INFORMATION INVASION

Computer criminals include those who create and spread viruses and hackers. Hackers divide themselves into two groups: 1) those with no intent to do criminal activity, and 2) those who intend to engage in criminal acts.[19] There are also computer scam artists who establish phony web sites and fraudulently obtain information and money.[20] All of these individuals however, have the same purpose, to cause disruptions that result in a loss of time and money. Great expense is incurred in undoing the damage these criminals create. In addition, thousands of dollars and hours are spent in configuring software and developing sophisticated firewalls and security patches to deter criminal activity.

Another type of computer privacy invasion involves the selling of personal information of a web site user to a third party. The practice of selling information has been a lucrative source of revenue for quite some time. Some states have even been involved in the practice of selling the public, albeit personal, information, of its residents. Illinois raises $10 million annually from the sale of public records.[21] The advent of the Internet has added another dimension to this type of business. Information gathering via the Net occurs when a web site forces a consumer to register or provide personal information in order to utilize the site or as the result of making a purchase. After the information is provided, it is sold to a third party without the consumer's knowledge. In turn, consumers are placed on mailing list and receive a variety of advertisements.

Another method of information gathering utilizes computer systems to gain marketing details about consumers without their knowledge or consent. [22] This method is referred to as a "cookie." Cookies collect information as a user utilizes a specific browser and feeds information back to the web server. "A web site sends a cookie to the user's computer, where it serves as a digital tag that notifies the site each time the user enters. This information can be used to collect information about an on-line shopper's preferences so electronic marketers can target their offering to that individual."[23] Marketing companies contend that this action does not violate individual privacy since the information collected does not personally identify the user but rather the hardware or software utilized.[24] "Whether Internet users must be specifically asked for their consent for the appropriation of information regarding their on-line activities remains a continual privacy issue".[25]

Internet privacy invasion is a growing concern of many Internet users. A National Consumer League survey indicated that 41% feared that when making purchases via the net, their credit card numbers could be stolen during the transmission of the card number to the intended merchant. [26] This type of invasion leads to the fear of identity theft. This crime involves the stealing of an individual's identity after gaining access to vital information. The impersonator is able to obtain credit cards and bank loans, as well as purchase clothing, automobiles and other items either in person or via the web. An even greater threat to the individual is the thief's ability to withdraw funds from the victim's bank account when armed with an ATM card and PIN number.

VI. SOLUTIONS

Electronic businesses have a vested interest in creating and fostering consumer safeguards since failure to do could cripple their ability to conduct transactions through the Internet. It therefore behooves these companies to voluntarily assist in creating as safe an atmosphere as possible. Precautionary measures could include the initiation of codes of conduct. Such codes would discourage certain behaviors while assisting in establishing legal standards of care. This solution has been voluntarily undertaken by some web sites both in and outside of the United states.

A. GLOBAL INITIATIVES

In an effort to promote greater consumer protection, representatives from 29 countries, including the United States, France, Belgium, Germany and Japan, attended the Organization for Economic Co-Operation and Development (OECD) Ministerial Conference in Ottawa, Canada in October 1998. The OECD is a vehicle through which its members discuss and develop economic and social policy. The Ottawa Conference endorsed the Declaration on Consumer Protection in the Context of Electronic Commerce.[27] This Declaration expresses the members' commitment toward protecting electronic transactions by:

> 1) reviewing and adapting laws and practices if necessary to address the special circumstances of electronic commerce; 2) supporting and encouraging the development of effective market-driven self regulatory mechanisms that include input from consumer representatives, and contain specific, substantive rules for dispute resolution and compliance mechanisms; 3) encouraging the development of technology as a tool to protect consumers; 4) taking steps to educate users, foster informed decision-making by consumers participating in electronic commerce, and increasing business awareness of the consumer protection framework that applies to their on-line activities; and 5) increasing awareness among judicial and law enforcement officials of the need for effective international cooperation to protect consumers and combat cross-border fraudulent, misleading, and unfair commercial conduct.[28]

More recently, the OECD held its first International Conference and Knowledge Fair form June 26 - 28, 2000 in Paris, France. One of the issues discussed at the fair included the effectiveness of mechanisms for protecting consumer interests, privacy and personal data. [29]

B. U.S. COMMON & FEDERAL STATUTORY LAW

A limited number of common law torts protect individuals against certain privacy invasions. One in particular, the unreasonable intrusion tort,[30] may serve to offer consumers remedies in instances where they feel that their privacy has been invaded by online collection of personal data.[31] "The plaintiff must prove that the defendant intentionally intruded, physically or otherwise, upon the solitude or seclusion of another or his private affairs or concerns and that that intrusion was highly offensive to the reasonable person".[32] This tort could seemingly apply in circumstances where information providers collect personal information without advising the consumer of their collection procedures. One question that must be answered, however, is whether or not the Internet could be considered a private place where consumers' expectations of privacy are reasonable.[33]

Congress enacted the Electronic Communications Privacy Act (ECPA) in 1986.[34] It mandates the issuance of court orders for government action that includes wiretapping and other intrusions that seek to obtain computer data transmissions such as voice mail and e-mail. With the growth of electronic commerce, this statute also serves to prohibit Internet service providers from disclosing the contents of such stored communications except in limited circumstances.[35] Such situations include disclosures that are authorized by either sender or receiver of the message, those that are necessary for the effective retention of the service or system, and those that pertain to the commission of a crime to law enforcement.[36] The ECPA's ability to curtail the disclosure of personal information to government is effective, however its mandates do not cover private individuals.

The Federal Trade Commission Act[37] further protects consumers against unfair and deceptive collection and dissemination of personal data. The FTC did so in *In re GeoCities, Inc.*, No. C-3849 (FTC Feb. 5, 1999) by alleging that GeoCities falsely represented that the mandatory information provided by its members would not be released to third parties without permission.[38] The consent agreement entered by GeoCities helped establish some of the key elements of fair information practices that include in part: 1) notice of the site's privacy practices; 2) consumer choice regarding the use of information collected and 3) consumer access to correct or remove personal information.[39]

The Children's Online Privacy Protection Act[40] is a statute that seeks to protect the privacy of children as related to the Internet. Among other things, this statute requires that operators of web sites directed toward children under 13 who knowing collect personal information from children provide parents with notice of the web site's information practices, acquire parental consent for the collection, use and disclosure of personal information from children, and provide the ability for parents to review the information collected on their child.[41]

In an effort to regulate computer crime, Congress enacted the Computer Fraud and Abuse Act in 1984.[42] At its inception, this legislation was directed toward Internet crimes related to defense and foreign relations information, obtaining financial records from reporting agencies and conduct that affected government use of a computer.[43] The 1986 and 1988 amendments have broadened it to include and financial institutions other then those issuing credit cards and the trafficking of computer passwords.[44] One of the changes presented in the 1994 amendment created two offenses based on intent; intentional and reckless acts.[45]

Other statutes that can provide some protection to consumers include the Fair Credit Reporting Act,[46] and the Truth in Lending Act. [48] The Fair Credit Reporting imposes liability on companies that report incorrect information to credit reporting agencies. [47] The Truth in Lending Act limits a consumer's loss when a credit card is used without authorization.[49] Both these actions can take place via the Internet.

In an effort to protect consumer's privacy rights and address their concerns the Federal Trade Commission (FTC) held hearings in November 1995 that focused on globalization and technical innovations for consumer protection issues. The FTC articulated its goals as: "(1) to identify potential consumer protection issues related to online marketing and commercial transactions; (2) to provide a public forum for the exchange of ideas and presentation of research and technology; and (3) to encourage effective self-regulation.[50] In 1996, the FTC continued its exploration of this topic by conducting workshops that examined web site collection and disclosure practices of consumer's personal information."[51] By July 1998 the FTC issued its final recommendations to Congress on the issue of privacy protection for consumers purchasing merchandise from U.S. web sites. It promulgated and endorsed a legislative model that would be ratified should the Internet industry fail to implement self-regulation. Its recommendations called for: (1) the requirement that web sites provide consumers notice of their information practices; (2) the mandate that sites be required to offer consumers choices as to how that information is used beyond the sue for which the information is provided; (3) that sites would be required to offer consumers reasonable access to that information and an opportunity to correct inaccuracies; and (4) the mandate that sites be required to take reasonable steps to protect the security and integrity of that information.[52]

C. CONCLUSION

Companies endeavoring to promote products and services are opening World Wide Web sites. [53] Conducting business via the Internet is so attractive because it allows consumers the ease of doing so quickly and effortlessly. Over 100 million

people have access to the Internet. Annual consumer sales are expected to sore from approximately $15 billion in 1999 to $184 billion in 2004.[54] However, these statistics do not account for those millions of dollars that would have been spent but for customer security concerns. The fact that Internet use is increasing, raises cause for stiffer security measures and data control. Although stipulations are in place that assists in creating greater security, there is room for improvement. The bottom line is consumer trust. In order to on-line merchants to thrive, they must address this concern.

ENDNOTES

[1] See Oversight Hearing on Privacy in Electronic Commerce Before the Subcomm. On Courts and Intellectual Property of the House Comm. On the Judiciary, 105th Cong. (1988) Statement of David Medine, Associate Director for Credit Practices, Bureau of Consumer Protection, FTC).

[2] Id.

[3] See Ron MacLean, *What Business is amazon.com Really in*? 86 Inc., February 1, 2000 at 86.

[4] See Sonya Donaldson, *B2B Grows Online*, 24 Home Office Computing, March 1, 2000 at 24.

[5] Elizabeth deGrazia Blumebfeld, *Privacy Please: will the Internet Industry Act to Protect Consumer Privacy before the Government Steps In?*, 54 Bus. Law. 349, 352 (1998).

[6] Id at 353.

[7] Mark E. Budnick, *Privacy Protection for Consumer transactions in Electronic Commerce: Why Self-Regulation is Inadequate*, 49 S.C. L. Rev. 847,850 (1998).

[8] Id.

[9] Id at 849.

[10] William Hodkowski,, *The Future of the Internet Security: How New Technologies Will Shape the Internet and affect the Law*, 13 Santa Clara Computer & High Tech. L.J. 217, 225 (1997).

[11] Id.

[12] Drew Clark, *Worries About Privacy on Net Commerce Parade*, U.S. Banker, July 3, 1994, at 4.

[13] Joanna Smith Bers, *Secrets For Sale*, Future Banker, Aug. 1997 at 40.

[14] Jo-Ann M. Adams, *Controlling Cyberspace: Applying the Computer Fraud and Abuse Act to the Internet*, 12 Santa Clara Computer & High Tech. L.J., 403, 409. (1996).

[15] Barron's Law Dictionary, 195 (1984).

[16] Joseph Radegon, *Information Highway Robbers Try Cracking the Vault... or 50 Million Ways to Fleece Your Banker*, U.S. Banker, May 1995 at 67.

[17] Monique R. Brown, *Going Once, Going Twice...No Sale,* Black Enterprise Magazine, March 1, 2000. at 119.

[18] Id.

[19] Laura Evenson & Michelle Quinn, *Outlaws on the Cyberpraire,* S.F. Chron., Apr. 2, 1995, at 1/Z1.

[20] Mark E. Budnitz, *Privacy Protection For Consumer Transactions in Electronic Commerce: Why Self-Regulation is Inadequate,* 49 S.C. L. Rev. 847, 851 (1998).

[21] Id. at 856.

[22] Id. at 851.

[23] Reuters Limited, *U.S. Admits Net Privacy Breach,* htpp://www.news.com/News/0-1005-200-2123188.hyml?tag=st.ne.1005-203-2123118..ni.

[24] Dorothy Glancy, *At the Intersection of Visible and Invisible Worlds: United States Privacy Law and the Internet,* 16 Santa Clara Computer & High Tech. L.J., 357, 375 (2000).

[25] Id. At 370.

[26] Roberta Furger, *Cyberspace Security: Is Your Credit Card Safe?* Family PC, June 2000 at 90.

[27] Nicole Ladouceur, *Calibrating the Electronic Scales: Tipping the Balance in Favor of a Vigorous and Competitive Electronic Market for Consumers*, 25 Can.-U.S.L.J. 295,299 (1999).

[28] *Declaration of Consumer Protection in the Context of Electronic Commerce,* Cot. 7-9, 1998 OECD Ministerial Conference on a Boarderless World: Realizing the Potential of Global Electronic Commerce, Conference Conclusions, Annex 2, OECD Doc. SG/EC(98)14/REV, at 16.

[29] OECD, *The Internet, Growth, Source Into the Future?* (June 26, 2000), available in http://www.oecd.org/Forum2000/conference/themes.htm.

[30] Restatement (Second) of Torts § 652B (1977).

[31] Elizabeth deGarazia Blumefeld, *Privacy Please: will the Internet Industry Act to Protect Consumer Privacy before the Government Steps In?*, 54 Bus. Law. 358 (1998).

[32] Id.

[33] Dorothy Glancy, *At the Intersection of Visible and Invisible Worlds: United States Privacy Law and the Internet,* 16 Santa Clara Computer & High Tech. L.J., 357, 368 (2000).

[34] 18 U.S.C. § 2510-25-22, 2701 (1994).

[35] 18 U.S.C.A. § 2702 (1994).

[36] Id. at § 2701-2710.

[37] 15 U.S.C.A. § 45(a) (1994)

[38] Debra A. Valentine, *Privacy on the Internet: The Evolving Legal Landscape*, Address Before Santa Clara University (February 11-12, 2000), in 16 Santa Clara Computer & High Tech. L.J., 401,406 (2000).

[39] Id.

[40] 15 U.S.C.A. § 6501-6506 (West Supp. 1999).

[41] Debra A. Valentine, *Privacy on the Internet: The Evolving Legal Landscape*, Address Before Santa Clara University (February 11-12, 2000), in 16 Santa Clara Computer & High Tech. L.J., 401,412 (2000).

[42] 18 U.S.C. § 1030.

[43] Jo-Ann M. Adams, *Controlling Cyberspace: Applying the Computer Fraud and Abuse Act to the Internet,* 12 Santa Clara Computer & High Tech. L. J., 403, 423. (1996).

[44] Id.

[45] Id. at 425.

[46] 15 U.S.C. § 1681–1681t (1994).

[48] 15 U.S.C.A. § 1681s-2 (West Supp. 1998).

[47] 15 U.S.C. § 1643 (1994).

[49] Mark E. Budnitz, *Privacy Protection For Consumer Transactions in Electronic Commerce: Why Self-Regulation is Inadequate*, 49 S.C. L. Rev. 847, 860 (1998).

[50] FTC, *Privacy Online: A Report to Congress* Sec. II.B.I., II.A. (June 1998), available in http://www.ftc/gov/reports/privacy/3/priv-23a.pdf.

[51] Robert Pitofsky, Chariman, FTC, *Consumer Privacy on the World Wide Web* Sec. I.C.3 (July 21, 1998) http://www.ftc.gov/opa/1998/9807/privacyh.htm

[52] Elizabeth deGarazia Blumebfeld, *Privacy Please: will the Internet Industry Act to Protect Consumer Privacy before the Government Steps In?,* 54 Bus. Law. 373 (1998).

[53] Mark Kiminky, *Getting Up to Speed on Net Law,* 82-Jun. A.B.A. J. 90.

[54] Debra A. Valentine, *Privacy on the Internet: The Evolving Legal Landscape,* Address Before Santa Clara University (February 11-12, 2000), in 16 Santa Clara Computer & High Tech. L.J., 401,402 (2000).

CLONING HUMANS: LEGAL AND ETHICAL CONSIDERATIONS

by

Peter M. Edelstein*

I. Introduction

New York Times, March 14, 2000: "President Clinton and Prime Minister Tony Blair of Britain said ... that the sequence of the human genome should be made freely available to all researchers. The statement led to a sharp sell-off in the stocks of biotechnology companies, which hope to profit by creating drugs based on genetic data."[1]

The charitable motives of the two world leaders notwithstanding, the dramatically negative market reaction to that announcement evidenced the public's serious commercial interest in biotech research. While gene mapping is the latest biotech advance to receive popular attention, just three years ago sci-fi became reality when a mammal was successfully cloned using an asexual reproductive technique.[2] The mapping of the human genome portends a future in which now common diseases may be effectively managed or eliminated; a future in which parents may be assured that their children will be born healthy. The possibility of human cloning heralds a future that some would consider miraculously wonderful and others would consider Frankensteinian.[3] The legal and ethical considerations associated with the "new biology" represented by recent scientific advances will have to be addressed as society adjusts to what was, up to now, futuristic.

