A Poison Apple: The Status of the Defamed Teacher

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I. INTRODUCTION

Throughout the last decade, the teaching profession has correctly positioned itself as critical to American society and its youth. Consequently, the public is increasingly debating the mission of education, critiquing its delivery, and scrutinizing its agents, i.e., teachers. Indeed, their connection to this public mission and position of public trust imbues teachers with many of the characteristics of a public official or a public figure. Yet, once the bell rings, the teacher returns home to the life of a private citizen. This duality raises questions regarding the status of teachers who complain of defamation: are they public officials or figures who bear the burden of proving actual malice, or are they private citizens protected by a reduced burden?

This article begins with a brief overview of defamation law, including the effect of a plaintiff's status on the burden of proof. It then reviews and analyzes conflicting decisional law regarding the application of actual malice standard to teachers. Finally, it suggests a model for analyzing the status of the defamed teacher question, including the burden-of-proof question in light of the teacher-private citizen bifurcation.

II. DEFAMATION AND TEACHERS

Defamation is a false remark, communicated to others, that injures one's reputation.[1] It may diminish "the esteem, respect, good-will, or confidence" that an individual enjoys[2] or expose one "to public

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[1]. New York Times v. Sullivan, 76 U.S. 254 (1964).
Defamation is commonly divided into slander--spoken defamation, RESTATEMENT (SECOND) OF TORTS § 568 (1977), and libel-- written defamation. PROSSER & KEETON ON TORTS, § 112 (5th ed. 1984) ("communicated by sense of sight").

[2]. PROSSER & KEETON, *supra* note 1, at § 111.

hatred, shame, . . . disgrace, or . . . evil opinion."[3] With regard to K-12 educators, defamation arises in the context of parent complaints about the classroom[4] or community behavior of teachers, evaluative remarks within the employment relationship[5] (including Personal Improvement Plans, state-mandated reviews of new teachers, comments in tenure documents, and at Board meetings),[6] and responses to reference checks upon severing that relationship.[7] As in many other employment contexts, the issue of teacher defamation is arising with increasing frequency.[8]

A defamed individual may sue in tort under state defamation laws.[9] In addition to providing public vindication of reputation and monetary compensation for its damage, these actions encourage future speakers to exercise considered judgment in their exclamations.[10] As explained by Justice Stewart, the right to protect one's good name reflects "our basic concept of essential dignity and worth of every human being -- a concept at the root of any decent system of ordered liberty."[11] At common law, if speech was defamatory, a plaintiff could under some circumstances recover "compensatory" damages without proving actual damages.[12]

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[3]. Kimmerle v. New York Evening Journal, 262 N.Y. 99, 102 (1933).

[4]. *Cf.* Nodar v. Galbreath, 462 So.2d 803 (Fla. Sup. Ct. 1984).

[5]. Snitowsky v. NBC Subsidiary, 297 Il. App. 3d 304, 306 (1st Dist., 2d Div. 198); Meyer v. McKeown, 641 N.E.2d 1212, 1213 (App. CT. Ill., 3d Dist. 1994).

[6]. *See generally* notes 103 – 19, 123-28 and accompanying text.

[7]. Zerr v. Johnson, 894 F. Supp. 372 (D. Colo. 1995) (negative reference check).

[8]. Tara L. Eyer & Clarence C. Kegel, Jr., *Confidentiality of School Personnel Matters & Due Process Restrictions On The School Board: Developing Rational Policies, Balancing Interests, And Resolving A Recurrent Dilemma*, 101 DICK. L. REV. 325, 329-30 (1997); *see also* Cohen v. Wales, 133 A.D. 2d 94 (NY App. Div., 1987) (recommendation of former teacher); Duffy v. Leading Edge Products, Inc., 44 F.3d 308 (5th Cir. 1995) (dismissal of employee); Susan Oliver, *Note, Opening the Channels of Communication Among Employers: Can Employers Discard Their "No Comment" and Neutral Job Reference Policies?*, 33 VAL. U. L. REV. 687 (1999).

This article does not address whether any of these comments would be protected by the defense of absolute or qualified privilege (which may exist in both statute and at common law). *See generally*, Meyer v. McKeown, 266 Ill. App. 3d 324 (Ill. App. Ct. 3d Dist. 1994); Nodar v. Galbreath, 462 So.2d 803 (Fla. 1984).

[9]. Swede v. Passaic Daily News, 30 N.J. 320, 331 (1959). Under common law, a plaintiff must show that the statement was false, defamatory, and published. *Id.*

[10]. Celle v. Filipino Report Enterprises Inc., 209 F.3d 163, 171 (2nd Cir. 2000).

[11]. Rosenblatt v. Baer, 383 U.S. 75, 92 (1966) (concurring opinion).

[12]. Gertz v. Robert Welch, Inc., 418 U.S. 323, 349 (1974).

A. The Mediating Force of the First Amendment

State defamation laws are not without their limits.[13] They are constrained by the free speech guarantees of the First Amendment.[14] The First Amendment[15] "was fashioned to assure unfettered interchange of ideas" to promote the political and social changes sought by the public.[16] Therefore, it favors uninhibited public discussion on matters of social concern,[17] affording them the greatest degree of protection.[18] Vigorous speech, however, sometimes leads to mistaken assertions.[19] Nevertheless, because these mistaken utterances also contribute to the social dialogue, it too is protected.[20] Otherwise, valid speech might be suffocated.[21]

Thus, tension exists between protecting an individual's reputation and nurturing public debates contemplated by the First Amendment.[22] False statements are devoid of value and damaging to one's reputation.[23] On the other hand, one "prerogative[] of American citizenship is to criticize public men and measures."[24] The law is not ignorant of this tension, but recognizes that, in some instances, the personal interest in unblemished reputation must give way to first

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[13]. New York Times v. Sullivan. 376 U.S. 254 (1964).

[14]. Rocci v. Ecole Secondaire Macdonald-Cartier, 755 A.2d 583, 587 ("[T]he proper balance between protecting one's reputation and protecting free speech" must be achieved).

[15]. U.S. CONST., amend. I ("Congress shall make no law. . . abridging the freedom of speech, or of the press").

[16]. Connick v. Meyers, 461 U.S. 138, 145 (1983); Roth v. U.S. 354 U.S. 476, 484 (1957).

[17]. Alexander Meiklejohn argues that public speech should be immune for regulation whereas private speech has less complete protection. *See* ALEXANDER MEIKLEJOHN, FREE SPEECH AND ITS RELATION TO SELF-GOVERNMENT (1948).

[18]. Connick v. Myers, 461 U.S. at 145.

[19]. Hustler Magazine v. Falwell, 485 U.S. 52, 99 (1988) (Falsities are "inevitable in free debate").

[20]. Tavoulareas v. Piro [Washington Post Co.], 817 F.2d 762, 795 (D.C. Cir. 1987).

[21]. Falwell, 485 U.S. at 99 ("would have an undoubted chilling effect on speech relating to public figures").

While strict liability protected the individual's good name, it chilled that critical speech about public issues and officials. Indeed, speakers tended to practice self-censorship rather risk suit over mistaken remarks (and knowing that they could defend themselves against liability only if they had incontrovertible proof of their statements).

[22]. *See* Celle, 209 F.3d at 163.

[23]. Falwell, 485 U.S. at 52.

[24]. Baumgartner v. United States, 322 U.S. 665, 673-74 (1944).

Amendment expression regarding the public position or issue with which an individual is associated.

B. The Impact of Plaintiff Status

In *New York Times v. Sullivan*,[25] the Supreme Court repudiated the strict liability doctrine of defamation. There, the elected police commissioner of Alabama, sued the New York Times for a full-page advertisement asserting an "unprecedented wave of terror" against black students engaged in non-violent protest.[26] The advertisement stated that "truckloads of police armed with shotguns and teargas ringed the Alabama State College Campus."[27] Many of these and similar allegations were untrue.[28] Though Sullivan had suffered no pecuniary loss, state law permitted his per se recovery.[29]

Fearing the chilling effect of strict liability laws have on public speech, the Court held the strict liability rule of defamation unconstitutional.[30] In doing so, it explained that debate on issues important to the public and about people in positions to influence those issues may include "vehement, caustic, and sometimes unpleasantly sharp attacks on government and public officials."[31] Nevertheless, just because those comments are harsh or mistaken does not mean they have failed to advance public discourse on the issue. Indeed, they are inevitable in free debate.[32] This, if speech is to be realized to its full extent,[33] discussion must "be uninhibited, robust, and wide-open," and even untrue or erroneous statements must be protected.[34] "The

[25]. 376 U.S. 254 (1964).