The modern era of biotechnology, and the accompanying public anxiety about the possibility of cloning humans, began on February 22, 1997, when the world learned that Ian Wilmut and his team at the Roslin Institute in Scotland had successfully cloned[4] a sheep (named "Dolly"[5]) by the use of a new technique known as somatic cell nuclear transfer ("SCNT").[6] This process is an extension of research that had been ongoing for over 40 years using nuclei derived from non-human embryonic and fetal cells.[7] In the Dolly case, cells from an adult ewe were starved of nutrition to arrest development and to restore them to a "totipotent"state[8] (having potential to develop in specialized ways). The nuclei of these cells were then transplanted into sheep "oocytes" (immature eggs) to which an electric current was applied.[9] When the egg divided and became an embryo it was implanted in a surrogate mother sheep. The result was a "delayed genetic twin" of the original adult ewe from which the cells were taken.[10]

II. Cloning of Humans Determined to be Immoral

Almost immediately after the Dolly cloning announcement, President Clinton declared

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that no federal moneys would be spent to fund cloning experiments involving humans.[11] He then requested that the National Bioethics Advisory Commission (the "NBAC," or the "Commission") report to him within 90 days on legal and ethical issues involved in cloning techniques and "possible Federal actions to prevent its abuse"[12] The President requested, further, that private researchers voluntarily refrain from human cloning research, stating that "people should resist the temptation to replicate themselves."[13]

Its mission thus presented, the National Bioethics Advisory Commission undertook to review the scientific, religious, ethical and legal issues raised by the possibility that humans could be replicated. The result of the NBAC effort, entitled "Cloning Human Beings, Report and Recommendations of the National Bioethics Advisory Commission, Rockville, Maryland, June 1997" (the "NBAC Report" or the "Report") was transmitted to the President under cover letter dated June 9, 1997. The NBAC Report, which is surprisingly readable for such a weighty and technical subject, concludes and recommends, *inter alia,* that "... at this time it is morally unacceptable for anyone in the public or private sector, whether in a research or clinical setting, to attempt to create a child using somatic cell nuclear transfer cloning.[14]

The finding that human cloning is "morally unacceptable" was substantially based on the belief that the SCNT technique "[a]t present"... involves "unacceptable risk,"[15] and that to attempt to create a child using the SCNT method would violate important ethical obligations due to unacceptable risks to the fetus and/or potential child.[16]

The Commission, in its Report, made several recommendations:

A continuation of the ban on federal funding in support of any attempt to create a child by SCNT.[17]

- An immediate request to all non-federally funded researchers to comply voluntarily with the intent of the federal ban and that professional and scientific societies should make clear that any attempt to create a child by SCNT would be an irresponsible, unethical, and unprofessional act.[18]
- Federal legislation should be enacted to prohibit such human cloning, which legislation should be reviewed after a three to five year period.[19]
- Any regulations or legislation should be carefully written so as not to interfere with other important areas of scientific research.[20]
- If a legislative ban is not enacted, or if a legislative ban is ever lifted, clinical use of SCNT techniques should be preceded by research trials that are governed by independent review and informed consent.[21]
- The U.S. government should cooperate with other nations and

international organizations to enforce any common aspects of their policies.[22]

- Different ethical and religious perspectives and traditions are divided on many of the important moral issues that surround any attempt to create a child using SCNT techniques. Therefore, the federal government and all interested parties should encourage widespread and continuing deliberation of these issues in order to further understand the ethical and social implications of this technology and to enable society to produce appropriate long-term policies.[23]

- Because scientific knowledge is essential for all citizens to participate in a full and informed fashion in governance, federal departments and agencies concerned with science should cooperate in seeking out and supporting opportunities to provide information and education to the public in the area of genetics, and on other developments in the biomedical sciences, especially where these affect important cultural practices, values and beliefs.[24]

In the year 2000, we probably lack the perspective to appreciate the enormity of the significance of the discovery of the ability to clone mammals. But the immediate reaction to the possibility of human cloning was neither subtle nor positive. Polls of public opinion evidenced widespread disapproval of the idea of cloning humans.[25] Worldwide health organizations expressed their opposition to the concept.[26] Countries considered or enacted laws prohibiting cloning of humans.[27] Religious groups viewed the cloning of humans as a prohibited encroachment on the powers of the creator.[28] In anticipation of and in reaction to the NBAC report, no fewer than ten bills with the apparently main purpose of prohibiting the cloning of humans have been introduced in Congress.[29]

III. The Human Genome Project

A decade before the cloning of Dolly another groundbreaking biotech undertaking was beginning. In 1990, a consortium including the U.S. Department of Energy and the National Institute of Health formed the Human Genome Project.[30] This public endeavor, funded by the U.S. Government (two-thirds) and a British charity, the Wellcome Trust (one-third), had the following projected goals: identify all the approximately 100,000 genes in the human DNA, determine the sequence of the 3 billion chemical bases that make up human DNA, store this information in databases, develop tools for data analysis, and address the ethical, legal and social issues that may arise from the project.[31] Originally planned to span a period of 15 years, rapid progress has resulted in the projected completion date being moved forward to 2003.[32] The Human Genome Project, as a public effort, posts its results daily on its web site.[33]

In true entrepreneurial spirit, several private companies including Celera,[34] of Rockville, Maryland, have challenged not only the methodology of the Human Genome

Project but also the ownership of the intellectual property discovered in connection with the search to map the human genome.[35] The strategy of the private genome research companies is to focus on the genes themselves and to obtain patents on as many as possible.[36] On April 7, 2000, Celera[37] announced that it had completed sequencing the genes of one person (and the stock market rallied).[38]

The relatively contemporaneous phenomena of cloning mammals and sequencing of the human gene have bought mankind to nothing less than the threshold of a new era in science. Biology is now poised to become a major influence on the next step in the evolution of law. At the cusp of the new era, the U.S. government has put the brakes on cloning research while private industry has pushed the accelerator on human genomic research.

IV. Is There a Legal Right to Clone Humans?

It is not difficult to imagine societal benefits of plant cloning (to produce greater crop yield, healthier, more beneficial foods) or even animal cloning (increased food supply, healthier food, better lab animals, a source of organs or parts for humans). When it comes to human cloning, the perceived benefits are more difficult to evaluate and thus the need to do so more tenuous.

Perhaps the purest, albeit amoral, argument supporting the eventual cloning of humans is that, presumably, we will be able to clone. There is a certain intellectual repugnance to the current official U.S. position that such scientific inquiry should simply stop. Surely there will be a maverick scientist that will proceed with human cloning for fame or profit regardless of any official proscription.[39] One must wonder if it would not have been more prudent (and scientifically productive) for our government to attempt to regulate, rather than ban research in the field of human cloning.[40]

Proponents of human cloning offer several potential benefits for the process including its use as a treatment for infertility, a source of organ or tissue,[41] replicating a person, or replacing a dead person. Opponents of human cloning raise a variety of objections from those based in moral, ethical and religious grounds[42] to those based on horrific fantasies to the effect that legions of soldiers, slaves or superhumans will be created.[43] Eventually the law will be called upon to determine if there is a right to clone humans.

Those in favor of cloning humans tend to categorize such cloning as merely another method of technology-assisted reproduction. This argument may be a gross oversimplification by ignoring the vast difference between cloning and other reproductive techniques. Current reproduction technologies, which are widely accepted, include artificial insemination, *in vitro* fertilization, traditional surrogacy (in which a female is artificially inseminated by a male to whom she surrenders the child), non-traditional surrogacy (in which the female is impregnated by a male to whom she surrenders the child), and sex-selection techniques (pre-fertilization, pre-implantation, post-implantation).[44] If human cloning is accepted by society as just another form of assisted reproduction one can look to the established law concerning reproductive freedom for guidance.

Case law offers no definitive holding as to the extent of individual freedom to, or the right of the government to interfere with, asexual reproduction. The Supreme Court of the United States has interpreted the Fourteenth Amendment's due process guarantee of "liberty"[45] to include a right to privacy that includes individual autonomy[46] and "fundamental values" have been protected by the Supreme Court in the areas of privacy, autonomy and family values.[47]

Washington v. *Glucksberg*,[48] a 1997 Supreme Court case, involved a state statute providing that a person who knowingly causes or aids another person to attempt suicide is guilty of a felony. The plaintiffs, (consisting of doctors who treated terminally ill patients and individuals who were terminally ill), argued that the existence of a liberty interest protected by the Fourteenth Amendment extended to the personal choice to commit physician-assisted suicide. While finding that the right to commit suicide was not a fundamental liberty protected by the due process clause, the Court did state:

"...in addition to the specific freedoms protected by the Bill of Rights, the 'liberty' specifically protected by the Due Process Clause includes the right to marry...,[49] to have children[50].... to direct the education and upbringing of one's children[51]....to marital privacy[52].... to use contraception[53]....to bodily integrity[54]....and to abortion[55]...."

One of the cases cited by the Supreme Court in *Washington v. Glucksberg*[56] was *Skinner v. Oklahoma.*[57] In that case the Supreme Court reviewed the right of the State of Oklahoma to sterilize habitual criminals. The Court held "we are dealing with legislation that involves the basic civil rights of man. Marriage and procreation are fundamental to the very existence and survival of the race."[58] On the one hand, the government's authority to interfere with procreative liberty has been limited by the Fourteenth Amendment "liberty" guarantee[59] but, on the other, there is a reluctance to elevate personal autonomy to the level required to allow a substantive due process challenge.

Bowers v. Hartwich[60] examined a Georgia statute that made it a criminal offense to commit sodomy. The Supreme Court rejected a challenge to that law based on the assertion of a constitutional right to personal autonomy.

In limiting its view of the scope of Constitutional rights, the Court held:
"...we [are not] inclined to take a more expansive view of our authority to discover new fundamental rights embedded in the Due Process Clause. The Court is most vulnerable and comes nearest to illegitimacy when it deals with judge-made constitutional law having little or no cognizable roots in the language of the Constitution."[61]

Where, exactly, human cloning will fall in the spectrum of guaranteed liberties has yet to be decided. Existing case law would seem to reject cloning as a fundamental liberty entitled to Constitutional protection. As the debate over cloning continues, the perception of the process as an ungodly exercise of human power or as merely an extension of

technology-assisted reproduction may affect the legal rights attached to the concept.

V. Conclusion

The absence of any Constitutional foundation that can securely anchor procreative liberty seems, for the present time, to leave the assertion of the right to clone humans, in an unsettled and probably tenuous state.

Based on its belief that cloning humans by the SCNT technique was not safe, the NBAC made it clear that such cloning is not only considered "morally unacceptable," but is also "irresponsible, unethical, and unprofessional." By its use of the "not safe," rationale to ground its moral and ethical conclusions, the NBAC intentionally chose to take an easy path around the more fundamental and profound ethical and moral issues. Unresolved by the Commission and apparently left open for debate and decision at a later time are: What if the SCNT method is eventually proved to be safe? What if other methods of safe cloning are developed? If safety is removed as an issue,
is it then moral and ethical to clone humans?

Lest one lose hope in the ability of our society to cope with the "Brave New World,"[62] the Internet now reports that you can sign up *now* to have your pet cloned.[63] The New York Times Magazine reports that " ...the idea of cloning has been normalized, even cute-ified, in remarkably short order."[64]

ENDNOTES

1. See Alex Berenson and Nicholas Wade, *The Markets: Stocks & Bonds; A Call for Sharing of Research Causes Gene Stocks to Plunge*, N.Y. Times, March 15, 2000, at A1.

2. See Gina Kolata, *Scientist Reports First Cloning Ever of Adult Mammal*, N.Y. Times, Feb. 23, 1997, at A1.

3. See George J. Annas, *Human Cloning: Should the United States Legislate Against it?*, A.B.A. J., May 1997, at 80.

4. "Cloning," is the verb form of the noun "clone," which means "A precise copy of a molecule cell, or individual plant or animal." "Cellular cloning" is "a process by which cells derived from the soma, or body, are grown in tissue culture in a laboratory. The genetic makeup of the resulting cloned cells, or cell line, is identical to that of the original cell. See NATIONAL BIOETHICS ADVISORY COMM'N, CLONING HUMAN BEINGS: REPORT AND RECOMMENDATIONS

of the National Bioethics Advisory Commission App. A: Glossary (1997) [hereinafter NBAC Cloning Report]

5. The name Dolly is reportedly a reference to Dolly Parton. The cell which Dr. Wilmut used was taken from the "impressive" udder of the adult sheep. See John Arlidge, *Scientists Able to Create Human Clones*, Guardian (London), Feb. 26, 1997, at 6.

6. See Gina Kolata, *supra* note 2, at A1.

7. See NBAC Cloning Report, *supra* note 2 at i.

8. See Gina Kolata, Clone: The Road to Dolly and the Path Ahead, 204-208 (William Morrow Company 1998).

9. See I. Wilmut *et al.* Viable Offspring Derived from Fetal and Adult Mamalian cells, 385 Nature 810, 813 (1997).

10. *Id.*

11. See Katharine Q. Seelye, *Clinton Bans Federal Money for Efforts to Clone Humans*, N.Y. Times Mar. 5, 1997, at A13.

12. See Gina Kolata, *Little- Known Panel Challenged to Make Quick Cloning Study*, N.Y. Times, Mar. 5, 1997, at A13.

13. See Seelye, *supra* note 11, at A13.

14. See NBAC Report, *supra* note 2 at 106.

15. *Id.*

16. *Id.*

17. *Id.* at 107.

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.* at 108.

23. *Id.*

24. *Id.*

25. See David Masci, *Cloning Humans Sparks Debate, Advisory Panel to Report Thursday on Issues and Give Guidelines*, Pitt. Post-Gazette, May 25, 1997, at A15.

26. See *Global Group Urges a Voluntary Ban on Human Cloning*, Chi. Trib., May 12, 1997, at 6.; *U.N. Body Decries Human Cloning*, St. Petersburg Times, May 17, 1997, at 3, *Chinese Scientific Institute Bans Cloning of Humans as Unethical Procedure Presented Dilemma for Scientists Doing Disease Research*, Rocky Mtn. News May 25, 1997, at A70.

27. Michele Grygotis, *The Cloning of a Sheep Named Dolly Just One Biotech Development Producing Unprecedented Opportunities to Explore New Treatments of Human Diseases*, Transplant News, May 12, 1997.

28. See Gustav Niebuhr, *Suddenly Religious Ethicists Face a Quandary on Cloning*, N.Y. Times Mar. 1, 1997, at 1.

29. See Human Cloning Prohibition Act (Introduced in the Senate) [S.1574. IS], Prohibition on Cloning of Human Beings Act of 1998 (Introduced in the Senate) [S.1602.IS], To Prohibit the Use of Federal Funds for Human Cloning Research. (Introduced in the Senate) [S.368.IS], Prohibition on Cloning of Human Beings Act of 1998 (Placed in the Senate)

[S.1611.PCS], Human Cloning Prohibition Act (Introduced in the House)[H.R. 923.IH], Human Cloning Research Prohibition Act (Introduced in the House) [H.R. 3133.IH], Human Cloning Prohibition Act (Placed in the Senate) [S.1601.PCS], Human Cloning Prohibition Act of 1998 (Introduced n the Senate) [S.1599.IS], To Provide for the Establishment of a Commission to Promote a National Dialogue on Bioethics. (Introduced in the Senate) [S.1595.IS].