[26]. *Id.* at 259.

[27]. *Id.* at 257-58.

[28]. *Id.* at 258-59.

[29]. *Id.* at 260. Furthermore, under state law, once libel was established, no defense was permitted. *Id.* at 268.

[30]. *Id.* at 264-65. Hence, the Court constitutionalized the law of defamation. Richard E. Johnson, *No More Teachers' Dirty Looks -- Now They Sure: An Analysis of Plaintiff Status Determinations in Defamation Actions By Public Educators*, 17 FLA. ST. U.L. REV. 76, 762 (Sp 1990).

[31]. New York Times, 376 U.S. at 270. In Rosenblatt v. Baer, 383 U.S. 75, 85 (1966), the Court later reiterated the dual concerns of New York Times: the strong interest in debate on public issues and the strong interest in debate about the people who are in a position to influence the outcome of those issues.

[32]. New York Times, 376 U.S at 279; *but see* Gertz v. Robert Welch, 418 U.S. 323, 340 (1974) (false statements do not add to public debate.).

[33]. New York Times, 376 U.S at 271-72.

[34]. The Court later repeated in Gertz, 418 U.S. 323, that "some falsehoods need to be protected in order to protect speech that matters"; *see also* Curtis Publishing Co. v. Butts and Associated Press v. Walker decided together at 388 U.S. 130 (1967).

constitutional protection does not turn upon truth, popularity, or social utility of the ideas and beliefs which are offered."[35]

Accordingly, to protect free speech about government and its actors, when speech is about a public official, the First Amendment constrains state defamation laws,[36] and, conversely, heightens the burden of proof borne by the plaintiff. Even if statements are false and harmful, a public official must prove that the statements were published with actual malice.[37] Actual malice requires more than ill will,[38] a failure to investigate,[39] or negligence discovering misstatements.[40] Instead, it demands that the publisher speak with knowledge that the statement is false or with "reckless disregard" as to whether it false.[41] Where, for instance, a reporter entertains serious doubts about the truth of information, yet reports that information without investigating its validity (and this as accompanied by known personal animosity between the reporter and the allegedly defamed, malice will be found).[42]

In justifying this burden,[43] the Court noted that public officials, by accepting their post, have knowingly and voluntarily exposed themselves to increased scrutiny. By assuming a greater role in the public arena, they assume some risk of injury from defamatory falsehoods. Private individuals, by contrast, have not relinquished the right to maintain their good name, and, therefore, have not assumed such a risk. Additionally, public officials have some degree of access to the channels of communication that private individuals do not. Hence, the former possess the communicative self-help remedies

[35]. The First Amendment guarantees "refuse to recognize an exception for any test of truth . . . and especially not one that puts the burden of proving truth on the speaker." New York Times, 376 U.S. at 371-72.

[36]. New York Times, 376 U.S. at 269.

[37]. *Id.* at 285-86.

[38]. Harte-Hanks Communications, Inc. v. Connaughton, 491 U.S. 657, 666 (1989). Typically, ill-will would constitute common law malice.

[39]. St. Amant v. Thompson, 390 U.S. 727, 732-33 (1968); Gertz, 318 U.S. at 322.

[40]. New York Times, 376 U.S. 254.

[41]. *Id.* at 280.

[42]. Celle, 209 F.3d at 185-87, 189-90.

[43]. New York Times eschewed the idiom of balancing the individual and social interest of expression against the social interest sought by regulation. *See* Kalven, "*The NY Times Case: A Note on The Central Meaning if the First Amendment*," 1964 SUP. CT. REV. 191, responding to Emerson, *Toward a General Theory of the First Amendment*, 72 YALE L. J. 877, 912 (1963). Yet, its progeny has undoubtedly balanced the interest of protecting personal reputation against the First Amendment values implicated by libel laws.

preferred under the First Amendment[44] to correct or address falsities, unavailable to the latter.

One useful standard for identifying public officials is found in *Rosenblatt v. Baer*.[45] *Rosenblatt* assesses public official status in terms of whether an individual possesses apparent governmental authority or whether the public has a real interest in the way in which she performs her job.[46] Where an individual has or appears to the public to have "substantial responsibility for or control over the conduct of governmental affairs"[47] or "Where a position in government has such apparent importance that the public has an independent interest in the qualifications and performance of the person who holds it[48] beyond that general public interest in the qualifications and performance of all government employees," she is a public official.[49] This designation applies "at the very least to those among the hierarchy of government employees who have or appear to have substantial responsibility for or control of governmental affairs."[50]

With regard to the former, the "substantial responsibility" criterion is not relegated to actualities, but encompasses both employees who possess substantial responsibility and those who only appear to possess substantial responsibility. Therefore, a plaintiff alleging defamation will not be deemed private by virtue of governmental hierarchy and lack of actual (perhaps unknown) authority, for if it appears that she has power or authority, the public's interest in the position remains the same -- "it is the element of public position."[51] Essentially, if the general public thinks an individual somewhere in the government hierarchy exerts influence or holds power, it is as though they do. Where one holds or aspires to hold "any public post which entails control over matters of substantial public concern, then his qualifications for serving in that capacity are likely to engender the type of public debate and discussion that the First Amendment protects."[52] Two things motivated this formulation: first, the "strong interest in debate on public issues," and, second, the "strong interest" in

[44]. That is, counter-speech, i.e., contradicting or correcting a lie and thereby minimizing its impact, is preferred over litigation about speech.

[45]. 383 U.S. 75, 79-80, 85-86 (1966) (supervisor of county-owned recreation center sued newspaper for criticizing his job performance).

[46]. *Id.* at 86.

[47]. *Id.* at 85-86.

[48]. That is, whether that job is the type that invites public scrutiny.

[49]. Rosenblatt, 383 U.S. at 85. Hence, the New York Times malice standard applies.

[50]. *Id.* at 85.

[51]. *Id.* at 86.

[52]. Pendleton v. City of Haverhill, 156 F.3d 57, 69-70 (1st Cir. 1998).

discussion about people who are in the types of positions that can significantly influence the resolution of those public issues.[53] It is this criticism that is central to constitutionally-protected speech.

III. EXTENSION OF NEW YORK TIMES

The *New York Times* analysis was soon extended to other individuals, who, while not elected, were "'public figures' and, thus, involved in issues in which the public has a justified and important interest."[54] For example, in *Curtis Publishing v. Butts*, a Saturday Evening Post article claimed that University of Georgia athletic director (and former football coach) Wally Butts had (along with "Bear" Bryant) fixed a game.[55] In *Associated Press v. Walker*, an AP report asserted that a retired general had led a violent crowd in opposition to the enforcement of a desegregation decree at the University of Mississippi.[56] In each instance, the Court applied the actual malice standard. It recognized that public figures such as these, like public officials, "play an influential role in ordering society."[57] Therefore, because citizens have a legitimate and substantial interest in their conduct, uninhibited debate about their behavior pertaining to these events is as crucial as it is in the case of public officials.[58] Furthermore, this group possessed a degree of access to mass media, not only to influence public policy, but also to "counter criticism of their views and activities."[59]

A. Circumscribing the Category of Public Figure

Just when it seemed that the concept of public figure was virtually boundless, the Court narrowed it in *Gertz v. Robert Welch, Inc.*[60] In *Gertz*, a Chicago lawyer sued the publisher of "American Opinion" for accusing him of being a "Communist-fronter" and framing a police officer in a murder trial.[61] Although Gertz had been retained

[53]. Rosenblatt, 383 U.S. 75.

[54]. Curtis Publishing Co. v. Butts and Associated Press v. Walker decided together at 388 U.S. 130 (1967). Some individuals may attain this status by virtue of their notoriety, alone.