30. See *In-gen-nous*, The Economist, March 18, 2000.

31. See http://www.ornl.gov/hgmis/about.html

32. *Id.*

33. See http://www.ornl.gov/hgmis/project/progress.html

34. Symbol CRA, NYSE, its official full name is PE Corp.-Celera Genomics Grp. Other private companies in the race to map the human genome include Incyte Pharmaceuticals (symbol INCY, NASDAQ) and Human Genome Sciences (HGSI, NASDAQ).

35. See Berenson and Wade, *supra* note 1.

36. *Id.*

37. According to Celera's website, its mission is "to become the definitive source of genomic, proteomic and related biological and medical information." See http://celera.com/corporate/ about.html

38. See *The Markets: Stocks; Advances in Biotechnology and Retail Sales Spur Rally*, N.Y. Times, April 7, 2000, at C6.

39. Dr. Richard Seed has announced that he intends to clone a human. See Rick Weiss, *Scientist Plans to Clone Humans; Anticipating Ban Researcher Says He Has Assembled Doctors, Volunteers*, Wash. Post, Jan. 7, 1998, at A3.

40. See Susan M. Wolf, *Ban Cloning? Why NBAC Is Wrong*, The Hastings Center Report, September-October 1997, at 12.

41. See John A. Robertson, *Liberty, Identity, and Human Cloning*, 76 Texas Law Review 1376-1382 (1998).

42. See Leon R. Kass, *The Wisdom of Repugnance*, New Republic, June 2, 1997, at 17.

43. See Gina Kolata, *Proposal for Human Cloning Draws Dismay and Disbelief*, N.Y. Times, Jan. 8, 1989 at A22.

44. See Katheryn D. Katz, *The Clonal Child: Procreative Liberty and Asexual Reproduction*, 8 Alb. L.J. Sci & Tech 1 (1999).

45. See U.S. Const. amend. XIV, 1.

46. See *Meyer v. Nebraska*, 262 U.S. 390 (1923); *Olmstead v. United States*, 277 U.S. 438 (1928).

47. *Washington v. Glucksberg*, 117 S. Ct. 2258 (1997).

48. *Id.*

49. Citing *Loving v. Virginia*, 388 U.S. 1 (1967)

50. Citing *Skinner v. Oklahoma ex rel. Williamson*, 316 U.S. 535 (1942).

51. Citing *Meyer v. Nebraska*, 262 U.S. 390 (1923); *Pierce v. Society of Sisters*, 268 U.S. 510 (1925).

52. Citing *Griswold v. Connecticut*, 381 U.S. 479 (1965).

53. Citing *Griswold supra* note 52; *Eisenstadt v. Baird*, 405 U.S. 438 (1972).

54. Citing *Rochin v. California*, 342 U.S. 165 (1952).

55. *Planned Parenthood of Southeastern Pa v. Casey*, 505 U.S. 833 (1992).

56. See *Washington v. Glucksberg, supra* note 47.

57. See *Skinner v. Oklahoma, supra* note 50.

58. See *Skinner, supra* note 53 at 541.

59. See *Eisenstadt v. Baird, supra* note 50, re: distribution of contraceptives, *Carey v. Population Servers Int'l*, 431 U.S. 678 (1977) re: access to contraceptives.

60. 478 U.S. 186 (1986).

61. *Id.*

62. Aldous Huxley, *Brave New World* (Times Inc. Books 1963).

63. It has been reported on the Internet that a company called Genetic Savings and Clone will clone your pet. See http://www.discovery.com/news/briefs/20000218/tech_petclones.html.

64. See also Margaret Talbot, *Clone of Silence*, New York Times Magazine, April 16, 2000, at 21.

THE LONG AND THE SHORT OF IT: ARE EMPLOYER GROOMING CODES DISCRIMINATORY?

By

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As the country becomes more diverse, employers have seen more variations in personal appearance that may clash with the corporate culture. This paper will analyze a recent Connecticut case in which an employee claimed a discriminatory dismissal based on an unequal application of the company's dress code.

INTRODUCTION

As the country becomes more diverse and individuals exercise their personal freedom, the workplace has seen a diversity of appearance and clothing styles. The "Man in the Gray Flannel Suit," a 1950's stereotype of business dress no longer applies as the workforce dresses more casually.

Can an employer fire an employee for wearing clothing the employer deems inappropriate, or can an employer dismiss a male employee for wearing long hair when other female employees can wear such a hairstyle?

Both of these issues were addressed in a recent Connecticut case, *Hart v. Knights of Columbus*[1] which arose under Connecticut's *Fair Employment Practices Act*,[2] the state counterpart of Title VII of the Civil Rights Act of 1964. Such workplace issues are sure to recur in future cases as more and more employees claim that they are victims of such discrimination.

Robert Hart was a male college graduate holding a B.A. degree in Business Management, who sued his employer, the Knights of Columbus, a New Haven based religious organization. Hart was hired as a file clerk on November 10, 1996 and a few months later ran afoul of the Knights' dress code which provided in part that:

> "Dressy shorts or shorts of reasonable lengths may be acceptable only if they are part of a total outfit that presents a professional business-like appearance."[3]

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On June 11, 1997, Hart wore shorts to work. As a result of his fashion choice, the Director of Human Resources Thomas Lynch called him into his office and in front of at least one other person ordered Hart to stand on a chair so that he (Lynch) could look at Hart's legs. Lynch then concluded that Hart's shorts were "not appropriate business attire."[4] And further stated "We would never want somebody like you to represent our company." Lynch also asked Hart the name of the College he had attended so "We don't donate any money to them."[5] Lynch conceded that if Hart were a woman there would be no problem with wearing the shorts.

The next day, June 12, 1997, when Hart wore shorts to work, Lynch again summoned Hart to his office and informed him that shorts were "not appropriate for men" and suspended him for the day without pay.[6]

Hart brought suit claiming that he was constructively discharged and forced to seek another job. Hart claimed that the Knights of Columbus enforcement of its written dress policy discriminated against him based on gender.[7] He argued that the defendant had a written dress policy that permitted the wearing of shorts but that he was not allowed to wear them because he was a man and not a woman.

DISCRIMINATION CLAIM

Hart brought his action under the State's Fair Employment Practices Act. As interpreted in another Connecticut case, *Pik Wik Stores, Inc. v. Commission on Human Rights and Opportunities*,[8] the purpose of 31-126a of the Connecticut Law is to prohibit employer discrimination based on such immutable characteristics as race, color, national origin or sex.

In the *Pik Wik* case, the issue was the chain's grooming policy, which required male employees to have "neat well groomed hair, off the collar and above the ears", but these restrictions did not affect female employees.[9]

An applicant for the job with the chain refused to comply with the grooming policy and was not hired prompting him to file a discrimination suit.

The Court found that a hiring policy which applies to issues such as grooming codes or hair length was related to an employer's decision about how to run a business rather than to equal opportunity. The *Pik Wik* Court stated that the plaintiff was denied a job as a result of a conscious choice not to cut his hair and not because of his sex.[10]

Then both the Courts in *Pik Wik* and in the Knights of Columbus cases could find no discrimination based on an immutable characteristic.[11]

BREACH OF CONTRACT

Hart alleged that the Knights of Columbus breached its written contract with him by not allowing him to wear shorts as authorized in the written dress code. The court found that a written policy can some time give way to an expressed or implied contract between the employer and employee but in this case the employer, Knights of Columbus had clarified the fact that its policy did not apply to both its male and female employees. Hart thus failed in the cause of action.[12]

EMOTIONAL DISTRESS CLAIMS

Hart alleged both the intentional and negligent infliction of emotional distress in his complaint against the Knights of Columbus.

Under Connecticut cases, [13] four elements must be established before the plaintiff can prevail on a claim of an intentional infliction of emotional distress:

1. That the defendant intended to inflict emotional distress or that he knew or should have known that emotional distress was likely to result.
2. That the defendant's conduct was extreme and outrageous.
3. That the defendant's conduct was the cause of Hart's distress.
4. That the plaintiff sustained severe emotional distress.

The Knights of Columbus denied that its conduct with respect to enforcement of the dress code was outrageous.[14] In general, the tort of the intentional infliction of emotional distress will lie only when the defendant's conduct:

> "Exceeds all bounds usually tolerated by decent society,
> of a nature which is especially calculated to cause and
> does cause mental distress of a serious kind."[15]

The Court believed that the conduct of Director of Human Resources Lynch fell far short of that standard even if it could be it could be considered "reprehensible."[16]

The Court also found Hart's claim of the negligent infliction of emotional distress failed because under Connecticut case law[17] the tort will not lie unless there is a termination of employment. As Hart was not fired by the Knights -- he resigned – the claim failed. Hart countered that he was the victim of a constructive discharge and so the requirement of "termination" was satisfied but the Court disagreed that Hart's resignation was a constructive discharge. A constructive discharge means that an employer has made the employee's working conditions so intolerable that a reasonable person in the latter's shoes would feel compelled to resign.[18] The Court did not find that the Knights' made Hart's working conditions so difficult that he was forced to leave his job.

Thus Hart's complaint failed on four theories: the state's anti-discrimination law, breach of implied contract and the intentional and negligent infliction of emotional distress.

OTHER CASES

Based on the outcome of the *Hart* case it would appear that employees will have little leverage in challenging what they regard as unfair enforcement of a company dress code.

Frank J. Kleinsorge, an optometrist filed suit in U.S. District Court in November 1999 contending that he was fired from Eyeland Optical Center in Stroudsburg, Pennsylvania because he wore an earring in his ear. He worked at Eyeland for two months before being fired in April, 1999. Kleinsorge's lawyer noted that his client was wearing an earring when he was interviewed for the job and no one advised him that it was inappropriate. The owner of Eyeland, later informed Kleinsorge that he could not wear the earring which his lawyer insisted was a "style choice" that Kleinsorge made. As his lawyer stated, "It's the way he wants to look."[19]

The Kleinsorge case differs from Hart's in two important ways. First, Kleinsorge was fired by his employer while Hart resigned his job. Second, Kleinsorge wore the earring during the job interview so his potential employer had ample warning that Kleinsorge sported an earring that violated company rules. Clearly Hart wore shorts only after he was employed.

Both cases have in common the claim that if Hart and Kleinsorge were females they would be free to wear the shorts and the earring in the work place prompting both to claim that they were victims of gender discrimination. If the notion of "immutable characteristic" is applied to the Kleinsorge case, his suit will be unsuccessful because he can change his appearance by removing the earring. It appears that Eyeland's anti-earring policy is a matter of choice and not a denial of equal opportunity.

While the wearing of earrings has become a more prevalent style for men in recent years; so too has the wearing of tattoos by women as well as the fashion of body piercing by both sexes.

Can an employer lawfully discharge an employee who is adorned with visible tatoos or pierced body parts? As a result of the Hart case, the answer appears to be "yes." Employers can impose appearance codes because it is within their discretion to decide how their businesses should be run and what kind of appearance their employees should present as their representatives. Can an employer decline to hire or dismiss a tattooed female employee while declining to dismiss a tattooed male employee? Again the answer would appear to be "yes." The female employee might argue that the presence of tattoos is an "immutable characteristic" but the courts would not likely accept the immutability of a tattoo as comparable to the immutability of race, color, national origin or sex. Indeed, the acquisition of a tattoo is a voluntary undertaking while the latter qualities are things that are beyond the control of the employee.

CONCLUSION

As lifestyles change and fads come and go, employers are sure to be faced with decisions regarding employees whose physical appearance differs from the employer's idea. In the 1800s, pierced earrings were popular but went out of style in the early 1900s.[20] Pierced ears were once regarded as a sign that someone was part of a lower socio-economic class. In the iconoclastic 1960s, pierced ears for women made a comeback and in the 1990s the piercing of one ear and wearing of earrings became a male fad. Now many men and women have multiple piercings on the ears as well as eyebrows, lips, tongues and navels. Tattoos, once associated with naval service, were also a rite of passage for men. They too were considered a mark of lower class status, but today, tattoos are ubiquitous on both young males and females of all social classes.[21]

Despite the presence of such fashion trends, it does not appear that the Courts will allow discrimination laws to protect such fads in contravention of allowing an employer the discretion to dictate how a member of his/her workforce present themselves to the public.

ENDNOTES

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[1] No. CV 98-04171125 25 Conn. L. Rptr. No. 9 304 (November 1, 1999).

[2] 46a – 60 et.seg.

[3] 25 Conn. L. Rptr. No. 9, 304.

[4] Id.

[5] Id.

[6] Id.

[7] 25 Conn L. Reptr, No. 9 305.

[8] 170 Conn. 327, 365 A. 2d.1210 (1976).

[9] 25 Conn. L. Rptr. No. 9, 305.

[10] Id.

[11] *Willingham v. Mason Telegraph Publishing Co.* 507 F. 2d 1084 (5th Cir.).

[12] 25 Conn. L. Reptr. No. 9, 305.

[13] *Honan v. Dimyas,* 52 Conn. App. P.3, 133 (1999) and *Delaurentis v. New Haven,* 220 Conn 225, 266-267, 597 A 2d 807 (1991).

[14] 25 Conn.L.Rptr. No. 9, 305.

[15] N. Prosso and W. Keeton, *Torts* (5th Ed. 1984 12 A 60). Quoted in,42 Conn.Sup. 17, 20 (1991).

[16] 25 Conn. L. Rptr. No. 9 30, 6.

[17] *Morris v. Hartford Courant,* 200 Conn 672, 682 (1986).

[18] 25 Conn. L. Reptr. No.9 306 quoting *Seery v. Yale New Haven Hospital,* 17 Conn. App. 532, 540 (1982).

[19] "Man Says Earring Cause of Firing," *Waterbury Republican,* Nov. 5, 1999 at A-2.

[20] Amy Welch, "Fashion: Boys Catching Up with Age-Old Need to Impress," *Waterbury Sunday Republican,* Jan 16, 2000. At 3G.

[21] Id.

ELECTRONIC CONTRACTS: ARE THEY ENFORCEABLE?

by

Diana D'Amico Juettner* and Roy J. Girasa

Introduction

The use of the Internet by consumers has increased dramatically since 1995. In June of 1995, there were less than 1.5 million users; however, one year later the number of users had grown to 20 million. The increase in the number of users has contributed to the growth of business to consumer sales on the Internet. By 1998, approximately 10 million households purchased a product online and the volume of sales was around $66.4 billion. The volume of sales for 1999 has been estimated at $66.4 billion with sales reaching $177.7 billion by 2003.[1] This phenomenon has propelled the use of electronic contracts by those who provide computer-generated goods and services to those who wish to take advantage of the new technology. This expansion of electronic commerce is compelling changes in contract law.

There are two types of contracts that can be entered into online. The first type concerns the delivery of products or services outside the computer system, while the second type relates to subject matter that resides within one or more computer systems. These agreements, contracted for and performed online, are created through the use of electronic agents. Currently, contracts that relate to products deliverable outside the computer may be covered by the Uniform Commercial Code (UCC) while contracts that are completed totally by computer may not be covered. The major issue is whether computer contracts should be governed by the UCC or by some other uniform statute.[2] Other important issues that must be addressed include: whether an electronic contract satisfies the Statute of Frauds; whether the writing can be authenticated; and the validity of the use of digital signatures.

In this paper, we will consider: (1) the Statute of Frauds, authentication of the writing, and the use of digital signatures; (2) applicability of the UCC to electronic contracts, (3) Uniform Computer Information Transactions Act (UCITA), (4) the Electronic Signatures in Global and National Commerce Act of 2000, (5) the potential impact of the passage of these statutes on electronic contracts, and (6) Shrink-Wrap and Click Wrap licenses.

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Contracts Formed on the Internet

Our initial inquiries are: Whether electronic contracts are writings that satisfy the requirements of the Statute of Frauds? Can the writings be authenticated? Can the alteration of the document by the parties after it is executed be determined and prevented? What is the validity of the electronic signature to a contract?

Authentication & Electronic Signatures

There are justified concerns that sophisticated users may be able to change on-screen contracts and allege that the altered agreements are the real agreements entered into by the parties be relied upon. Encryption devices can be used to protect the integrity of the contents of a document and its signature.

What constitutes a "signature" has been broadly interpreted by many courts to encompass typed signatures, letterheads, indecipherable scribbling, and pre-printed signatures.[3] It can be argued that electronic signatures may be more reliable rather than encompassing an impediment to the fulfillment of the Statute of Frauds. The use of encryption devices may provide *greater* security than one's written signature. Such devices would permit both the sender and receiver of a transmission to possess private numeric keys known only to them. Thus they would be able to authenticate the transmission without fear of a third party intrusion.[4]

Digital signatures permit the verification of the authenticity of a document sent through the Internet. Digital signatures operate in electronic commerce the way written signatures operate on typed documents. Neither can disown the signature absence proof of forgery. Digital signatures require use of two keys, one private and one public. The keys are issued by a Certification Authority [CA]. The private key is for the sender and messages are decrypted with the public key. A sender who signs a document with the private key can have his/her signature confirmed by use of the public key.

A document is initially created as, e.g., a word document, which is sent to digital signature software to be processed. The processing or coding is done by means of a sender performing a mathematical computation on his document ("hash function"), which generates a string of code called a message digest. The message digest is based on the specific content of the original document so that any changes would give a different message digest. The algorithm may, e.g., create or count the number of letters or characters between two specific letters in the document. The hash function or result is exhibited as a series of numbers.

The sender encrypts the message digest with his private key, which is a password or number known by the sender only, attaches his signature to the end of the documents thereby signing it by means of a second algorithm, and sends it to the receiver. The receiver having access to the public key may now verify the sender's identity and integrity of the document. The signature is decrypted with the sender's public key and the

original message digest is revealed. The receiver performs the hash function by typing in a public key on his/her copy of the message digest. The public key performs its own algorithm on both the hash function and the signature. If it is identical, the receiver knows the message was not altered and knows that it could only have been encrypted with the sender's private key.[5]

Under the American Bar Association guidelines[6], there are three participating parties: the sender, receiver and the certification authority. The sender or subscriber to the certification process creates a private and public key. A copy of the public key is given to the certification authority. The private key is kept secret by the subscriber. The certification authority acts as an intermediary between the sender/subscriber and the receiver. The certification authority confirms the sender's identity and validity of the key pair. Upon verification, the certification authority issues a certificate with the subscriber's name, identifying information, and the subscriber's public key. Once accepted by the subscriber, the party may then use the key pair to digitally sign the documents. All certificates issued by the authority are placed on-line for receivers so that they can access the subscriber.[7]

Digital signatures allow parties to authenticate and bind parties rendering enforceable online contracts and agreements. Signatures are valuable in furnishing evidence of agreement; they are hard to forge; the document is original and authentic; they constitute affirmation of the person signing to be bound; and they are efficient in indicating authorization of a transaction.

Digital signatures would satisfy the Statute of Frauds, which makes agreements not signed by the party to be charged with exceptions unenforceable. Companies and customers would feel more secure in doing business online knowing whom they are dealing with. Stock traders would feel more comfortable in selling to clients who may not be able to disclaim the purchase.[8]

Problems Raised by the Use of Encryption and Digital Signatures

A major problem is that encryption and digital signature capabilities are not free. It is costly to train representatives, create new institutions, establish accreditation procedures, and determine how to license and audit. There are costs of purchasing the software and keys. A second problem is the many differing laws governing the area. Unless a uniform system of law and regulation is agreed upon by all state authorities and global authorities, the use of such encryption systems may have limited application.[9]

Federal Digital Signature Legislation

Federal legislation is the solution to overcoming the multiplicity of state laws. On July 4, 2000, President Clinton signed the Electronic Signatures in Global and National Commerce Act. Some state laws give wide credence to digital signature use, while other are very restrictive. There is a need for a singular standard. Such legislation should allow non-financial institutions to use electronic authentication services and should allow use of electronic signatures online.

The validity of electronic signatures, as set forth in § 101 of the statute states:

(a) GENERAL RULE- With respect to any contract, agreement, or record entered into or provided in, or affecting, interstate or foreign commerce, notwithstanding any statute, regulation, or other rule of law, the legal effect, validity, or enforceability or such contract, agreement, or record shall not be denied—

(1) on the ground that the contract, agreement, or record is not in writing if the contract, agreement, or record is an electronic record; or

(2) on the ground that the contract, agreement, or record is not signed or is not affirmed by a signature if the contract, agreement, or record is signed or affirmed by an electronic signature.

The statute does not require the parties to use electronic means for agreements nor does it deny them the right to choose the type or method of electronic record or signature to utilize (§101(b)). If a state statute requires a record be provided in writing to a consumer, an electronic record would suffice provided the consumer has consented to such methodology by means of a "conspicuous and visually separate" consent, has been informed of the hardware and software requirements for access and retention of electronic records, and has been otherwise advised of the obligation to provide notifications be electronic means (§ 101(b)(2)).

A state statute requiring that a contract, agreement, or record be retained will be met by an electronic record provided it is an accurate reflection of the information set forth in the written agreement and is accessible for the time required by state law. Requirements for the maintenance of originals, including checks, will suffice if the electronic record contains all of the relevant information (§101(2)(c)).

Of particular importance to our discussion is §102 of the Act concerning the right of a state to modify or supercede the within statute. The Act does permit a state to do so if the state statute, regulation, or rule of law:

(1)(A) constitutes an enactment or adoption of the Uniform Electronic Transactions Act as reported to the State legislatures by the National Conference of Commissioners on Uniform State Laws; or

(B) specifies the alternative procedures or requirements for the use or acceptance (or both) of electronic records or electronic signatures to establish the legal effect, validity, or enforceability of contracts, agreements or records; and

(3) if enacted or adopted after the date of the enactment of this Act, makes specific reference to this Act.

The state statute, if any, may not discriminate in favor of or against a specific technology for authentication of electronic records or specifies a specific type or size of entity engaged in business or is otherwise inconsistent with the Act.

Article 2B of the UCC and UCITA ("Uniform Computer Information Transactions Act")

The National Conference of Commissioners on Uniform State Law (NCCUSL) worked for about ten years to revise Article 2 of the UCC to cover electronic contracts. In March of 1988, the Permanent Editorial Board of the UCC and the (NCCUSL) appointed a study group to identify the problems that electronic exchanges were creating and to recommend possible revisions to the UCC. In December of 1991, a drafting committee was created by the NCCUSL to revise Article 2(Sales) to preserve freedom of contract in connection with electronic contracts. In order to achieve this task, the Drafting Committee considered various alternatives to address the scope of electronic contracts.[10] Three of the alternatives are:

(1) Defining the scope of Article 2 to include software license contracts in Article 2, making adjustments in Article 2 sections to encompass the intangibles character of the transaction, and adopting new sections in the 800 and 900 series to deal with applicable licensing issues.
(2) Adopting an "hub and spoke" configuration for Article 2 in which Article 2 contains general principles applicable to all commercial contracts and have these apply to various sub-articles dealing with specific types of transactions such as 2A (leases), Article B (sales), Article 2C (licenses).
(3) Taking software contracts out of Article 2 and develop a new article of the UCC:

Article 2B Licensing of Intangibles.[11]

In July of 1995, the Executive Committee of the NCCUSL decided that the best way to revise Article 2 was to create a new article to address the issues involving digital information and related rights in intangible property. Accordingly, the American Law Institute and the National Conference of Commissioners on Uniform State Laws prepared a draft of an Article 2B of the Uniform Commercial Code, called "Software Contracts and Licenses of Information."[12] The groups spent many years working to develop Article 2B.

About ten years ago, a Subcommittee of the American Bar Association began studying whether there was a need for a statute that would address the licensing transactions of computer information. The Subcommittee concluded that three was a need to clarify these transactions and recommend to the NCCUSL that a uniform act be drafted. The NCCUSL agreed and appointed a Drafting Committee in the early 1990's.

Firstly, the UCITA Committee was merged into the UCC Drafting Committee for Article 2. In 1995, the UCITA Committee was removed as a separate drafting committee and in 1998 began drafting a separate uniform act.[13]

On April 7, 1999, the ALI and the NCCUSL announced that they would not recommend amending the UCC with Article 2B but were recommending the Uniform Computer Information Transactions Act (UCITA) for adoption by the states. They reached this conclusion because the Internet and Information Technology does not presently allow the kind of codification that is represented by the UCC.[14] The first state to adopt UCITA was Virginia.

The Uniform Computer Information Transactions Act

UCITA applies to contracts to license or buy software, create computer programs online, access to databases and contracts to distribute information over the Internet. Proponents of UCITA assert that the statute:

- Provides for freedom to contract,
- Supports commercial expansion
- Permits federal intellectual property law to co-exist with state contract law, and
- Permits the parties to opt in or out of the statute.[15]

Statutory Definitions

A computer information transaction is "an agreement and the performance of that agreement to create, modify, transfer or license computer information or informational rights in computer information."[16]

Computer information is "information in electronic form that is obtained from or through the use of a computer or that is in digital or similar form capable of being processed by a computer." This term also includes an electronic copy of the information together with any documentation or packaging related to the copy.

Items Not Covered by UCITA

UCITA excludes the following:
1. Financial services transactions which are addressed by the Uniform Electronic Transactions Act(UETA)
2. Contracts related to television, music and motion picture industry
3. Compulsory licenses
4. Employment contracts
5. De minimus transactions.

Mixed Contractual Transactions and UCITA

UCITA will govern the entire contract if the primary purpose of the contract is computer information. When UCITA is not the primary purpose of the contract, UCITA will govern only the computer information portion of the agreement. UCITA does not apply to Articles 3, 4, 4A, 5, 6, 7, and 8 of the Uniform Commercial Code and Article 9 governs if there are conflicts between the two statutes.

Some UCITA Provisions

UCITA permits the formation of electronic contracts by electronic agents if they engage in operations that confirm a contract. It can also be formulated if an individual takes an action and has reason to know that the action will cause the electronic agent to perform.

UCITA does provide(s) the following remedies for licensors of Shrink-wrapped software agreements if the licensee doesn't have the chance to read all the terms of the shrink-wrapped license contract before paying:
1. a full refund,
2. reimbursement of reasonable expenses related to return, and/or
3. payment for foreseeable losses caused by installation of the information.

The warranties provided under UCITA are similar to Article 2 as well as disclaimers that are permitted with certain limitations. They reflect typical computer information considerations such as infringement, integration, etc.

UCITA Remedies

The general rule is to give the aggrieved party the benefit of the contract if there is a breach; however, the aggrieved party must take reasonable measures to mitigate his/her damages. The most controversial of the remedies is electronic self-help.

Pros and Cons of UCITA

UCITA is supported by the large computer related corporations such as: Microsoft, Adobe, America Online and the Federal Reserve. Opponents of UCITA include small businesses, educational institutions, consumer advocates, attorneys general, library associations, and insurance companies.

Satisfying The Writing Requirement of the UCC

One benefit that was derived from the Article 2B proposals and incorporated into UCITA was the change in the definition of a writing to include the maintenance of an electronic record.[17] It gives legal recognition to electronic records as writings as well as digital and electronic signatures. This change helps to address the issues created when the Statute of Frauds is invoked by a party to an action in an electronic contract case.

Historically, oral contracts were enforceable under English law until 1677 when the *Statute of Frauds and Perjuries* was enacted by the British Parliament.[18] In essence, the Statute provided that certain agreements had to be in writing, to wit:

(1) promise to answer for the debt of another;
(2) agreement that by their tenor cannot be performed within one year from the making thereof;
(3) agreements made in consideration of marriage;
(4) agreements concerning the sale of realty;
(5) promise by an executor or administrator of a decedent's estate to pay estate indebtedness from his/her personal funds;
(6) sale of goods whose price is $500 or more; and
(7) miscellaneous other agreements as provided by state law.

The difficulty presented by the Statute of Frauds is that a writing is required for all of the above contracts thus rendering agreements not in accordance therewith unenforceable. The writing must include the signature signed by the party to be charged. Does a digital signature conform to the Statute of Frauds? Without statutory amendments, digital signatures may not qualify. The Statute of Frauds says that the agreement, promise, or undertaking must be "subscribed by the party to be charged therewith, or by his lawful agent…"[19]

The Statute of Frauds requires a signature but the term "signature" is broadly interpreted. The test is whether the person seeking to enforce the contract reasonably believed that the other party intended to authenticate the writing. Thus, initials or other symbols may be sufficient. The sign or symbol can be anywhere on the document and not necessarily at the end thereto. The signature may be typed, stamped, or printed.[20] The UCC 1-201 (39) states that "signed" includes "any symbol, executed or adopted by a party with present intention to authenticate a writing."

In the absence of a broad interpretation by the courts as to admission of electronic terms and signatures under the Statute of Frauds, it would appear that amendments to existing statutory requirements would be necessary. The U.S. could follow English law which abolished the Statute of Frauds for most contracts that previously required a writing or the Statute can be amended to permit a statutory exception for electronic contracts. A modification of the Statute's requirements was instituted by the enactment of the Uniform Commercial Code, Article 2-201 which contains the requirement of a writing for the purchase or sale of goods $500 or more also has a number of exceptions not applicable to the Statute's other sections.[21]

It appears from the exceptions created by the enactment of the UCC three centuries later that scholars are uneasy about rendering unenforceable contracts lacking the requirements of a writing. Historically, prior to the 1677 Statute writings were unnecessary because most inhabitants were illiterate. With the post-World War II enactment of the Uniform Commercial Code, the addition of several major exceptions to the requirement of a writing indicated a desire by the drafters to be more in accord with the realities of the marketplace. The new realities of cyberspace and the multitude of contracts of purchase and sales now taking place illustrate the need to create a new regime for Internet contracts. One may seriously question whether the Statute protects against fraud or permits fraud by allowing a person wishing to avoid a contract to raise the lack of writing defense.[22]

Another advantage of the provisions set forth in the suggested Article 2B may be found in a number of proposed sections thereto. For example, Section 2B-203A(a) would mimic Section 2-207(1) of the UCC Sales Article by permitting acceptance of an offer for Internet services "even if the acceptance contains terms that vary from the terms of the offer, unless the acceptance materially conflicts with material term of the offer or materially varies from the terms of the offer."[23] Section 2B-204 discusses the rules for automated transactions. It explicitly permits the formation of a contract if the interaction by the electronic agents "results in the electronic agents' engaging in operations that confirm or indicate the existence of a contract unless the operations resulted from electronic mistake, fraud and the like."

A contract may be formed in any manner showing agreement including by offer and acceptance, conduct of the parties, and/or operations of electronic agents recognizing the existence of a contract. Such agreement may be established even in the absence of the determination of when the agreement was entered into, or if one or more terms are left open but such terms can be reasonably ascertained. If there is a material disagreement in the absence of contrary conduct, then the contract is not formed.[24] Assent is manifested to a record or term in electronic contracts by authenticating the record or term, by conduct or statements indicating assent, or circumstances show assent by an electronic agent.[25] Shrinkwrap license agreements [discussed below] are enforceable under Section 2B-208(a) unless they are unconscionable or other unenforceable.[26]

Damages in electronic contracts to a licensor by a licensee would include sums not to exceed the contract fee and the market value of other consideration required for performance under the contract. They include accrued and unpaid contract fees, the market value of other consideration earned but not received, consequential and incidental damages, and "damages calculated in any reasonable manner."[27]

Does the Legal Reasoning Applicable to Click Wrap/Shrink-Wrap Licenses Control in Electronic Contracts?

Is the act of entering a credit card number and clicking acceptance of purchase sufficient to make a purchaser liable under terms and conditions set out on the screen in an unreadable form or which are declared after the purchase ? Perhaps the legal reasoning that was promulgated in deciding shrink-wrap license cases will provide a possible direction for electronic cases.

An on-going issue in which courts have decided in opposition to each other is the legality of shrink-wrap licenses. We are all familiar with the packages ensconced in clear plastic cellophane wrappers containing the familiar notice:

> Before you open this package: Carefully read the following legal agreement regarding your use of the enclosed product. By the act of opening the sealed package, using the software or permitting its use, you will indicate your full consent to the terms and conditions of this agreement. If you don't agree with what it says, you may return the software package within 7 days of your receipt for a full refund.