[55]. *Butts*, 388 U.S. at 162.

[56]. *Id.* at 140.

[57]. *Id.* at 170.

[58]. *Id.* at 162-65, 170.

[59]. *Id.* at 170-71.

[60]. 418 U.S. 323 (1974).

[61]. *Id.* at 325-26.

by the victim's family in a suit against the convicted officer, Gertz had never been in the public eye.[62]

Noting his lack of *general* fame or notoriety in the community, the Court determined that Gertz was not a "public figure."[63] Unless clear evidence of general fame and notoriety in the community, and pervasive involvement in the affairs of society could be shown, an individual maintained his private status. Thus, the "nature and extent of an individual's participation in the particular controversy giving rise to the defamation" is instructive in determining the public nature of the plaintiff.[64] While not reviving pre-New York Times conceptions of strict liability, the Court, nonetheless, directed that states could provide greater protection for private libel plaintiffs: Liability without fault still was not permitted, but lesser standards of fault, such as a negligence standard could be used, if the defamatory statement put one's reputation at substantial risk.[65] Just as the public ownership of and interest in a public official warranted holding free speech above the personal interest in reputation, where that was absent, the private interest now prevailed.

Moreover, private individuals, unlike public figures, did not posses the same self-help remedies and had not "voluntarily exposed themselves to increased risk of injury from defamatory falsehoods concerning them."[66] Thus, they were "more deserving of recovery."[67] Consequently, the state's interest in compensating private individuals exceeded its interest in compensating "public figures," making the less demanding standard of liability appropriate.[68]

Gertz, thus, initiated a trend of narrowing the "public figure" category, creating a spectrum of public figures, i.e., the pervasive or all-purpose public figure, the limited or vortex public figure, and the involuntary public figure.[69] The Court further elaborated on the "public figure" category in *Time, Inc. v. Firestone*.[70] There, Time had erroneously reported that Ms. Firestone's divorce had been granted on grounds of adultery as well as extreme cruelty.[71] As in *Gertz*, the Court

62. *Id.* at 325.
63. *Id.* at 344-45.
64. *Id.* at 344-47.
65. *Id.* at 347.
66. Gertz, 418 U.S. at 344.
67. *Id.*
68. *Id.* at 344-45.
69. Thus, Gertz refashioned the *Rosenbloom* approach considered insensitive to an individual's interest in their good reputation. Gertz, 418 U.S. at 323.
70. 424 U.S. 448 (1976).
71. *Id.* at 450.

found that, because Firestone had not assumed any role of special prominence in the affairs of society, "other than perhaps Palm Beach society," and because she had not "thrust herself to the forefront of any particular public controversy," she was not a "public figure."[72]

Hutchinson v. Proxmire[73] and *Wolston v. Reader's Digest Association, Inc.*[74] continued this reasoning. In *Hutchinson*, a senator had characterized a scientist's federally funded research on monkey behavior as an egregious example of wasteful government spending. Because the plaintiff had not "thrust himself or his views into public controversy to influence others," he was not a public figure, but a private individual, for purposes of defamation.[75] Similarly, in *Reader's Digest*, the plaintiff sued for libel because a 1974 book had listed him as a "Soviet agent." Though the plaintiff had briefly been in the public eye in 1958, after a criminal contempt conviction for failure to appear before a grand jury investigating Soviet espionage, he had not "voluntarily thrust" himself into a public controversy. Therefore, he was not a public figure, but a private individual.[76]

B. *Plaintiff Status: The Range of Public Individuals*

Through these cases, the Supreme Court created a plaintiff status in which the plaintiff's status (public or private) and the speech's status (public concern or private issue) were weighted to determine the standard of fault imposed.[77] These standards are expressed in terms of their plaintiffs and causes: public officials, public figures (of different levels), public issues, and private individuals.

On the one end of the spectrum lies the private individual, who is not involved in public affairs and has not spoken out on a public issue. Having maintained her privacy, she is the most protected from defamation. At the other end of the spectrum sits the public official. This includes all elected and high level appointed government personnel, but stops short of including every public employee.[78] Lawrence Tribe, however, has opined that the public official includes "most ordinary civil servants, including public school teachers. . . ."[79]

72. *Id.* at 455.
73. 443 U.S. 111 (1979).
74. 443 U.S. 157 (1979).
75. Hutchinson, 424 U.S. at 450.
76. Reader's Digest, 443 U.S. at 159.
77. Elsa Ransom, *The Ex-Public Figure: A Libel Plaintiff Without a Class*, 5 SETON HALL J. SPORTS L. 389 (1995).
78. Hutchinson, 443 U.S. at 119.
79. Lawrence Tribe, AMERICAN CONSTITUTIONAL LAW, 866 (2d. ed. 1988).

In addition to public officials, there are also public figures. A public figure is someone who through his or her achievements obtains notoreity or who commands "sufficient public interest,"[80] has sufficient access to the means of counterargument to expose the falsity of defamatory statements. Public figure status typically emerges when people (1) assume roles of "especial prominence in the affairs of society," perhaps occupying positions of "persuasive power and influence," or (2) "thrust themselves to the forefront of particular public controversies in order to influence the resolution of the issues involved."[81] Hence, they resemble the public official as defined by Rosenblatt. Public figures have been found to include a "well known radio commentator,"[82] national sports writer,[83] candidates for and occupants of public office,[84] a television preacher,[85] and professional football player.[86] By contrast, involvement in a notorious criminal proceeding,[87] defending oneself publicly against accusations,[88] long-diluted former fame,[89] or appearing pursuant to a coroner's request[90] is not enough to ingeminate public figure status. Although determination of public figure status requires reference to the facts, it is a question of law.[91]

While public figuredom encompasses many positions, not all are created equal.[92] As described in *Gertz* and its progeny, there is a range of public figures. Some bear the burden of proving malice regardless of whether defamation touches their public role or private life while others bear this burden only where defamatory comment touches on public issues with which they are associated. Those who achieve "pervasive fame or notoriety" are deemed public figures for all

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[80]. *See* Gertz, 418 U.S. at 342-43.

[81]. *Id.* at 345, n.7; *see also* Peter Cane, *Defamation of Teachers*, 56 FORDHAM L. REV. 1191, 1195 (1988).

[82]. Celle, 209 F.3d 163.

[83]. Maule v. NYM Corp., 54 N.Y.2d 880 (1981).

[84]. Patriot Co. v. Roy, 401 U.S. 265, 266 (1971).

[85]. Hustler Magazine v. Falwell, 485 U.S. 52 (1988).

[86]. Chuy v. Philadelphia Eagles Football Club, 595 F.2d 1265 (3rd Cir. 1979).

[87]. Pendleton v. City of Haverhill, 156 F.2d at 70; *see* Wolston v. Reader's Digest Ass'n, 443 U.S. 157, 168 (1979).

[88]. Time, Inc. v. Firestone, 424 U.S. 448, 454, n.3 (1976).

[89]. Pendleton, 156 F.2d at 68-69.

[90]. Gertz, 418 U.S. at 351.

[91]. Pendleton, 156 F.2d 57.

[92]. There are three categories of public figures: the voluntary limited public figure (who has injected herself into a public controversy; the general public figure; and the public figure who is so endowed through no purposeful action of her own.

purposes,[93] and, therefore, must prove actual malice.[94] Those who thrust themselves into particular public controversy are limited public figures, subject to enhanced burdens, "for only a limited range of issues,"[95] i.e., those pertaining to the controversy. Speech on a matter of private concern unrelated to the limited public figure status does not obtain the same degree of protection, but obtains the more lenient standard of *Gertz*.

This is sound, for liability will not chill debate about self-governance.[96] Consequently, a plaintiff alleging defamation (regarding speech of a private concern) need not demonstrate "actual malice" to prevail. For example, in *Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc.*,[97] speech did not concern a public issue, but a private one: a false and defamatory credit report about a private citizen. Because this was not the type of speech that would affect public matters, it was not subject to the malice standard.[98] Consequently, the plaintiff could receive the presumed and punitive damages (awarded at common law) without showing actual malice.[99]

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[93]. Gertz, 418 U.S. at 345 (a plaintiff must "invite attention and comment" before he will be held to the new York Times actual malice standard); *see also* Cane, *supra* note 81, at 1195.

[94]. Gertz, 418 U.S. at 352.

[95]. *Id.* at 351. Just as the First Amendment militates in favor of speech, when an individual obtains the status of a public official, so does it when an individual, regardless of status is affirmatively involved in matter of public interest. Yet, one does "not become fair game for eternity merely by injecting oneself into the debate of the moment." Rosenblatt, 383 U.S. at 87 n.14. The Court has not since applied these criteria. Alan Kaminsky, *Defamation Law: Once A Public Figure Always a Public Figure?* 10 HOFSTRA L. REV. 803, 812-13 (1982).

As the First Amendment 'was fashioned to assure unfettered interchange of ideas" to propel "the political and social changes desired by the people," Connick v. Meyers, 461 U.S. 138, 145 (1983); Roth v. U. S. 354 U.S. 476, 484 (1957), and "matters of public concern" lie at the heart of that protection, so enjoy the "highest rung of the hierarchy of First Amendment values." Connick, 461 U.S. at 145.

[96]. Connick, 461 U.S. at 146-47.

[97]. 472 U.S. 749, 761 (1985).

[98]. *Id.* at 761.

[99]. Thus, the Court drew a distinction, thereby affording speech on a public concern, about public figures its special, inherent protections, while continuing to protect the wholly private citizen from unfounded defamatory attack. Hence, the showing of fault necessary for plaintiff to prevail on a defamation claim varies according to the plaintiff's status in society and to the degree to which society has a vested interest in her behavior. Philadelphia Newspapers, Inc. v. Hepps, 475 U.S. 767, 775 (1986); New York Times v. Sullivan, 376 U.S. 254 (1964).

IV. THE STATUS OF TEACHERS IN DEFAMATION SUITS

As the status of a plaintiff determines the burden imposed, it is often the dispositive factor in a defamation suit. Therefore, it is important to identify whether defamed teachers are public officials, public figures, or private individuals. Additionally, depending on that conclusion, it may also be important to assess the issue underlying any defamatory comments, i.e., is the issue underpinning defamation a matter of public concern or a matter of private concern. In determining status, courts have defined teachers as all of the above, and have done so for different reasons, over different periods of time.

A. Teachers are Private Individuals

Courts that decline to apply the actual malice standard to teacher defamation claims find either that teachers are not public officials or that, factually, they lack the "apparent governmental authority" to render them public figures under *Rosenblatt*. These include courts in Virginia, California, and Florida.[100] Such courts note that teachers are not elected to public office and neither exercise the degree of control common to mayors or governors, nor are imbued with their explicit authority. Furthermore, teachers have no legal authority to define policy, determine curricular and text choices, or control school hours or schedules. Rather, this authority is vested in the state or local Board of Education (or, within a private school, in the Board of Directors).[101] Consequently, to label teachers public officials or even public figures would exaggerate their role in the schools.

Aside from whether the powers exercised by teachers qualify them as public figures, courts have also been influenced by the lack of viable self-help remedies available to them.[102] Public officials who are defamed may, unlike average Americans, combat false speech with counterspeech. This makes their heightened burden of proof more just and can limit the harm of defamatory comment. Teachers, however, do not share the cadre of self-help remedies available to media moguls, Hollywood starlets, and politicians. If someone muddies a teacher's name, the teacher will not have the soapbox of a Today Show or a USA Today "My View" response. Thus, a teacher is like any other private

[100]. *See infra* notes 103 - 113.

[101]. Hazelwood v. Kuhlmeier, 484 U.S. 260 (1988); Virgil v. School Board of Columbia County, Fla., 862 F.2d 1517 (11th Cir. 1989); State ex re. Andrews v. Webbed, 8 N.E. 708 (Ind. 1886); *see also* Steirer by Steirer v. Bethlehem Area School District, 987 F.2d 989 (3rd Cir. 1993).

[102]. A concern voiced by the Court in *Gertz*. Gertz, 418 U.S. at 344.

individual who will not have any real ability to respond to defamatory comment, but will have only the remedy of suit.

The first, noteworthy decision holding that teachers were neither public officials nor public figures was the California court of appeals decision of *Franklin v. Lodge 1108, Benevolent and Protective Order of Elks*.[103] In *Order of Elks*, a teacher's book choice had been publicly criticized, and she had been called a "communist." In the aftermath, an article reported that the teacher had been fired and her employment applications rejected by several other districts.[104] Both of these assertions, however, were untrue.

Holding for the teacher, the court declared that two reasons relieved the teacher of the burden of actual malice. First, using common parlance to define "public official," the court explained that a public official must be involved in "governing." Implicit was a belief that "governing" involvement with the "big issues" and at the highest levels. Because the teacher's ability to "govern" and to control issues of government was "remote and philosophical at best,"[105] she could not, factually, be a public official. Second, the court considered the risk that the teacher had assumed in accepting a teaching position. This hearkened back to *New York Times*, which had noted that a public official assumes the risk of false public comment, and, thus, is less deserving of recovery than a private plaintiff. *The Order of Elks* court, therefore, saw assumption of the risk of defamation not as a consequence of being a public official, but as a characteristic possessed by any public official. Reasoning that a teacher does not enter the profession assuming such a risk (or by choosing any particular book), the court determined that she was not a public official.[106]

The court also dismissed the argument that the teacher fell into the lesser category of public figure. In doing so, it focused on the controversy and how it arose. Because the controversy leading to the defamatory statements arose out of the teacher's book choice and the teacher did not inject herself into the controversy of the choice

[103]. 97 Cal. App. 3d 915 (1979).

[104]. *Id.* at 920-21.

[105]. *Id.* at 929-30. A Florida court also followed this reasoning in part, finding that no controlling case law held that a teacher was a public official, and that a teaching position did not entail the same policymaking authority as an elected governmental position. Nodar v. Galbreath, 462 So.2d 803, 808 (Fla. 1984). Notwithstanding, that opinion later seemed to accept that the public had a substantial and legitimate reason to comment on the performance and behavior of teachers. *Id.* at 810 n.5.

[106]. Franklin v. Lodge 1108, Benevolent and Protective Order of Elks, 97 Cal. App. 3d 915, 929-30 (1979); *see also* Scott v. The News-Herald, 496 N.E.2d 699 (Oh. 1986) (noting in the syllabus that a teacher is not a public official, but not addressing issue in body of opinion).

voluntarily, rather, the controversy was about her, she failed to qualify as a public figure.[107]

The Virginia Supreme Court adopted the "public response" aspect of *Order of Elks*.[108] There, a newspaper article quoted parents and students who described the plaintiff teacher as "disorganized, erratic, forgetful, unfair," often absent from the classroom, and demeaning and humiliating to the students. Though colleagues and administrators subsequently testified to the contrary at trial,[109] the reporter limited his investigation to the few parents, colleagues, and principal quoted.[110]

As had *Order of Elks* before it, the Virginia Supreme court found that the teacher was not a public official or even a public figure, but, rather, a private individual deserving of the greatest protection against defamation. This conclusion rested largely on the teacher's inability to exercise the self-help mechanism of meaningful media response. Indeed, the court read *Gertz* to mean that, unless an individual had meaningful access to the media, he could not be a public figure.[111] The court also engaged in a comparative inquiry, noting that a lawyer (like Gertz) would certainly enjoy more self-help opportunities than a teacher. Therefore, if lawyer Gertz was not a public figure, a teacher certainly could not be.[112]

In *Nodar v. Galbreath*,[113] the Florida Supreme Court also determined that teachers were not public officials, but private individuals. There, a parent's complaints at a Board meeting had impugned a 10th grade English teacher's professional reputation. The court focused on the degree of risk that the teacher had likely thought he assumed by entering the profession. Concluding that this was less

[107]. Franklin, 97 Cal. App. 3d at 929-30. This decision, however, fails to consider the role of a teacher in society or that curricular choices may beget a controversy. Thus, somehow the court ignored that the teacher, herself, had chosen the book that became controversial.