Thereafter, a highly extensive, small print restrictive notice follows the warning. Such notice constitutes what is euphemistically is called a "shrink-wrap" license or agreement.[28] It is on most software packages. The difficulty is that most consumers purchase the product often unaware of the restrictions being imposed upon them until they have unwrapped the package. The notice is often repeated on screen when the user inserts the CD-ROM unto the hard drive. How legal is it to compel purchasers and users of goods containing such notices to comply with the post-purchase restrictions?

At first blush such notices may be superfluous inasmuch as software programs are protected by the copyright laws that restrict users from unlawful copying and/or distribution of the programs. The leading cases discussing the issue are: *ProCD, Incorporated v. Matthew Zeidenberg and Silken Mountain Web Services, Inc.* [29] and *Step-Saver Data Systems, Inc. v. Wyse Technology and the Software Link, Inc.*[30]

In *PROCD*, the plaintiff compiled a computer database containing some 3,000 telephone directories. The database is sold under the trademark label "SelectPhone" to users on CD-ROM discs. The license agreement is seen as soon as the packaging is unwrapped. A copyrighted application program permits the user to search the database for the telephone number of the person named by the user. The plaintiff spent some $10 million to compile and keep current the database. The database costs about $150 to purchasers thereof. The resale or other dissemination of the product was thus restricted by the licensing agreement when the package was opened as well as set forth on initial application of the software.

The defendant, Zeidenberg, bought the software and decided to ignore the restrictive notice by reselling the information under his corporation, Silken Mountain Web Services, Inc. The price charged was less than that charged by the plaintiff. When the plaintiff sued for an injunction and other relief, the lower court held that the license was not enforceable because the terms were not outside of the packaging.

The Court of Appeals reversed. Defendant's claim was that the package on the store's shelf was an offer that a person accepts by buying the product. It noted that the length of the license and other terms would preclude their exhibition on the box cover unless they were printed microscopically. A notice on the outside of the box that the sale is subject to a license with terms detailed on the inside with a right to return the purchase sufficed to protect the licensor. Purchases of goods before communication of detailed terms is made are common. For example, insurance purchases are made without a reading of the policy that follows after the purchase. Ditto for purchases of airline tickets. Tickets for shows have restrictions either on the rear of the ticket and/or at the theatre as to recording and use of cameras. Drugs and appliances have detailed warnings and other information within the box that is not opened until after the purchase.

The Court then addressed whether UCC section 2-201 precluded the holding herein. The lower Court felt that inasmuch as a new UCC section 2-2203 has been proposed to validate shrink-wrap licenses, then the existing section would not so validate. The Court stated that those changes in wording did not necessarily change the meaning of the prior statute but may have fortified or clarified the statute. The Court distinguished three other shrink-wrap cases[31] by stating that the issues therein concerned battle-of-the-forms and not the main issue in the within action.

The appropriate section according to the Court is UCC 2-204(1) which states that "A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract." Thus, a vendor may invite acceptance by conduct and can interpose limitations on what constitutes acceptance. The UCC explicitly allows contracts to be formed in other ways. Such is the case at hand. The defendant was displayed the license agreement on opening the package and on viewing the screen.

Moreover, UCC section 2-206 governing acceptance further reinforces the plaintiff's position. It states that a buyer accepts goods by failing to make an effective rejection after having had an opportunity to inspect them. The defendant inspected the package, used the software, saw the license, and failed to reject the goods.

The Court disposed of the alleged contradictory holding of the U.S. Supreme Court in *Feist Publications, Inc. v. Rural Telephone Service Co.*[32] that held a single alphabetical telephone directory was not original and therefore was not entitled to copyright protection.[33] In the within case, the defendant was precluded by contract if not by the Copyright Law to duplicate the information contained in the CD ROM.

In the *Step-Saver* action, the Court of Appeals for the Third Circuit came to a different conclusion. In 1981, Step-Saver developed a program combining hardware and software to satisfy word processing and other purposes for use by physicians and attorneys based on the IBM personal computer system. It selected a program by the defendant TSL as the operating system and terminals manufactured by Wyse to accomplish its purposes. After having done so, the Company received many complaints from customers and sued Wyse and TSL seeking indemnity with respect to lawsuits instituted against it by customers. The plaintiff, Step-Saver alleged breach of warranties by Wyse and TSL. The trial court dismissed as against TSL holding that the box-top license disclaimed all express and implied warranties.

The box-top licenses stated that the customer did not purchase the software but only a personal, non-transferable license to use the [program; that all expressed and implied warranties were disclaimed; that the sole remedy was to return the defective disk for replacement and that all damages were disclaimed; that the license was the final and complete expression of the parties' agreement' and that opening the package indicated an acceptance of the above terms and conditions. If the user did not agree, the purchase could be returned within fifteen days of purchase and all monies would be returned.

With respect to the effect of the box-top license that the plaintiff alleged did not become a part of the contract because it was a material alteration and that the license was not intended to be a final and complete expression of the terms of the agreement, the Court of Appeals stated that UCC section 2-207 was applicable. The section provides:

> Additional Terms in Acceptance or Confirmation.
>
> (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.
>
> (2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:
> (a) the offer expressly limits acceptance to the terms of the offer,
> (b) they materially alter it, or
> (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.
>
> (3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such a case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provision of the Act."

The Court stated that Section 2-207 attempts to distinguish between standard terms in a form confirmation that a party wishes the Court to incorporate in the event of a dispute and the actual terms understood by the parties as governing the agreement. The burden is upon the party asking the court to enforce its form to determine that a particular clause was a part of the contract. In applying this test, the Court said that the consent by opening provision did not make Step-Saver's acceptance conditional. When a person has gone through the effort of making a purchase, "the purchaser has made a decision to buy a particular product and has actually obtained the product, the purchaser may use it despite the refund offer, regardless of the additional terms specified after the contract formed [at p. 34]." There was no evidence to show that TSL would have refused to sell if Step-Saver had not consented to the restrictive terms. The Court thus held that the box-top license did not contain the complete and final expression of the terms of the parties' agreement.

The difference in the two decisions may lie in the refusal of both courts to become parties to actions by defendants to evade responsibility for errant actions. In the ProCD case, the defendant converted the effort of the plaintiff in amassing data requiring the expenditure of millions of dollars and significant time to integrate telephone listing from many hundreds of sources. In the Step-Saver case, the defendant sought to prevent liability accruing to it for defective performances as to leave the plaintiff in the position of being responsible for its unsatisfactory performance. It would appear, however, that shrink-wrap licenses will be enforceable provided they are not unreasonable, particularly in consumer transactions.

Click-Wrap Agreements

Click-wrap agreements are similar to shrink-wrap licenses. The user generally opens a new program being installed on a computer or where the program was initially installed on a new computer and is faced with an agreement to which the user is given the choice of agreeing or not agreeing with the contents. The program will not open unless consent by clicking on the box containing the words "I agree" or similar wording to the terms on the agreement is given. The question again is whether such agreements are valid and enforceable against the user.

In *Crispi v. Microsoft Network, L.L.C.*, 323 N.J. Super. 118 (N.J. App. Div., 1999), the New Jersey Appellate Court upheld the trial court's determination that such consent by a user becomes a binding contract. The Court also upheld the forum selection clause contained in the agreement that compels all lawsuits arising out of the contract to take place in Kings County, in the State of Washington. Thus, the result of the case is that a person purchasing and using Microsoft programs may have to travel to the State of Washington to sue or defend a lawsuit for an alleged breach of the agreement consented to which agreement becomes known only after one opens the program.

A similar result took place in *Geoff v. A.O.L.*, File No. C.A. No. PC 97-0331, 1998 (R.I. Sup. Ct., 1998), wherein the Court upheld an agreement that a subscriber to America Online's Internet service had to consent to before the service could be accessed. The Court said that a person who signs an agreement by clicking onto the "I agree" button cannot later complain that the agreement was not read or understood.

The Uniform Electronic Transfers Act

In July of 1999, the NCCUSL approved the Uniform Electronic Transfers Act ("UETA") for submission to the states for adoption. This process was underway for three years compared with the more than ten years that were spent working on the revisions to the UCC and ended with the adoption of UCITA about the same time.

The importance of the UETA is that congress specifically refers to the Electronic Signatures in Global and National Commerce Act as an exception to the Act's mandate. The key provision of the Act is Section 7, *Legal Recognition of Electronic Records, Electronic Signatures, and Electronic Contracts*, which states:

(a) A record or signature may not be denied legal effect or enforceability solely because it is in electronic form.
(b) A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation.
(c) If a law requires a record to be in writing, an electronic record satisfies the law.
(d) If a law requires a signature, an electronic signature satisfies the law.

The Act applies to electronic records and signatures relating to a transaction connected to a business, commercial and governmental affairs. It is broader that Article 2B and USCITA inasmuch as it is not limited to licensing agreements and covers the transactions in Article 2 of the UCC. By adopting the UETA, states need not be concerned with an expansive definition of a writing nor need it adopt the controversial Article 2B. Thus, it appears that states have a variety of choices in the legislative scheme they wish to adopt. The clear mandate is that an electronic record may no longer be denied legal effect.

CONCLUSION

The world of technology is transforming the marketplace (so as) to make global purchases as easy as going to a nearby shopping mall. In order to enable buyers and sellers of goods using the ever improving electronic marketing technology to engage in global purchases, the rules of the game have to keep pace. Contracts over the Internet are but one area of law that has to be greatly modified. Because the technology is changing at such a rapid pace, legal protections must be rapidly updated to keep current with the technology. Congressional enactments in diverse areas concerning the Internet have taken place as to

intellectual property rights, cybercrime and the like. Similar developments in cybercontracts are now taking shape. We have discussed a few of the issues being addressed at this time.

ENDNOTES

[1] Karle, Ted, "Information Supernova," Internet Guide/A Supplement to Government Technology, October 1999, p.13.

[2] Nimmer, Raymond T. "Electronic Contracting: Legal Issues," XIV Journal of Computer and Information Law, 211 (1996).

[3] The UCC 1-201, Comment 39 states: "The inclusion of authentication in the definition of "signed" is to make clear that as the term is used in this Act a complete signature is not necessary. Authentication may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible authentications can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always I whether the symbol was executed or adopted by the party with present intention to authenticate the writing." See also *Merrill Lynch, Pierce, Fenner & Smith v. Cole*, 189 Conn. 518, 457 A. 2d 656 (1983).

[4] Such transmissions may be made in accordance with the Digital Signature Guidelines: Legal Infrastructure for Certification Authorities and Secure Electronic Commerce.

[5] For a visual illustration of the process, see Ron White, "How It Works: Digital Signatures," *PC Computing*, (March 2000), pp. 152-153.

[6] (page 4)Digital Signature Guidelines, 1996 A.B.A. Sec. & Tech. Info. Security Committee 1.

[7] For a detailed description of the process and the Guidelines, see Edward D. Kania, "ESSAY: The ABA's Digital Signature Guidelines: An Imperfect Solution to Digital Signatures on the Internet," 7 *CommLaw Conspectus 297,* particularly pp. 301-302.

[8] See Kwan, *op. cit.*, pp. 463-468.

[9] A number of states, such as Florida, Minnesota, Utah, and Washington have adopted the Guidelines and there is pending a bill before Congress known as the Electronic Financial Services Efficiency Act of 1997, but there are a number of alleged flaws with the Guidelines that have caused the legislators to withhold a federally mandated statute. Such flaws include the possibility of fraud because it is the subscriber who creates the key pair and may attempt to act in bad faith by altering digitally signed documents after they have been transmitted. Kania, *id.*, p. 308.

[10] Szafran, Marc E., "Note: A Neo-Institutional Paradigm for Contracts Formed in Cyberspace: Judgment Day for the Statute of Frauds, 14 *Cardozo Ars and Ent. L.J. 491,498 (1996).*

[11] See Nimmer, Raymond et al. "License Contracts Under Article 2 of the Uniform Commercial Code: A Proposal," *19 Rutgers Computer and Technology Law Journal 281, 283 (1993).*

[12] For a lengthy examination of Article 2B, see Jody Storm Gale, "NOTE: Service Over the "Net": Principles of Contract Law in Conflict," 49 Case W. Res. 567 (Spring, 1999).

[13] Dively, Mary Jo Howard & Carlyle C. Ring, Jr. "Overview of Uniform Computer Information Transactions Act, p.3. Paper written by the Advisor to Drafting Committee and Chair of UCITA Drafting Committee respectively. http://www.law.upenn.edu/bll/ulc/ucita/htm

[14] Press Release of the National Conference of Commissioners on Uniform State Laws, April 7, 1999, Chicago, Illinois.

[15] Dively, Mary Jo Howard. Overview of the Uniform Computer Information Transactions Act. Paper presented at the Conference on Electronic Commerce: Exploring the Legal and Business Interface at Georgetown University School of Law, Washington, D.C., December 8-10,1999.

[16] UCITA, Section 102(12)

[17] Article 2B-102(37). See also 2B-207.

[18] For a discussion of the Statute of Frauds, see any standard basic business law text such as Ronald A. Anderson, Ivan Fox, David B. Twomey, and Marianne M. Jennings, *Business Law and the Legal Environment*, (17th ed., (West Publishing Company: 1999), pp. 300-304. The Statute of Frauds in New York can be found in *General Obligations Law, McKinney's Consolidated Laws of New York Annotated*, Book 23 A, section 5-701. See, also, the Uniform Commercial Code, section 2-201 for the sale of goods provision of the Statute of Frauds.

[19] See *McKinney's*, id, 5-701(a).

[20] See E. Allan Farnsworth, *Contracts*, 2d ed. (Little, Brown and Company, 1990), pp. 434-435, citing *Southwest Engr. Co. v. Martin Tractor Co.*, 205 Kan. 684, 473 P. 2d 1276 (4th Cir.) where the seller's trademark on sales brochures was a signature. In *Merrill, Lynch, Pierce, Fenner & Smith v. Cole*, 189 Conn. 518, 547 A. 2d 656 (1983), a letterhead or billhead was sufficient for statutory requirements under UCC 2-210.

[21] Section 2-201 provides: "(2) Between merchants if within a reasonable time a writing in confirmation of the contract is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within ten days after it is received. (3) A contract which does not satisfy the requirements of subsection (1) [requirement of a writing for sale of goods of $500 or more] but which is valid in other respects is enforceable (a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or (b) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or © with respect to goods for which payment has been made and accepted or which has been received and accepted..."

[22] For an in depth discussion of the Statute of Frauds and its applicability in today's world, see Shawn Pompian, *Note: Is the Statute of Frauds Ready for Electronic Contracting?*, 85 Va. L. Rev. 1447 (Oct. 1999).

[23] Like Article 2, as between parties either or both of whom are not merchants, then the terms of the original offer hold, nonmaterial added terms are treated as proposals for added terms and, as between merchants, the proposed added terms become part of the contract unless the offeror gives notice of objection before or with in a reasonable time after notice of the said added terms.

[24] Section 2B-202.

[25] Section 2B-111(a).

[26] Section 2B-208(a) provides: "A party adopts the terms of a mass-market license for purposes of Section 2B-207 only if the party agrees to the license, by manifesting assent or otherwise, before or during the party's initial performance or use of or access to the information." Section 2B-207 states that a party adopts the proposed license agreement by assenting to it initially or even later if the party knew the whole of it would be presented at a subsequent time.

[27] Section 2B-708-2B-709.

[28] For a more detailed discussion of this issue, see David A. Einhorn, "Shrink-Wrap Licenses: The Debate Continues," *IDEA: The Journal of Law and Technology*, 38 IDEA 383-401.

[29] _F. 2d _ (U.S.C.A. 7th Cir., 1996).

[30] 939 F. 2d 91 (U.S.C.A. 3d, 1991).

[31] *Step-Saver Data Systems, Inc. v. Wyse Technology*, 939 F. 2d 91 (3d Cir. 1991); *Vault Corp. v. Quaid Software Ltd.*, 847 F. 2d 255, 268-70 (5th Cir. 1988).;and *Arizona Retail Systems, Inc. v. Software Link, Inc.*; 831 F. Supp. 759 (D. Ariz. 1993).