[108]. Lipscomb v. Richmond Newspapers, Inc., 362 S.E. 2d 32, 34-35, 38 (Va. 1987); *see also*, McKay v. Clarke County School Board, 10 Va. Cir. (Clarke Co.) 442, 447 (1988).

[109]. Lipscomb, 362 S.E. 2d at 34-35, 38.

[110]. *Id.* at 38.

[111]. Milkovich v. The News-Herald, 473 N.E.2d 1191, 1195-96 (Oh. 1984) (Status of teacher-coach does not transform one, as a matter of law, into public official).

[112]. Furthermore, it suggested that a person who runs for public office (and is, hence, a public official) decides to accept the increased scrutiny regarding his performance, whereas the average teacher does not knowingly do so.

[113]. 462 So.2d 803 (Fla. 1984).

than the degree of risk attendant to a government policy-maker, the court held that the teacher was not a public official.[114]

B. Teachers are Public Figures

Courts subjecting teachers to the actual malice standard do so on alternate grounds: First, because most teachers work for local government and are paid with public funds, they are public officials; Second, under Rosenblatt, the public interest in and exposure of their work renders them public figures or some public official/figure hybrid.[115] Courts adopting this reasoning include those in Minnesota, Illinois, Oklahoma, Connecticut, Arizona, Tennessee, and Massachusetts.[116]

Some courts employ a rather straightforward analysis: that public teachers are public employees, paid with public funds, and exercise control over children. Therefore, they are public officials. Among the first to adopt this line of analysis was the Supreme Court of Illinois in *Basarich v. Rodeghero*. That court also described the importance of education and its agents in society. It explained that public teachers and coaches took part in a task -- education -- that was a prime governmental responsibility.[117] Consequently, their conduct and policy decisions were precisely the types of subjects about which the public would engage in legitimate and interested debate.[118] This, too, demonstrated that they were public officials. The Arizona Court of

[114]. Although it did not concern a teacher, but a principal, the Ohio Supreme Court recently held that a principal is not a public official. East Canton Education Ass'n v. McIntosh, 709 N.E.2d 468, 475 (Oh. 1999). Under this court's reasoning, if a principal is not a public official, certainly, a teacher would not be.

[115]. It is also important to distinguish cases where defamatory comments were directed toward teachers who were also football coaches or athletic directors. In those instances, the status of coach adds a public aspect to the teacher, particularly in locales where high school football is quite popular. *See e.g.*, Johnson v. Southwestern Newspapers Corp., 885 S.W.2d 182, 186-87 (Tex. Civ. App. 1993) (plaintiff both teacher and coach, therefore public official).

[116]. Elstrom v. Independent School District No 270, 533 N.W.2d 51 (Minn. App. 1995) (public school teacher is public official); Johnston v. Corinthian TV Corp., 538 P.2d 1101, 1103 (Okla. 1978) (Public school teacher and wrestling coach is public official because the public had an interest, beyond that in the average public employee, in his performance as a teacher and in enacting discipline as a coach. The court referred to *Basarich, infra* this note); Basarich v. Rodeghero, 321 N.E.2d 739 (Ill. 1974) (Public school teacher is public official.); *see also*, Ellerbee v. Mills, 262 Ga. 516 (1992) (holding suggesting that teacher is not private individual rescued from malice standard).

[117]. Basarich, 321 N.E.2d at 742. It also acknowledged that school athletic programs are commonly subjects of intense public interest

[118]. *Id.* The conception of public official, however, is relatively broad in Illinois, including, for example, doctors

Appeals followed this reasoning, concluding that teachers were, in fact, public officials. That court, however, did not explain its rationale, but merely cited to *Basarich*.[119]

One of the most recent courts to hold that a teacher is a public official is the Court of Appeals of Tennessee.[120] There, a newspaper article critical of felons working within the schools reported that a teacher had been arrested 24 years ago for "contributing to the delinquency of a minor." The court looked to *Rosenblatt's* two-fold motivation for the malice standard, i.e., the strong interest in debate on public issues and a strong interest in debate about people in positions who can influence the resolution of those interests. It reasoned that a public school teacher was exactly the type of person about whom the public would be concerned and who could influence education.[121] Therefore, a teacher is a public official.

Many courts have accepted that teachers possess a significant amount of power over education. In fact, with regard to policies and the administration of the schools, while some teachers may be constrained in curricular choices, *Basarich* declared that public school teachers "run" the school system.[122] A Connecticut court agreed that teachers exercise almost unlimited responsibility for the daily implementation of the governmental interest in educating young people, and that, in the classroom, "teachers are not mere functionaries. Rather, they conceive and apply both policy and procedure."[123]

Some courts that deem teachers public officials focus on the status of education in society and the ability of teachers to influence youth. Connecticut courts have also noted[124] the substantial public interest in the behavior of teachers, especially their behavior around students.[125] For example, in *Kelley v. Bonney*,[126] the Connecticut

[119]. Sewell v. Brookbank, 119 Ariz. 422, 425, 581 P.2d 267, 270 (Ct. App. 1978) (Teacher is a public official.).

[120]. Campbell v. Robinson, 955 S.W.2d 609 (Tenn. Ct. App 1997).

[121]. *Id.* at 611, 612.

[122]. Basarich, 321 N.E.2d at 742.

[123]. Kelley v. Bonney, 606 A.2d 693, 710 (Conn. 1992).

In fact, the Supreme Court described the task performed by teachers as one central to representative government. Ambach v. Norwick, 441 U.S. 68, 75-76 (1979) (upholding American citizenship requirement for teachers); *see* Sugarman v. Sougall, 413 U.S. 634, 647 (1973). This approach is also consistent with the belief of Justice Brennan who explained that teachers are the "central figure[s]" in the "Nation's most important institution." Milkovich v. News Herald, 474 U.S. 953, 958 (1985).

[124]. Kelley v. Bonney, 221 Conn. 549; Sewell, 119 Ariz. at 425 (teacher public figure under *Rosenblatt* two-prong test).

[125]. Di Cosala v. Kay, 91 N.J. 159 (1982).

[126]. 606 A.2d 693, 710 (Conn. 1992).

Supreme Court noted that, "unquestionably, members of society are profoundly interested in the qualifications and performance of the teachers who are responsible for educating and caring for the children in their classrooms."[127]

That *Kelly* court also considered a teacher's ability to respond to defamatory comments. It concluded that, while teachers may not possess the same cadre of media-induced counterspeech mechanisms common to public officials, they are not without means of response. Teachers, through the power and assistance of their unions (where applicable), wield an amount of power of response and self-help (via defense funds) unknown by the general public. Thus their ability to respond almost certainly exceeds that of the average citizen. In fact, due to the public's interest in teachers, it is likely that the media would not only report allegations made against a teacher, but also would invite the teacher to respond.[128]

For similar reasons, courts have also deemed teachers public figures. In *Pendleton v. City of Haverhill*,[129] the First Circuit held that a teacher was a limited public figure. Pendleton had worked as a substitute teacher in the Haverhill, Massachusetts district, but was unable to obtain a full-time appointment. This difficulty was recounted in a newspaper story, noting the irony that this African-American was unable to obtain a full-time teaching job notwithstanding the district's outcry for a more diverse staff.[130] That Fall, Pendleton was hired as a vocational counselor at a private, non-profit organization.

Subsequently, Pendleton was arrested for cocaine possession. Newspaper articles reporting the arrest described Pendleton as a "school jobs counselor" and "high school advisor" working with 30-40 students.[131] At trial, Pendleton was found not guilty. Consequently, another newspaper story reported the positive outcome and supposed that Pendleton would return to "doing . . . positive things in the community."[132] Yet, a few days later, the paper reported that officers involved in the arrest were upset that the judge had not ordered Pendleton into a drug program, and stated that, when arrested, Pendleton "had coke all over his face, from the tip of his chin to his eyebrows. . . [unlike a] first-time user [who] would not have had it all over his face." In fact, one officer claimed that he had "never made an arrest where there was this much cocaine on a person's face" and had

[127]. *Id.* at 749.

[128]. *Id.* at 710.

[129]. 156 F.3d 57 (1st Cir. 1998).

[130]. *Id.* at 60.

[131]. *Id.* at 61.

[132]. *Id.*

even found "a big bag of cocaine at his feet."[133] One month later, Pendleton was fired. He sued for defamation.

The court found that Pendleton was a limited public figure, thus requiring him to prove actual malice to prevail.[134] He achieved his status in two ways. First, because Pendleton had spoken to and permitted a newspaper to quote him extensively on the need to recruit and employ more teachers of color and the adequacy of the measures employed to that end,[135] he injected himself into that public controversy.[136] Therefore, he was a limited public figure regarding the school district's hiring people of color.

More important, however, was the court's calculation of Pendleton's status as a teacher applicant. By seeking the position of teacher and exposing his qualifications for that post, Pendleton had transformed himself into a limited public figure. Hence, any commentary on his qualifications for a teaching position was fair game, part of public discourse, and subject to the standard of actual malice.[137] Furthermore, like most public figures, Pendleton possessed access to media channels, as demonstrated by his previous access to the local paper.[138]

Rocci v. Ecole[139] also reflected the penultimate role of teachers in modern American society, and how that could render one a public figure. In *Rocci*, a teacher, sued another teacher, Tilli, for writing a defamatory letter about her and sending it to Rocci's principal. Rocci and Tilli had taken students on a trip to Spain.[140] The letter complained that Rocci' was unprofessional, drank excessively, and kept the students out late.[141] Though Rocci proved the falsity of the letter, she could not demonstrate any pecuniary loss or disciplinary action. She merely was "outraged" and embarrassed.[142]

The court determined that actual malice was required. First, because there is a strong public interest in the behavior of teachers,

133. *Id.* at 61-62.

134. *Id.* at 60, 69.

135. *Id.* at 61 (noting "flurry" of media reports and Pendleton's use of this resource).

136. *Id.* at 69.

137. *Id.*

138. Consequently, teachers invite public comment by virtue of taking on this role. This interest in a teacher's fitness for office satisfies the more specific, public interest prong of Rosenblatt.

139. Rocci v. Ecole Secondaire Macdonald-Cartier, 755 A.2d 583 (NJ Sup. Ct 2000).

140. *Id.* at 584-85.

141. *Id.* at 585.

142. *Id.* at 586.

especially regarding their conduct in the presence of students, Tilli's letter implicated a matter of public concern. That is precisely the type of topic which must received heightened protection: "[T]here must be free discourse, commentary, and criticism regarding a teacher's professionalism and behavior during a school-sponsored event."[143] Consequently, it was favored above the personal interest of the teacher.[144] Secondly, the court determined that Rocci *as a teacher* was a public figure. As a public figure, she had to show actual malice.

Furthermore, although the Supreme Court has not answered the question of whether teachers are public official or figures, in other decisions, it has noted the critical role of education in a democratic society and of teachers as agents in that process. The community looks to teachers as role models for children, and, through her impact on students, teachers exert a substantial amount of control in shaping the community.[145] As their influence in the classroom and over children "is crucial to their continued good faith of a democracy,"[146] They "have direct, day-to-day contact with students, exercise unsupervised discretion over them, act as role models, and influence their students about the government and the political process."[147] Indeed, as the "central figure[s]" in the "Nation's most important institution," the public's interest in the performance and qualifications of teachers exceeds that of most other government employees.[148] In a dissent to the denial of certiorari, Justice Brennan, author of both *New York Times* and *Rosenblatt*, explained[149] "the public has an independent interest in the qualifications and performance of those who teach" that extends "beyond the general public interest in the qualifications and performance of all government employees."[150] Accordingly, the status of teachers rises to that of a public official.

143. *Id.* at 587.

144. Jurisprudence must not "chill complaints about a teacher's behavior in the presence of students. . . ." *Id.*

145. *See* San Antonio Independent School District v. Rodriguez, 411 U.S. 1, 29-30 (importance of education to democratic society; education "is required in the performance of our most basic public responsibilities, even service in the armed forces. It is the very foundation of good citizenship. Today it is a principal instrument in awakening the child to cultural values, in preparing him for later professional training, and in helping him to adjust normally to his environment") (1973).

146. Ambach, 441 U.S. at 78-79.

147. Bernal v. Fainter, 467 U.S. 323, 345 (1974).

148. Milkovich v. News Herald, 474 U.S. 953, 958 (1985). Comparing teachers with "other public employees" accepts that teachers are public employees, otherwise there is not need to compare them with the other public employees, therefore public officials.

149. Lorain Journal v. Milkovich, 474 U.S. 953, 964 (1985).

150. *Id.* at 959.

V. ANALYSIS

In assessing the appropriate status of teacher plaintiffs in defamation actions, while it is important to consider the conflicting case law, it is also critical to contemplate the past and present role of education in American society. Many cases on either side of the issue are 20-30 years old. Hence, past cases finding that teachers are neither public officials nor public figures, may not remain relevant today. Typically, those cases determined that teachers were not adequately involved with issues pertinent to government. Yet, as the role of education and teachers in society has increased, the precedential value of these cases has decreased. This is not an affront to precedent, but a recognition of that the status of teachers and education in society has changed.

Education has undeniably grown to a matter in the eye of the public, debated by the public, and of concern to the public. Major networks air public service announcements thanking teachers for their work, presidential and local elections frame education as a critical issue, and newspapers devote weekly, if not daily sections on education and schools in the community. The importance of education and the status of those responsible for the day-to-day delivery of and partners in the educational mission has increased exponentially.[151] In *Brown v. Board of Education Topeka*,[152] the Supreme Court described education as perhaps the most important function of the state and local governments. Compulsory school attendance laws and the great expenditures for both demonstrate our recognition of the importance of education to our democratic society. It is required in the performance of our most basic public responsibilities. . . It is the very foundation of good citizenship. Today it is a principal instrument for awakening the child to cultural values, in preparing him for later professional training, and in helping him to adjust normally to his environment.[153]

A. Teachers as Public Figures

Consequently, education is precisely the type of undertaking with which the public would have a deep and legitimate concern, and consequential, the actions and policy choices of those entrusted with

[151]. Courts finding that teachers are not public officials, by contrasting their degree of control and notoriety with presidents and mayors, miscalibrate the scale. Indeed, the critical nature of the job and impact of teachers on society in some ways far exceeds that of the average public figure. Cane, *supra* note 65, at 1200.

[152]. 347 U.S. 483 (1954) (Brown I).

[153]. *Id.* at 493.

education would be prime for debate. By accepting the job of teacher (and allowing their qualification to be subject to broad scrutiny, scrutiny of Board members, public of private, parents, and supervisors), teachers have voluntarily associated themselves with that issue and moved into a position of increased public status. In *Pickering v. Board of Education*,[154] the Supreme Court described education as a public service and a teacher as an agent who promotes the interests of the State[155] – the task performed by teachers is central to representative government.[156] This places teachers on par with other public officials who also apply and conceive policy.[157]

Nonetheless, under *Rosenblatt*, teachers need not possess actual authority. Rather, they only must "appear to the public to have, substantial responsibility for or control over the conduct of governmental affairs."[158] And the public does see teachers as representatives of the school district, if not extensions of the administration, that exercise control over children (both in terms of education and custody). In small districts or those where responsibility for education is held by a strong, local Board of Education, teachers often exercise a significant degree of control over policies, textbooks, and curricular choices.

Moreover, teachers have a special relationship with students. They possess an ability to violate the privacy concerns of minors to a greater degree than even the police. Teachers may search students on less cause than required for a police search;[159] they may officiate "hearings" that deny students their state constitutional right to a free public education (via suspension and expulsion); and may posses liability for student-to-student interactions in the classroom.

[154]. 391 U.S. 563, 568 (1968).

[155]. *Id.*

[156]. Ambach, 441 U.S. at 75-76 (upholding American citizenship requirement for teachers); *see Sugarman*, 413 U.S. at 647.

This approach is also consistent with the belief of Justice Brennan who explained that teachers are the "central figure[s]" in the "Nation's most important institution." Milkovich v. News Herald, 474 U.S. 953, 958 (1985).

[157]. In other districts and those with strong Board of Education, the influence of a teacher to the day-to-day operation and the policy goals of a school are a function of the culture of the educational institution. Therefore, though it is possible that teachers wield little ultimate authority, even where they are not powerful, they will often exhibit some degree of control. For example, it is quite unusual for a BOE to adopt a textbook or curricular strategy that the teaching staff opposes.