[32] 499 U.S. 340 (1991).

[33] Section 301(a) preempts any "legal or equitable rights…that are equivalent to any of the exclusive rights within the general scope of copyright as specified in section 106 in works of authorship that are fixed in a tangible medium of expression and come within the subject matter of copyright as specified in sections 102 and 103."

THE EMERGING LAW IN RESIDENTIAL
REAL ESTATE RESALE
DISCLOSURES -- IS IT STYMIED!

by

Saul S. Le Vine*

Introduction

In 1985, the California legislature enacted the first statute requiring sellers of residential real property and participating brokers to disclose to prospective purchasers comprehensive information relative to the condition, value and desirability of the property offered for sale. As a result of this legislation, a substantial number of other states passed legislation mandating some form of disclosure by sellers but not by brokers. Many states are currently considering a more limited form of mandatory property-condition disclosure legislation.

The California legislation[1] essentially codified the state's unique common law requirement that both sellers and brokers discover and disclose all information material to the value and desirability of the property offered for sale.[2] In the states where this has been enacted however, the prevailing form of limited disclosure legislation has used the local common law which is far less than the California standards.[3] The desirability of this movement toward enacting property condition disclosure legislation can be most usefully evaluated only after a comparative analysis of the common law, the various legislative regulatory schemes and the effects of the latter on the evolution of the former.

Common Law

An examination of the common law development of inspection and disclosure duties on sellers, brokers and buyers in the residential real estate sales market concludes that the common law has been developing in a fashion which creates greater duties of fairness and commercial reasonableness on sellers and brokers. Various states have also imposed an explicit duty of inspection or disclosure on sellers or brokers.[4] These requirements have taken the form of being enacted by statute in many states. In some states regulatory agencies covering real estate brokers have been promulgated.[5]

History – Common Law

The right to buy, own and sell property is inherent and much protected individual rights under common law in this country. These rights have been reflected in the applicable provisions

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of the Fifth and Fourteenth Amendments of the Constitution.[6] It has always been consistently held that property rights in connection with the sale of residential real property by its owner was not burdened with the imposition of affirmative disclosure duties by the judicially created traditional common law.[7]

The case history seems to have created the duty to evaluate the property on the buyer rather than the seller or his agent (broker). It was held that mere non-disclosure of material facts would normally not be a ground for action in the nature of misrepresentation.[8] This formed the concept of the traditional *caveat emptor*, let the buyer beware or take care.[9]

Also serving to insulate the seller from liability and relating to *caveat emptor* is the doctrine of "merger" in a real estate transaction. This doctrine holds that all warranties and representations made in connection with a sale, are considered to be merged into the deed, unless specifically expressed in writing to survive delivery of the deed.[10] The deed is considered full compliance and performance of the obligations created in the Contract of Sale.[11] Once the buyer accepts the deed, the Contract ceases to exist and the rights of the seller and buyer are regulated by the deed.[12]

The merger doctrine satisfies and extinguishes all contract covenants that relate to title, possession, quantity or conditions of the land.[13] Traditionally, a purchaser of a resale residence had no remedy against the seller under an implied warranty of habitability theory, which theory was generally applied to the sale of newly constructed homes.[14]

In 1992, a New Jersey Appellate Court broke new ground by allowing a buyer to recover against the seller of a resale home with a defective septic tank. The Court held that "an implied warranty of habitability should also apply to the sale of a used home", because it is based on "current notions of what is right and just."[15] This law had been established that the elements of intentional misrepresentation are:

1. a false representation of fact;
2. knowledge by the defendant that the representation is false or a reckless disregard for the truth or falsity of the statement;
3. the knowledge to induce the plaintiff to rely on the information;
4. plaintiff's justifiable reliance upon such representation; and
5. resultant damage from such reliance.[16]

The primary difference between negligent misrepresentation and intentional misrepresentation is that in a negligent misrepresentation suit the plaintiff does not have to prove that the defendant made the false representation with the intention to deceive, or that he or she knew the disclosed information was false and just prove lack of reasonable care.[17]

The Illinois courts have recognized that an action is maintainable if it alleges the elements of a duty owed, a breach of such duty and an injury resulting from such breach.[18]

Influencing the concept of mandating disclosure through legislation has been a very gradual expansion of the scope of acknowledging common law fraud to include the nondisclosure of material information by sellers and brokers.[19] The courts have increasingly imposed a duty to speak, and coupled with the duties to speak have found liability for non-disclosure which is equivalent to false disclosure.[20]

It must be noted that while courts began to hold that non-disclosures may satisfy the elements of a false statement of a material fact, the remaining tort elements of culpability, reasonable reliance, causation and damage have remained essential to the recovery under common law fraud.

Under traditional common law, obligations imposed on the seller of real property created a duty to prospective purchasers not to make any false representations or actively conceal any defects or material facts.[21] That traditional duty did not, however, generally require sellers to affirmatively disclose such material facts. Mere silence without a duty to speak has never been actionable.[22] However, courts have increasingly found that certain circumstances, particularly partial disclosure, create a duty to speak.[23] Therefore, if the seller is asked about or speaks about a particular subject, he or she must make a full and fair disclosure as to that subject so as not to mislead the buyer.[24] Also rather well established is the obligation of complete disclosure based on a finding of an agency, fiduciary, confidential or other relationship of trust existing legally or factually between the parties. In several cases in various states, there were findings that there were no fiduciary duties between the parties where the seller did not have actual knowledge of the defect. In New York, as noted in my companion paper, the holdings of a vendor-builder was liable for fraudulently concealing massive foundation cracks in a home sold to a purchaser.[25]

A majority of state courts have expanded the scope of the duty of a seller of residential real property to disclose material facts to a prospective buyer.[26] One of the leading cases is *Lingsch v. Savage*.[27] The California Court of Appeals concluded: [Where it was] "presented with an instance of mere nondisclosure, rather than active concealment occurring between parties not in a confidential relationship...that it is now well settled in California that where the seller knows of facts materially affecting the value or desirability of the property which are known or accessible only to him and also knows that such facts are not known to, or within reach of the diligent attention and observation of the buyer, the seller is under a duty to disclose them to the buyer. Failure of the seller to fulfill such duty of disclosure constitutes actual fraud."[28]

In a similar case, the New Jersey Supreme Court reversed a ruling of summary judgment in favor of a seller of real property infested with roaches, holding that "current principles grounded on justice and fair dealing...clearly call for a full trial below."[29] In support of its decision, the court noted that:

> The statement may often be found if either party to a contract of sale conceals or suppresses a material fact which he is in good faith bound to disclose then his silence is fraudulent. The attitude of the courts toward nondisclosure is undergoing a change. Contrary to Lord Cairn's famous remark, it would seem that the object of the law in these cases should be to impose on parties to the transaction a duty to speak whenever justice, equity and fair dealing demand it. This statement is made only with reference to instances where the party to be charged is an actor in the transaction. This duty to speak does not result from an implied representation by silence, but exists because a refusal to speak constitutes unfair conduct.[30]

In a third case, *Johnson v. Davis* which involved property with a defective roof, the Florida Supreme Court affirmed a lower court's award of rescission reasoning that:

> "Modern concepts of justice and fair dealing have given our courts the opportunity and latitude to change legal precepts in order to conform to society's needs. Thus the tendency of the more recent cases has been to restrict rather than extend the doctrine of *caveat emptor*. The law appears to be working toward the ultimate conclusion that full disclosure of all material facts must be made whenever elementary fair conduct demands it."[31]

These cases illustrate a trend in state courts to expand the duty of the seller to disclose and thereby to make a nondisclosure as actionable as a false disclosure. In other words, the plaintiff must establish all of the several elements of common law fraud as previously set forth.[32]

In either case, the materiality of the nondisclosure is critical.[33] A fact is material as a matter of common law fraud if "a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question."[34] Specifically in the area of real estate fraud, state courts generally relied on that classic definition held that a material fact is one "to which a reasonable man might be expected to attach importance in making his choice of action." A Florida Court held that a material fact is one that substantially affects the value of the property.[35]

Although materiality is a mixed question of law and fact, courts have found the following conditions to be material so that a seller's failure to disclose them is actionable: prior termite damage, active termite damage, illegal and condemned building, defective roof, defective well, radioactive mine tailings, filled soil, defective septic system, building code violation, lot requiring retaining wall prior to constructing a building, generally deteriorated condition of the property, wood beetle damage, water rights, contaminated well, basement flooding, drain tile underneath house, structural defects, artisan well underneath property, prior fire damage, tilting house, sewer connection charges, house insulated with ureaformaldehyde insulation, defective earth-sheltered home, and flood damage.

Although this list is extensive, a few courts have found that sellers have a duty to disclose only where the defect or condition (whether or not material) is dangerous or poses a threat to health and safety.[36] Some states sellers are not liable for damages caused by defects existing at the time of sale. The courts acknowledge that they are required to "disclose to the purchaser any concealed condition known to him that involves an unreasonable danger. Failure to make such disclosure or efforts to conceal a dangerous condition, render the vendor liable for resulting injuries."[37] Similarly, a Pennsylvania Appeals Court, in holding the sellers liable for failing to disclose a defective sewage disposal system, affirmed that "the modern view...holds that where there is a serious and dangerous latent defect known to exist by the seller, then he must disclose such defect to the unknowing buyer or suffer liability for his failure to do so."[38] The facts of this case reflect that the seller may not have known of the dangerous condition, and suggest that the element of culpability may be satisfied by reckless disregard or negligence where an unsafe condition exists.[39]

Some courts have relieved the seller of liability when the contract contains an "as is" clause. Generally, an "as is" clause will be upheld if the defects are "obvious" or "reasonably discernible." In the absence of fraud, mutual mistake, or warranty, courts will respect an "as is" clause.[40]

In some jurisdictions, the existence of an "as is" clause in a contract of sale for real estate will not relieve the vendor of his obligation to disclose a condition which substantially affects the value or habitability of the property. When the seller has actual knowledge of the condition and it and would not be disclosed by a reasonable and diligent inspection to the purchaser, the failure to disclose has constituted fraud.[41]

Consumer protection laws are typical required disclosure statutes. They usually list prohibited acts and allow damages or rescission to an injured party.[42] Under the Connecticut Unfair Trade Practice Act, a buyer of residential real estate was awarded rescission in addition to monetary and punitive damages for injury resulting from the seller" nondisclosure of defects. The court stated that the seller was obligated to disclose the denied request for a subsurface sewage system permit.[43]

In cases of passive concealment by the seller of defective real property, there is an exception to the rule of *caveat emptor*...which imposes a duty on the seller to disclose material facts which are known or should be known to the seller and which would not be discoverable by the buyer's exercise of ordinary care and diligence.

Brokers have very little incentive (indeed, significant disincentives) to provide information to the buyer. Brokers are usually agents of the seller, but in many cases are effectively representing the buyers and therefore full disclosure should be compelled. It is suggested that brokers should not be allowed to continue to expect immunity from buyers' causes of action, and that brokers should be compelled to disclose to the buyer all available information.

Presently, a growing number of courts require brokers participating in the sale of residential real estate to disclose facts materially affecting the value or desirability of the offered property, so long as the facts are known by the broker (structural defects), and neither known by the prospective purchaser, nor available to her through a reasonable inspection.[45] Any failure to disclose in accordance with that judicially imposed duty constitutes actionable fraud, provided, of course, that the remaining essential elements of culpability, reasonable reliance, causation, and damages can be established by the complaining purchaser.

In view of the customary lack of any sort of confidential relationship between a prospective purchaser and the selling broker, it has been difficult for common law courts to logically impose a duty to disclose on the broker, or even to extend the seller's duty to the real estate broker. Although some courts have refused to hold a broker liable on such grounds, most agree with the Lingsch court that an actionable real estate fraud case "does not require privity of contract."

Obligations to Disclose under the Statute

In 1984, a California Court of Appeals ruled in the landmark case of *Easton v. Strassburger*[46] that a real estate broker acting for a seller of residential real property has an "affirmative duty to conduct a reasonably competent and diligent inspection of the residential property listed for sale and to disclose to prospective purchasers all facts materially affecting the value or desirability of the property that such an investigation would reveal."[47] At the time Easton was decided, state courts, including those in California, had repeatedly analyzed the applicability of the common law torts of fraudulent concealment, intentional misrepresentation, and negligent misrepresentation to cases of nondisclosure of property defects. Since an essential element for the establishment of common law fraud in a nondisclosure (rather than a false disclosure) case is the existence of a duty to disclose, erosion of the early doctrine of *caveat emptor* required the courts to define and rationalize the imposition of such a duty on the owner, the selling broker, or others participating in the sale of the offered property.[48]

No court, in California or elsewhere, however, at the time of Easton had yet interpreted a broker's duty to disclose known defects as including an obligation to conduct a reasonably competent and diligent inspection of the property. Further, no court had found, based on the imposition of such a duty, that a broker is liable to a buyer for negligently failing to disclose such discoverable information. The California Courts took a major step forward in expanding, if not creating, a remedy for not only a seller's but also a real estate broker's negligent failure to disclose reasonably discoverable defects or other adverse material information to a prospective buyer of the residential resale real property.

In July of 1985, California became the first state to enact legislation specifically covering this area of controversy. The legislature acted largely in response to outcries from real estate brokers who reacted to the Easton court's expansive view of their duties to inspect and disclose. Under the sponsorship and lobbying of the California Association of Realtors, the California legislature approved the first, and still the most comprehensive real property condition disclosure legislation.[50] It became effective on January 1, 1986, with respect to brokers and January 1, 1987, with regard to sellers. The legislature intended to "codify and make precise," but arguably also to limit certain obligations under the Easton decision.

The California legislature chose largely to embrace rather than reject, the expanded property condition disclosure requirements laid down by the Easton court. As explained below, however, in an effort to set objective, easily understood guidelines for making full and fair disclosure, the legislature may have created statutory scheme that falls short of what Easton requires. As a consequence, the courts as having effectively limited the impact of the Easton opinion may interpret the statute. Since California's enactment of its mandatory property condition disclosure legislation in 1985, other states have adopted a form of such regulation, which in every case were very much "watered down" versions of the legislation.

<u>The California Statutory Approach</u>

Two statutes (collectively the "California Act") were enacted in response to Easton. The first is entitled "Article 1.5 Disclosures Upon Transfer of Residential Property" (the "Disclosure Article"). [51] The second is entitled "Article 2. Duty to Prospective Purchaser of Residential Property" (the "Broker Duty Article"). [52] The statutes are applicable to all sales, exchanges and related transfers for value of residential real property or residential stock cooperatives containing four or fewer dwelling units. The Broker Duty Article, of course, only applies to such sales, exchanges and transfers involving a licensed real estate broker. The California Act, unlike most of the other States, applies to all sales of new or never occupied residences as well as to all resales.[53]

Given the Easton holding, it is noteworthy that neither the statutorily mandated form nor any other provision of the California Act requires the seller to disclose any defects or other facts not specifically called for, even if they are material to the Purchaser's assessment of the value or desirability of the property. However, the Disclosure Article makes clear that, "the specification of items for disclosure in this article does not limit ... any obligation for disclosure created by any other provision of law or which may exist in order to avoid fraud, misrepresentation, or deceit in the transfer transaction." In other words, while the new law mandates that specific information on a prescribed written form must be actually delivered to the prospective purchaser, it does not by its more limited scope effect any limitation on the broader duty to disclose "all facts materially affecting the value or desirability of the property, recognized by the Easton opinion." [54]

After defining the affirmative disclosure duties of brokers participating in a regulated sale, the California legislature, presumably in response to the uncertainties sounded by representatives of the real estate brokerage industry, added certain clarifying provisions to the statute. For example, Broker Duty Article Section 2079.2 explains that the standard of care owed by any broker subject to Section 2079's inspection and disclosure requirements is "the degree of care that a reasonably prudent real estate licensee would exercise and is measured by the degree of knowledge through education, experience and examination, required to obtain a license."[55] In passing over the reasonably prudent person standard, applicable to most common law tort claims including misrepresentation, in favor of this higher reasonably prudent licensed, educated, experienced, and examined real estate broker standard, the California legislature adopted the philosophy seemingly underlying the Easton decision.[56] That philosophy holds that a broker who presents himself to prospective purchasers and to the public as an experienced, licensed professional in the field of residential real property transactions, and who financially benefits as a result of so doing, should be held to a standard of care consistent with that position. While this stricter standard varies from that normally applied under ordinary negligence law (reasonable prudent person standard), it is well established in the analogous area of the federal regulation of sales of securities. There, the public investor (like the homebuyer) is less able than the broker to obtain the relevant information about the proposed investment. As a practical matter, he is forced to rely on the selling broker.