[158]. Rosenblatt, 383 U.S. at 85.

[159]. *Compare* New Jersey v. T.L.O., 469 U.S. 325 (1985) (may search students in school environment on reasonable suspicion, rather than probable cause) *with* U.S. CONST., amend IV. (no unreasonable searches)

The status and obvious publicity of teachers is also evidenced by more recent laws regarding professional qualifications,[160] disqualification from the profession, and extensive background checks. With regard to the latter, laws in many states have reduced privacy protections for teachers, because of their role and custodianship of children. States require fingerprint checks and criminal history background checks, two measures uncommon in most fields. Public "Right to Know" and "Sunshine" laws also, to greater and lesser degrees, include teachers within their reach.[161] The widespread existence of such laws significantly undercuts the premise. Accordingly, the risk assumption theory prominent in cases holding that teachers are private individuals does not hold up. In a profession where one must submit to fingerprint analysis (sent to the state and federal authorities) and criminal history background check, and runs the gauntlet of media and pubic opinion, it should be apparent to teaching candidates that they have a reduced interest in privacy.[162]

B. Teachers as Public Figures

Having voluntarily associated themselves with this matter of significant public concern (i.e., education, the controversy), teachers transform themselves into limited public figures. "[T]eachers "invite attention and comment" merely by accepting a public teaching position,"[163] and, thus, assume a risk of defamation.[164] The focus of *Rosenblatt* is position: hence, does the position of "teacher" invite scrutiny, not whether the teacher herself, wishes to be scrutinized. Indeed, cases that hold teachers are private individuals because teachers probably did not think that they were exposing themselves to the public

[160]. Even laws pertaining to professional qualifications have been enacted or tightened (or state-based teacher scholarship programs) to reflect the increased importance of teachers and education. The state may even require certification of the teachers of home-schooled children to ensure this significant sate interest. State v. Patzer, 382 N.W.2d 631 (N.D. 1986); Jernigan v. State, 412 So. 2d 1242 (Ala. 1982); *compare* People v. Bennet, 501 N.W.2d 106 (Mich. 1993).

[161]. Eyer & Kegel, *supra* note 8, at 331-32. Conversely, teachers also receive some protections as state agents. For example, some states grant public teachers governmental immunity for their acts. *See e.g.*, Col. Rev. Stat. Ann., § 24-10-101 to 120 (1996).

[162]. Justice Brennan's theory regarding the public's interest in the performance and qualification of teachers may also reflect *Gertz's* disparate levels of protection, i.e., that public figures have consciously accepted the risk of harm to their reputation. This would support placing teachers in the category of public figures

[163]. Cane, *supra* note 65, at 1205.

[164]. *Id.* at 1205.

miss the point. It is not whether the teacher accepted scrutiny – this is not within the teacher's purview – but whether the teacher accepted the position of teacher, a position that in the new millennium is one of scrutiny. (Otherwise, other public figures lower on the food chain could merely opt-out of the malice standard by arguing that they had not really contemplated that they would be scrutinized by the public, to this extent or in this way). It may be true that decades ago the public was uninterested in teachers, who they were and what they did in the classroom.

In any event, decisions that rest on the lack of self-help remedies likely possessed mis-state the test: *Gertz* made clear that the focus was on the position, not what the position would mean in terms of available response. Even in *New York Times*, the Court did not craft a test focused on ability to respond to commentary, but focused on the nature of the position and whether the position (or the issue) made it one that would be important for the public to comment on. That a public individual could also wrangle the media for his means, his response, was a further justification of this choice, but not the test itself.[165] *Gertz* described it as a preferred remedy to litigation (defamation litigation).[166] In fact, *Gertz*, itself, recognized that some public officials would not have the means to media response, but this lack of response still did not rescue them from the malice standard. Rather, the point was that the individual had taken on a governmental office and therefore must accept the consequences of that office, to wit: public complaint and discussion about her job performance.[167]

Because of the public interest in education and teachers as well as the heightened exposure of their background and qualifications, the most sensible status formulation of teachers is that of limited public figures. This status recognizes the role of education and its providers and permits public commentary on aspects of teacher behavior in and out of the classroom that pertain to the public issue of education, i.e., their role of teacher. In this way, the public would be free to engage in unfettered debate on teaching and classroom practices,[168] yet the non-

[165]. Further, as noted in *Rocci*, 755 A.2d at 587, it is likely that a criticized teacher has easier access to the media that the average person. Unions with legal defense funds and public relations personnel have also widened the availability of self-help remedies from teachers. Certainly, this unified front is unavailable to teachers at private schools, but private school teachers may also be more likely to have informal and school-sponsored connections or communication to parents.

[166]. Gertz, 318 U.S. at 344

[167]. *Id.*

[168]. In fact, it could be argued that, since teachers tend to the children, developing citizenship, and socializing them into our culture and democracy, and

professional aspects of a teachers life, such as marital discord, would be protected from public scrutiny (by eliminating the malice standard). This intelligently balances the public's interest in performance or behavior of "teacher" and that individual's (the citizen who happens to teach) interest in their reputation.

Such a formulation is superior to deeming teachers either private individuals or public officials. With regard to the former, the role of teacher has transcended that of a private individual with no public face or connection to a public undertaking. With regard to the latter, while it might be easy to rely on *Rosenblatt* to conclude that public school teachers, in the employ of the public, are public figures, thus would create a distinction between public and private educators: only public teachers are paid with public funds, employed by the public, and, therefore, public officials. Private individuals, as employees of a private educational enterprise could not be. Yet, private teachers are some times more highly scrutinized by boards of directors and parents than their public counterparts. Accordingly, a distinction based on employer, rather than job, would result. This would be non-sensical as it would not address the nature of the position or role of education in society.

C. *Application of the Standard*

Almost all alleged defamation of teachers arise from commentary about their behavior or actions (1) clearly within the employment relationship (during the school day, as an advisor on a trip, as a coach during practice); (2) fitness for service; and (3) off-the-job and unrelated to the job. The easiest situation to analyze is the first, situations in which defamation pertains to matters clearly within the school environment or relationship.

If defamatory comments about a teacher are responsive to her teaching, obvious representation of the school or contact with students, it speaks to job performance or concerns a teacher's professional status of educator. Consequently, it is certainly a matter of public concern. Therefore, because the teacher, at that juncture, has voluntarily

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because teachers fall under local government, speech on their behavior and teaching is akin to political speech. Even Thomas Jefferson in his Preamble to a Bill for the More General Diffusion of Knowledge (1779) urged that the most effective means of preventing tyranny and preserving democratic government is through education. Horace Mann described it as essential to the economic and social welfare of the people. *See also* Strangway v. Allen, 240 S.W. 384 (Ky. 1922).

Courts have increasingly deemed education a compelling governmental interest. Matter of Welfare of T.K. & W.K., 475 N.W. 2d 88 (Minn. App. 1991).

involved herself in the matter in the public interest, i.e., education, commentary is favored over the individual interest of the teacher. Thus, it receives heightened protection, and defamation requires proof of actual malice.

If defamatory comment responds to a purely private concern, such as divorce, gonorrhea,[169] or the marital infidelity of a spouse, such comments would not relate to the job, to the teacher's qualifications, and would not be a matter of substantial public concern. Therefore, the personal interest in reputation would prevail over public comment, and a showing of malice would be unnecessary.[170]

The more difficult issue is determining when and the extent to which off-campus or seemingly personal behavior become a matter of public concern. The position of a teacher in present society extends beyond state-mandated academic credential and job qualifications, but includes fitness for service.[171] Fitness for service includes less discreet variables like, criminal convictions, crimes (misdemeanors or felonies) of dishonesty, and discrimination. Sometimes these can easily be translated into qualification for the classroom. For example, a racist

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[169]. Poulous v. Latheran Society Services of Illinois, Inc., 312 Ill. App. 3d. (Ill. App. 2000).