The Disclosure Article offers no remedy of recession and restitution once the transaction has been completed.[57] It does allow a purchaser to recover the actual damages suffered, as a result of any person's willful or negligent failure to comply with any of the statute's requirements. As against the seller, then, who, as noted above, is required to disclose only in response to the form's enumerated list of questions, a purchaser may recover damages under the statute only if the seller willfully or negligently failed to deliver the disclosure statement, failed to answer any of the enumerated questions, or falsely answered one or more of those questions. As mentioned above, this remedy is in addition to, and in no way replaces or limits, any common

law remedy, whether or not grounded in Easton, that may be available to a damaged purchaser.[58] As against brokers, a purchaser may recover damages under the Disclosure Article if the broker willfully or negligently failed to adequately complete the visual inspection of the premises or failed to make complete disclosure of material facts discoverable from the inspection required in the Broker Duty Article.

The Disclosure Article makes clear that, irrespective of whether the defendant is a seller or a broker, there is no liability for any false or omitted information unless it was within the actual knowledge of the defendant or, in the case of information supplied by a public agency or a recognized expert, unless he or she failed to exercise ordinary care in obtaining and transmitting it. No seller or broker can be found liable for an innocent misstatement or omission; he or she must be found guilty of no less than negligence in fulfilling the duties of investigation and disclosure as described in the statute. Consistent with the common law, if the seller or broker exercised due diligence by meeting the required standard of care, no liability will attach. The affirmative defense of due diligence is reinforced by Section 2079.5, which makes it clear that a buyer must exercise reasonable care to protect himself and cannot recover from a broker who fails to point out a defect or other adverse fact that should have been discovered by a reasonably attentive and observant buyer. Indeed, further reinforcement can be inferred from the statutorily required suggestion of the mandated disclosure statement that buyers and sellers should consider having the property professionally inspected. The statutorily available due diligence defense and its recognition of the corresponding purchaser duty of exercising ordinary care is consistent with the common law, even as expanded by Easton. Section 1102.4 allows reasonable reliance on such experts as licensed engineers, land surveyors, geologists, structural pest control operators, contractors and others.

Neither the California Act nor any of its five earlier legislative undertakings require the seller of residential real property to make any disclosure of material information not specifically called for by the applicable disclosure document. However, disclosure to prospective buyers of all known or reasonably discoverable material information is required of seller and brokers by the Easton decision and of brokers by the Broker Duty Article of the California Act. Furthermore, disclosure of all known "material defects" (though not other material information) is required of brokers by the Maine and New Hampshire Rules. It is noteworthy that other statutes also impose upon sellers this more open-ended duty to disclose any other known material defects, in addition to the items specifically enumerated in the statute.[59] While these acts facially go further than the Disclosure Article of the California Act, the common law in most jurisdictions already prohibits the fraudulent concealment of known defects and increasingly requires disclosure of those defects that are reasonably ascertainable by sellers of real property and participating brokers.

Historically, the sale of residential real property, like the sale of other real and personal property of all sorts, was regulated largely by the common law torts of fraudulent concealment, intentional misrepresentation, and negligent misrepresentation. The elements of real estate fraud are a characteristic and strength of the common law, and the courts to accommodate the realities of the marketplace have from time to time adopted them. As a result the courts in the Easton case recognized a duty to be imposed upon the sellers of residential real property, and imposing the same duty on any and all participating brokers, to inspect the offered real property and to disclose not only any defects discoverable during that inspection, but also "all facts materially affecting the value or desirability of the property"[60] to any and all prospective purchasers. This expansion of real estate fraud to provide a common law damage remedy for buyers in California would, in the normal course, have been further refined by case law in that state. No doubt it would also have been adopted by at least some other state courts that have long regarded the California courts to beat the forefront of tort law evolution. Instead, the major consequence of the Easton decision was the enactment of the California Act. The impact of that legislation on the scope and direction of the law of real estate fraud has been and continues to be enormous. Essentially the evolving Easton approach, even to the extent, preserved in the California codification, now stands stymied.

The California Act largely codified and thereby ratified the expanded duties owed by the sellers and brokers of residential real property. The Disclosure Article goes further than the judicially created law by affirmatively requiring the preparation and delivery of a disclosure statement containing prescribed detailed useful information, and by providing a buyer with a remedy for any damages caused by a violation of that requirement. While the statutory disclosure requirement clearly helps the buyer obtain at least some useful information, and presumably makes him aware of the right to obtain correct and complete information, it adds only modestly to the broad run from the earlier of the date of the discovery of the actionable misstatement or omission on the date on which it should reasonably have been discovered.

Unlike the Disclosure Article, there is no provision in the Broker Duty Article stating that it is in addition to the broader duty and corresponding remedy afforded a prospective buyer by the Easton opinion. Accordingly, it could be argued that the California legislature was persuaded and that it intended to ratify only a portion of Easton, thereby limiting the scope of the broker's duty of inspection and disclosure to that expressly detailed in that Article.[61] Under this analysis, one effect of the statute is to reduce the risk of liability that existed after Easton to a broker who provides false or incomplete disclosure. As a practical matter, such an interpretation of the statute would be to afford protection to the broker at the expense of the buyer, and perhaps more importantly, at the expense of the seller to whom the buyer would be forced to look exclusively for his or her remedy. Until the intent of the legislature is determined by the California courts faced with facts that would cause a broker to be found liable under Easton but not under the statute, the effect of the statute on the then-existing common law in this critical area of broker liability is a continuing uncertainty.

In most jurisdictions other than California, the early well-established doctrine of *caveat emptor* remained substantially intact, precluding or at least slowing any judicial creation and expansion of disclosure duties necessary to support a remedy for nondisclosure. In general, an uninformed, rather than misinformed buyer's only legal remedy law in the doctrine of fraudulent concealment of a known defect to the limited extent that it existed under the applicable state law. It therefore eliminated for the foreseeable future, any judicial attempt to move in the direction of imposing any duty of disclosure whatsoever on members of the real estate industry. To the limited extent that a purchaser of real estate is benefited by the Prevailing Disclosure Act, all costs of that benefit fall on the individual seller rather than on the real estate professional.

Another category of relevant statutes is that of the various consumer protection acts, where again, the presumed purpose was to afford legal recourse to inadequately protected consumers.[62] In those somewhat analogous areas, the lawmakers seem to have concluded that the protection of the then inadequately protected investor or consumer was necessary and desirable, that the disclosure form of regulation was effective, and that the costs of compliance were not unreasonably burdensome to the sellers and their agents, as compared to the resulting benefits for the protected class and the marketplace generally.

The Prevailing Disclosure Act has the appearance of being enacted in order to provide needed protection to the purchasers of residential real estate. Therefore, it too should be evaluated and measured against possible alternatives by balancing its benefits with its costs to all concerned parties.

As set forth above, the purchaser of residential real estate has a common law remedy against the seller and participating brokers for damages proximately caused by the misrepresentation or fraudulent concealment of known material defects. Prior to the enactment of the Prevailing Disclosure Act, neither sellers nor brokers in states other than California, Maine and New Hampshire had any duty to make any disclosure unless they had knowledge of a material defect. Furthermore, they had no duty to inspect or to take other action to discover the existence of any material defects.

As a practical matter, the buyer must undertake the same inspection of the premises as was necessary in the absence of the Prevailing Disclosure Act to protect against overpaying and to establish the element of reasonable reliance for a possible fraud claim. An unfortunate affect of the statute is that upon receiving a disclosure document with a formal and legalistic appearance, the buyer may assume that he or she is fully informed and forego such an investigation.

Another cost to the buyer is the increase in price resulting from the burdens of complying with the mandated disclosure requirements. A seller may reasonably believe that the complexities of the new law preclude her selling the property without the services of a broker, and will therefore increase the price to cover the broker's commission. Ironically, however, the imposition of greater duties of inspection and disclosure on the broker was short-circuited by the passage of the Prevailing Disclosure Act, which at the same time makes the broker more essential.

Practically, however, the seller is forced or believes he is forced to engage a real estate broker in order to handle the required compliance at a cost that the seller may not be able to fully pass on to the buyer. The increased cost is at least a small burden on an individual's inherent right to acquire and sell real property, especially since many sellers list with brokers in any event. Again, ironically, while the broker becomes almost indispensable as a result of the statutory compliance obligations, that same statute not only fails to impose any new duties of inspection or disclosure on the broker but also even fails to acknowledge any duties arguably still existing at common law. Accordingly, the statutory limit on a broker's potential liability to a defrauded purchaser has shifted the risk of any such liability dramatically from the broker to the seller.

As a matter of substance, the seller's burden is only marginally increased since he or she is already obligated under common law principles to disclose all known defects. In addition, the seller gains some benefit since he cannot be held liable for any damage caused by a disclosed defect or condition.

As mentioned above, the National Association of Realtors has been the prime impetus behind the passage of the Prevailing Disclosure Act.[63] It comes as no surprise, therefore, that the benefits to the broker and the brokerage industry are enormous. Simply put, the statute enhances the dependence of a seller of residential real estate on the services of a broker, effectively limits the broker's liability for nondisclosure to the purchaser, and prevents the imposition of a duty on the broker to inspect and disclose to the purchaser the discoverable fruits of that inspection. The imposition of such a duty would likely occur through judicial development in the absence of the statutes' enactment. The Prevailing Disclosure Act provides some small-added disclosure to the purchaser.[64] All of these effects occur at the expense of the seller rather than the broker, without a single cost to the broker. It would be difficult to envision a statutory scheme better designed to further the special interests of the real estate brokerage industry.

Another factor that bears on defining the parameters of any required inspection is the scope of the inspection. The key question is whether the inspection should cover only readily accessible areas or consist of a more complete investigation. Again, this is related to the identity of the inspector. A seller inspection cannot be expected to extend beyond readily accessible areas; a professional home inspector will look for hidden defects and examine hard to reach areas. The real question arises if a statute requires a broker inspection. Based on an assumed level of expertise, it would be fair to require brokers to perform a more complete inspection. However, brokers are not as competent or experienced as professional home inspectors to perform a truly complete inspection are.[65] Clearly, if the public policy goal of disclosure legislation is to fully inform the buyer of potential defects, a full, rather than a visual inspection is preferable. Following the scope of inspection logic would argue for broker inspection at a minimum and a professional inspection as preferable.

If policy moves in the direction of a professional inspection, the legislature must deal with the issue of cost. Inspection and disclosure by the seller is cost-free to the parties and provides the buyer with no additional protection. Although it is true that the broker may be liable for negligence or misfeasance if he does the inspection himself. Brokers are compensated almost universally on a commission basis, based on a percentage of the sales price. The commission covers all of the broker's activities in marketing the property, assisting the buyer and closing the transaction. The broker must undertake some level of property inspection for no other reason than to become familiar with the property and to make suggestions to the seller to repair or improve the house so it "shows" better. Requiring the broker to undertake a more complete physical inspection of the property for disclosure purposes does not materially add to the time or effort that he or she devotes to the property.

On the other hand, the old adage "you get what you pay for" might apply to opting for a broker inspection solely because it imposes no additional cost on the transaction. The best protection comes from a professional inspection. Depending on the market area, type of property, and the items included in the inspection, home inspection costs typically range from

$500 to $1000. If the legislature mandates a professional inspection, it should allocate the cost of the inspection in the legislation.

Most of the existing disclosure legislation applies the duty to sales of existing residences rather than newly constructed houses. This seems to be the correct approach. In most states, sales of newly constructed dwellings are covered by well-established warranty doctrines of merchantability, fitness and habitability. Several states have enacted legislation requiring that builders expressly or implicitly warrant the new home. Even where warranties are not statutorily mandated, many builders offer warranties as a marketing tool. In addition, state or local building inspectors during construction inspects all new construction. While such inspections do not assure absence or defects, they do provide adequate protection to the purchaser.

Conclusion

The cases and the statutes that followed will not shed a great deal of light upon how the courts will interpret or should interpret the statutes in the future, but they seem to be a step in the right direction. The decisions following the statutes in various states seem to construe ambiguous portions, both in the construction cases and the resale cases to the benefit of the purchasers. However, the statutes have created the ability to have limited liability and thus create generous defense portions of the statutes, which inevitably yield inequitable results.

The statutes in residential construction cases have created the ability to significantly reduce the impact of the statute and have created different standards for builders in the construction cases, brokers in the limitation of their liability, and sellers in their ability to remain silent and not discuss defects which are not easily visible to the average purchaser.

The unimpeded development of the common law would provide sufficient buyer protection without the necessity of state legislation. The Prevailing Disclosure Act weakens buyer protection compared to that developed by the common law. There are some benefits to legislation, however, but only if the legislation is comprehensive and clear in mandating an inspection and disclosure duty. The best solution is a statute mandating that the seller or listing broker retain and provide an inspection report by a professional home inspector. Such an inspection should include all material elements of the house, including physical systems and other items located in inaccessible areas.

One benefit of a statutory solution over continued development of the common law is that legislation would specify what items and systems must be inspected, which would make the disclosure obligation more uniform and less subject to interpretation. The item by item development of the common law leaves areas of uncertainty. What areas must be disclosed, what types of defects and the materiality of the defect must all is developed through litigation. One major advantage of legislation would be to clearly establish the types of things that must be disclosed, thus making the disclosure duty less subject to interpretive difficulties. A clearly defined disclosure obligation coupled with a professional inspection should serve to rationalize the seller's disclosure obligation and provide a high level of protection for the buyer.

As a result of the statutory allowable modifications, builder-vendors have been able to limit their liability substantially by contractual agreements.

A companion paper prepared by me entitled DOES THE STATUTORY "HOUSING MERCHANT IMPLIED WARRANTY" OF GENERAL BUSINESS LAW – ARTICLE 36-B COMPLETELY SUPERSEDE THE COMMON LAW VERSION?" is also being distributed covering the resultant statutory changes in New York, after the courts have expanded consumer/purchaser rights and duties.

END NOTES

1. Cal. Civ. Code Sections 1102-1102.15, 2079-2079.10.

2. *Easton v. Strassburger*, 199 Cal. Rptr. 383 (Cal.Ct. of App.1984).

3. *Id.*

4. Cal. Health & Safety Code Sec. 25359.7 and Conn. Gen. Stat. Ann. Sections 22a-134 and;

5. Maine and New Hampshire Rules.

6. U.S. Const. amends. V, XIV.

7. *Herbert v. Saffell*, 877 F.2d 267 (4th Cir.) 1989, and Comment, Real Estate Broker Liability To Purchasers, Robert M. Zeit, 63 Temp. Law Rev. 165 (1990).

8. *Peek v. Gurney*, L.R. 6H.L. 377, 403 (1873) and *Wilhite v. Mays*, 232 S.E.2d 141,142-143 (Ga. Ct. of App.).

9. *Kellogg Bridge Co. v. Hamilton*, 110 US 108, 116 (1884).

10. *Andreychak v. Lent*, 607 A.2d 1346, (N.J. Superior Ct. App. Div.1992).

11. *Id.*

12. *Id.*

13. *Knight v. Breckheimer*, 489 A. 2d 1066, 1068 (Conn. App. Ct. 1985).

14. *Haygood v. Burl Pounders Realty Inc.*, 571 So. 2d 1086 (Ala. 1990).

15. *Andreychak v. Lent*, 607 A.2d 1346 (1992).

16. Restatement of Torts (Second) section 525 (1989).

17. *Lyons v. Christ Episcopal Church*, 389 NE 2d 623,625 (Ill. App. Ct. 1979).

18. *Id.*

19. Restatement of Torts (Second) (1989).

20. *Lingsch v. Savage*, 29 Cal. Rptr. 201,206 (Cal. Ct. App 1963).

21. Restatement of Torts (Second) (1989).

22. *Jarvis v. Bellefeuille*, No. 577 1991 WL 253086 (Mass. App. Div. 1991).

23. *Burman v. Richmond Homes, Ltd.*, 821 P.2d 913,919 (Colo. Ct. App 1991).

24. *Id.*

25. *Haberman v.Greenspan*, 368 NYS2d 717,719 NY Sup. Ct. 1975;
Remel v. Chasebrook Constr. Co., 135 So.2d 876,882 (Fla. Dist. Ct. App. 1961).

26. Relief for Innocent Misrepresentation: A Retreat from Traditional Doctrine of *Caveat Emptor* 19 Real. Est. LJ 130 1990.

27. *Lingsch v. Savage*, 29 Cal. Rptr. 201,206 (Cal. Ct. App 1963).

28. *Id.* at 204.

29. *Weintraub v. Krobatsch*, 317 A.2d 68,75 (N.J. 1974).

30. *Id.* at 72.

31. *Johnson v. Davis*, 480 So. 2d 625,629 (Fla. 1986).

32. Restatement of Torts (Second) Section 525 (1989) Second.

33. *Reed v. King*, 193 Cal. Rptr 130,131 (Cal. App 1983);
Harlan v. Smith, 507 So.2d 943, (Ala.Civ. App 1986).

34. Restatement of Torts (Second) Sec. 538(1989).

35. *Stewart v. Thrasher*, 610 NE 2d 799,804 (Ill App. Ct. 1993) and Hill, 725 P.2d1119.

36. *Catucci v. Ouellette*, 592 A.D.2d 962 (Conn. App. Ct. 1991) and *Scharf v. Tiegerman*, 561 NYS2d 271,272-72 N.Y. App. Div. 1990.

37. Restatement of Torts (Second) Sec. 353.

38. *Anderson v. Harper*, 622 A. 2d 319, Pa. Super. Ct.; appeal denied 634 A.2d 222(1993).

39. *Id.* at 324.

40. *Atkins v. Kirkpatrick*, 823 SW 2d 547 (Tenn 1991).

41. *Stemple v.Dobson*, 400 S.E.2d 561,567 (W. Va 1990).

42. *Catucci v. Ouellette*, 592 A2d 962,964 (Conn. App.Ct 1994)
Conn. Gen. Stat ANN Section 4-110g(a).

43. Holcomb, 365 N.W.2d at 512.

44. *Cooper v. Jevne*, 128 Cal. Rptr 724,727.

45. *Lingsch v. Savage* @ 205.

46. *Easton v. Strassburger* (199 Cal. Rptr. 383 (Cal. Ct. App [1984]).

47. *Id.* at 390.

48. *Id.*

49. *Id.* at 387-388.

50. Cal. Civ. Code sections 1102-1102.15.

51. *Id.*

52. *Id.* sections 2079-2079.10.

53. *Id.* at sec. 1102.

54. *Id.* at sec. 1102.8.

55. *Id.* at section 2079.2.

56. *Easton v. Strassburger* at 388-392.

57. Cal. Civ. Code section 1102.13.

58. *Id.* at 1102.8.

59. Delaware, Maryland, and Rhode Island.

60. *Easton v. Strassburger* at 390.

61. Cal. Civ. Code Sections 2079-2079.9 (1994).

62. Uniform Deceptive Trade Practices Acts (several states).

63. Cal. Civ. Code.

64. *Id.*

65. Kevin C. Culum, *Comment Hidden-But-Discoverable Defects; Resolving the Conflicts Between Real Estate Buyers and Brokers*, 50 Mont. Law Rev. 331,343 (1989).

THE UCC: CURRENT AND COMING CHANGES

by

Arthur M. Magaldi*

Begun in the 1950's with the objectives of updating the common law and providing uniformity throughout all American jurisdictions for commercial transactions, the Uniform Commercial Code ("the Code") is now a given in American jurisprudence. Business interests and consumers have flourished in the years since the Code's inception and to keep the law current, parts of it have been amended in 1962, 1966, 1972, 1977, and 1987. Today the Code is being revised again with objectives similar to those of the original drafters. The National Conference of Commissioners on Uniform State Laws and the American Law Institute have proposed substantial changes to the Code with a proposed effective date of July 1, 2001. To date, seven states have passed the revisions and virtually all states will be considering adoption.

Article 9 which governs secured transactions is the area of greatest emphasis in the Revised Code. The drafters enlarge the types of collateral which may be the subject of a secured transaction and attempt to make the article more user friendly by incorporating modern business practices into the statute. Just as the original UCC modified and updated the common law, the Revised Code makes changes to the present UCC in important areas such as attachment, perfection, filing requirements, and priorities of secured parties. The body of this paper will focus on the important Article 9 changes, the first general revision of that article since 1972, set forth in the Revised Code. All statutory references herein to the Code will refer to the Revised Code unless otherwise stated.

Attachment

The most fundamental concept of secured transactions is attachment. Indeed, attachment involves the creation of the security interest. Section 9-203(a) provides, "A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral." Current law provides that for the security interest to attach the debtor must sign a security agreement which contains a description of the collateral or the collateral must be in the possession of the secured party. This rule is modified by Section 9-203(a) which allows for authentication of the security agreement by the debtor. The concept of authentication recognizes and incorporates modern business practices, e.g., e-mail and fax, as appropriate indications of assent to Article 9 transactions. A debtor need not sign a security agreement. A security agreement may be signed by the debtor, but other appropriate electronic means of authenticating the assent of the debtor to the transaction are permissible. Revised Article 9 does not limit the concept of authentication to security agreements. Section 9-102(a)(7) states that to authenticate means to sign or "to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record." As the business world has moved to means of indicating assent other than by signing paper, the Code has embraced these means of authentication as well. In this regard, the Revised Code is said to be "medium neutral" recognizing authenticated records, i.e., information contained in a medium that can be retrieved in understandable manner or way.

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As an alternative to a signed security agreement, a creditor could have, or be given, possession of the collateral pursuant to an agreement that the creditor have a lien or rights in the collateral. Although this is generally not done since the debtor commonly wants the use of the collateral, attachment by possession recognizes transactions such as a simple pledge or pawn shop transaction. The concept of possession is extended by the revisers to "control" for deposit accounts, electronic chattel paper, investment property, and letter-of-credit rights (Section 9-203(a)(3)(D)). Accordingly, one may create a security interest in favor of a creditor by granting control to the creditor by agreement. The concept of control is also important concerning perfection and allows for collateral hitherto governed by common law rules to come within the purview of Article 9. The widened scope of Article 9 and changed perfection rules will be discussed herein.

For a debtor to grant a security interest in collateral, the debtor traditionally had to have rights in the collateral. The theory was, of course, that a debtor could not grant a lien on collateral unless the debtor had some rights in the collateral on which to place the lien. The revisers also broaden somewhat the rights in collateral concept by providing that one with the power to transfer rights in the collateral to a secured party may also grant a security interest.

Disputes over the sufficiency of descriptions of collateral in security agreements have caused litigation. In Section 9-108 the revisers attempt to clarify the concept of reasonable identification by listing a number of safe harbor ways by which collateral may be reasonably described, including category and type of collateral as generally sufficient. Subsection (c), however, makes clear that a supergeneric description of "all the debtor's assets" or "all the debtor's personal property" does not sufficiently describe the collateral. Thus, a modest amount of specificity is required to alert the debtor as to the property upon which the lien will rest, but general descriptions are permissible. Additional specificity is also required for consumer transactions.

Changes in Filing Rules

For the great majority of secured transactions, perfection is achieved by the filing of a financing statement. The Revised Code introduces a number of rules to simplify and clarity filing issues.

Consistent with the overall concept of "medium neutrality," electronic filing will be permissible and the filing must take place at the place where the debtor is located. The debtor does not have to sign the financing statement, since consent to a security agreement is deemed to be consent to the filing of a financing statement consistent with the security agreement. Filings must take place at the location of the debtor (Section 9-301(1)). A debtor which itself comes into being by registration or filing, e.g., a corporation or limited liability company, is deemed located in the state of incorporation or registration (Section 9-307(d)). This modifies the current rule requiring filing at the place of the debtor's principal place of business or executive office. For a corporation doing business nationally or regionally, the appropriate place for filing financing statements is the state of incorporation of the debtor. A debtor who is an individual is "located" at the individual's principal residence (Section 9-307(1)). Filing at the location of collateral will hereafter be considered unnecessary. To encourage ease of filing and searching of financing statements, filing will be centralized in one location in each state except for filings of real estate fixtures which will still be filed locally (Section 9-501(a)(2)).

A great deal of litigation has centered on the contents of financing statements concerning questions of whether the debtor and/or collateral have been sufficiently identified. In an effort to foster clarity and avoid unnecessary litigation, the revisers have set forth relatively simple rules concerning the requirements for the contents of financing statements. Section 9-502(a) provides as the three essentials of a financing statement, the name of the debtor, the name of the secured party or a representative, and the collateral covered by the financing statement. A financing statement which fails to include the three required elements may be rejected for filing by the filing office, but there are only limited additional grounds for rejection thereby removing from the filing office the need to make filing decisions. Since entities frequently use trade names, a debtor which is a registered organization, e.g., a corporation, must be identified by the exact name on the public record of the place or organization. Identification by trade name alone is insufficient to properly identify the debtor. But minor errors in filing continue to be disregarded if they are not seriously misleading, and if a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic would disclose the name of the debtor, the name provided would not be deemed seriously misleading. Concerning descriptions of collateral, although prohibited in security agreements, a description of "all assets or all personal property" (Section 9-504) is expressly stated to be sufficient. In a further effort at standardization and simplification, Section 9-521 provides for national filing forms which the secured party may, but not must, use and which must be accepted by the filing office.

Broadened Scope and New Collateral

Even a casual observer of financial markets and financial transactions in general will realize that things that were previously not the subject of financial transactions have today had values assigned to them and become included in types of financial transactions that were hitherto unknown. Thus, in the twenty-first century we have loans and credit extensions being made on the bases of extremely varied collateral. Typically, creditors

will attempt to make new collateral the subject of secured transactions. The difficulty with these attempts was that much of the untraditional collateral was not within the purview of Article Nine. Since the collateral was not covered by the Code, creation of the liens was left to the laws of the various states leading to a lack of clarity and increased uncertainty for businesspersons. Uncertainty generally inhibits economic growth and leads to litigation. To remedy this situation, the Revised Code broadens the scope of collateral which may be the subject of Article Nine secured transactions.

Revised Article Nine as set forth in Section 9-109(a)(3) now covers deposit accounts when used as original collateral for a transaction as well as accounts, chattel paper, payment intangibles and promissory notes. In addition, health care receivables, agricultural liens, commercial tort claims, consignments and general intangibles are included by Section 9-109. Investment property and software may also be the subject of secured transactions governed by the Code. The inclusion of these new types of collateral has necessitated new and clarified rules for perfection. In many cases, the rules are simplified when compared to the varied rules prevailing in the various states.

Special Rules of Perfection and Priority

A creditor may perfect a security interest in a deposit account, e.g., a bank account, only by control. For determining control, the depositary institution must agree that the institution will follow the secured creditor's direction without the additional consent of the debtor or the account must be actually converted into the name of the secured creditor. Filing will not achieve control over the account. It should be noted, however, that the secured creditor may be considered in control of the account for secured transactions purposes despite the fact that the debtor has access to the account. In the case of the debtor having access to the funds, while the secured creditor may run the risk of the debtor withdrawing the funds, in the case of a bankruptcy of the debtor, the perfection by control would still be in effect.

Article Nine traditionally covered accounts, but the revisers expanded the definition in response to the heightened use of account financing. Accounts under the Revised Code will not be limited to payment obligations arising out of the sale or lease of goods, but by virtue of Section 9-102(a)(2) will include payment obligations arising out of the sale, lease, or license of all tangible and intangible property. This would include credit card receivables and the intellectual property rights which have become such an important part of today's financial transactions. Perfection in accounts may be accomplished by filing. Health care receivables are treated as accounts. To clarify the Code's recognition of account financing as being within Article Nine, by virtue of Section 9-406(d), terms restricting assignment in the agreement between the account debtor and the assignor are generally ineffective.

Consignments, except in the rare case of a consumer acting as consignor, are treated as purchase money security interests requiring the secured creditor to file to perfect its security interest. Failure to perfect the security interest would allow the creditors of the bailee to reach the collateral. Case law frequently held that the posting of a sign on the premises of the consignee-bialee would be sufficient notice, but this question is now clarified by the revision. Similarly a consignee of goods does not have to have true rights in collateral to grant a security interest in the goods since the expanded definition of attachment would encompass one who has the power to transfer rights in the collateral. Clearly the consignee has the power to transfer rights, hence the power to grant a security interest in the collateral. An unperfected security interest created by consignment would be subordinate to a security interest granted by the consignee which was perfected.

Investment property may be thought of as securities. With so much interest in securities of late, it is only reasonable that credit will be extended on the basis of investment property. Consistent with such extensions of credit will be creditors who will wish to securitize such transactions. A security interest in investment property may be perfected by filing or by control with the latter affording the greater protection. In addition to the traditional way of safeguarding the lien by having the debtor deliver the securities to the creditor with an appropriate indorsement, the parties may opt to give the creditor control of a securities entitlement by having a securities intermediary, e.g., a broker or transfer agent, agree that the intermediary will follow directions of the secured creditor without additional approval of the debtor (Section 9-314(a)) or by putting the securities account in the name of the secured party. Perfection by control is generally superior to perfection by filing (Section 9-328(1)).

Letter-of-credit rights also require control for perfection. Section 9-107 provides that control is established "if the issuer or nominated person has consented to an assignment of proceeds of the letter of credit under Section 5-114(c) or otherwise applicable law or practice." It is clear that perfection will always be dependent on the issuer of the letter of credit's consent. Accordingly, the stage is now set for those with letter-of-credit rights to use them as the source of financing in secured transactions.

Chattel paper, defined in Section 9-102(a)(11) as a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods or a lease of specific goods, may be the subject of a secured transaction. The interesting leap into the twenty-first century by the revisers is the recognition of electronic chattel paper. Of course, there can be no perfection by possession since there is nothing to possess, the electronic chattel paper being stored in an electronic medium. Perfection in electronic chattel paper may be accomplished by control or filing, but perfection by control is generally considered to have priority over one who has perfected by filing by virtue of Section 9-329(1). This priority rule is similar to the one for ordinary chattel paper which allows for perfection by filing or possession with the party who perfects by possession having priority over the one who perfects by filing alone.

Section 9-105 requires that for control of electronic chattel paper to be established there must be a single authoritative copy of the record which is unique, unalterable, and identifiable. The copy must identify the secured party and the copy must be maintained by the secured party. It may be challenging to find ways to electronically identify the

secured party on the one definitive copy of electronic party, but it is obvious that the revisers are aware that parties will attempt to use these types of collateral and are providing a consistent framework for their use.

Conclusion

Financing transactions have become more numerous and more complex as the twentieth century ends and the new millennium begins. Parties will always try to use new collateral to arrange financing. Collateral which ten or fifteen years ago was not contemplated as useful as the subject of secured financing is now being utilized in the fast paced and rapidly changing area of secured transactions. New collateral and speed of transactions inspired in large part by electronic advancements which are now considered commonplace in business are the subject of the changes in Article Nine. In general, it appears that the revisers have made an admirable attempt to make the laws which govern these new transactions both reasonable and uniform. Due respect seems to have been accorded by the revisers to need for speed and certainty in these newer type secured transactions. Although adoption is in an early stage, history tells us that approval is probable by the projected date of July 1, 2001, or some time relatively soon thereafter. It is likely that the revisions will become the law.