[170]. A misguided student author claims that teachers should not be subjected to the malice standard, because it may result in teachers being driven from the classroom. Brian Markovitz, *Note, Public School Teachers as Plaintiffs in Defamation Suits: Do They Deserve Actual Malice?* 88 GEO. L. J. 1953, 1958 (2000). It is questionable whether an individual seeking to maximize their self-interest via a teaching career factors into that job choice the potential of a bringing a defamation action let alone the heightened burden of malice they might bear. Furthermore, the facts of the case cited suggest a contrary outcome. As an example of such a "[l]oss to the education system and the community" was the loss of an athletic coach and teacher who lost his job after media coverage accurately reported that the coach invited, permitted, and watched the team haze a member (who crawled through a gauntlet legs spread and naked, where be was clapped), but did not, himself, touch the student. The report incorrectly insinuated that far more had occurred. Markovitz, *supra*, at 1158. Although the report was incorrect, this is hardly the appropriate educator over whose loss the community and school should mourn. *See* Johnston v. Corinthian Television Corp., (Okl. 1977, 1978)

This same author also asserts that "[t]eachers' [sic] molestation or abuse of children are criminal justice issues, wholly outside of the realm of education . . . ." Markovitz, *supra*, at 1959. Apparently ignorant of the manifold state laws that concern the fitness of a teacher for employment upon indictment or conviction, and similarly unaware that it may be a bad idea to put a child molester into a classroom of potential victims, and as their sole guardian.

[171]. "[A]nything which might touch on an official's fitness for office is relevant" to official conduct, Garrison, 379 U.S. at 77, including charges of criminal conduct, Monitor Patriot Co. v. Roy, 401 U.S. 265, 277 (1971), or dishonesty, Garrison, 379 U.S at 77, intimidating business tactics, Johnson v. Capital City Press, 346 So. 2d 819, 820 (La. Ct. Ap. 1977, 1976), or even, false statements regarding a Secret Service agent's sexuality, Buendorf v. National Public Radio, 822 F. Supp. 6, 12 (D.C.Cir. 1993).

teacher at home, would likely be a racist teacher in the school; a teacher who trafficks drugs may sell to students. Some state statutes permit the dismissal of a teacher for immorality (as it relates to fitness to teach). Morality also extends to lying[172] and any course of conduct that "offends the morals of the community and is a bad example to the youth, whose ideals a teacher is supposed to foster and elevate."[173] Although valid regarding many crimes and honesty may mutate into a litmus test for tradition. For example, some states include sexual activities within their morality acts. Obviously, behavior when in the classroom, on-campus, as a delegated representative of the district, or reasonably perceived representative of the district would be relevant, but the categories of moral turpitude and sexuality raise questions of merely reflecting community biases. If fitness for office is defined too broadly, or if it includes undefined morality, it is possible that all aspects of a person's life would be considered relevant.[174] This would expand the scope of public comment to usurp the protections of the limited public figure. This is inconsistent with *Gertz* and its progeny, which seek to provide some safe harbor for people with some public personae.

VI. CONCLUSION

The imprecision of the Supreme Court's definition of public figure has resulted in uncertainty regarding the status of teachers for purposes of defamation. Though there is a split of authority on the issue, with some courts finding that teachers are private individuals, others finding them to be public officials, and still others deeming them public figures, it is important to assess the status of teacher and education in today's society. Teachers and K-12 education have risen to previously unknown status; they are among the most important issues of the day, figuring prominently in presidential elections, media coverage, and developing democratic ideals. No other profession touches more families and carried more public interest than those intimately involved with the school system. Furthermore, states have increasingly regulated and imposed on the privacy of those in the teaching profession. Although teachers may historically have been more private than public

[172]. Bethel Park School District v. Krall, 445 A.2d 1377 (Pa. 1982).

[173]. Horosko v. Mount Pleasant Township School District, 6 A.2d 866 (Pa. 1939).

[174]. In defamation and privacy actions, the laws favors a finding of relevancy of the information. Bussewitz v. Wis. Teacher's Ass'n, 188 Wis. 121, 125 (1925).

individuals, that is no longer the case. Rather, the behavior and actions of teachers in their educational capacity has risen to a matter of public concern. Consequently, it is appropriate to contemplate teachers as limited public figures. This permits free, public debate on their actions--as those actions pertain to their role as teachers and role models for students -- but protects the private aspects of their lives unrelated to that charge by eliminating the standard of actual malice.

Legal Issue Associated with Marketing and Webpage Management

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I. *INTRODUCTION*

The Internet and electronic communications are rapidly changing traditional marketing methods. Practically every type of business organization, from producers to retailers, and hard-goods manufacturers to service providers, is found on the Internet today. Small local businesses, as well as large, multi-national corporations, are flocking to the Web. Business-to-business E-commerce was estimated at over $150 billion in 1999, with predictions that the figure could reach over $3 trillion by 2003. On-line business-to-business consumer transactions in America alone were worth $20 billion in 1999, with expectations by some that it will grow to $184 billion by 2004.[1]

As the Internet becomes an increasingly important marketing medium, the law governing this medium requires consideration. Whether companies utilize the Internet to sell products, provide information, streamline operations, or simply entertain, their "virtual marketing strategies" are not sheltered from potential legal pitfalls. There are more laws that apply to websites, from more states and countries, than anyone can possibly track.[2] This is especially problematic when one considers that E-commerce is still in its infancy worldwide.

While Internet businesses will increasingly come under the scrutiny of the laws of many different countries, U.S. law has attempted to address the emerging issues presented by E-commerce marketing efforts. There is already a growing body of case law dealing with E-commerce

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[1] John Peet, *Shopping Around the Web*, ECONOMIST, Feb. 26, 2000, at 5.

[2] Safe Site Main Page, *Build a Safer Website: Webmasters Can Lower Their Legal Risks, Even When the Laws Are Uncertain*, Oct. 2, 1998, *at* http://www.netlaw.com/safer.htm.

legal issues within the U.S. Further, Congress has begun to address many of the problems presented. Yet, with the projected exponential growth in international E-commerce, particularly in Europe, the volume of both international dispute resolution and legislative efforts will surely increase, and impact United States marketers, as well.

This article reviews several important legal issues arising from the use of websites in marketing. Though primary emphasis will be on U.S. law and how it has dealt with these issues, international considerations will be discussed. Finally, management implications will be drawn and recommendations made.

II. *JURISDICTION*

Once a marketer's website is created, a continuous on-line presence is established in every state and foreign country where a consumer can access the Internet. As such, a principal issue in the legal aspects of E-commerce concerns jurisdiction and the possibility of being sued in a remote state or foreign country. An additional issue is what substantive law of contract, privacy, or consumer protection should apply.

Common law and constitutional principles of personal jurisdiction evolved long before the Internet existed. Court jurisdiction is limited by the Federal Due Process Clause,[3] which requires the assertion of jurisdiction over the party or business to be fundamentally fair to a trial defendant. With this notion of fairness in mind, U.S. courts have limited jurisdiction over persons or businesses which: (a) are physically present in the court's territory; (b) are systematically doing business within the territory; or (c) have committed a significant "minimum contact" within the territory.[4] Minimum contacts have included the making of a contract, commission of a crime, completing of a tort (such as fraud or unfair competition), copyright or trademark infringement, and disparagement or defamation.

A. Personal Jurisdiction

In the past several years, U.S. courts have also come to terms with webpage marketing and other Internet-related activities when it

[3] U. S. CONST. amend. V.

[4] Pennoyer v. Neff, 95 U.S. 714 (1878) (holding no jurisdiction over the person of a non-resident unless served while present in the state); Int'l Shoe Co. v. Washington State, 326 U.S. 310 (1945) (holding Missouri company made sufficient minimum contacts with Washington by employees taking orders in a systematic matter within the state).

comes to the issue or jurisdiction. Although there is little question that the accessibility of a webpage can increase jurisdictional exposure, the modern approach of U.S. courts is to consider the issue of webpage jurisdiction on a case-by-case basis. Frequently, cases place a website within one of several categories, on a continuum or "sliding scale," following the leading case of *Zippo Mfg. v. Zippo.com.*[5]

The first category involves the passive informational website. U.S. courts have determined that defendants posting non-interactive information on-line are not subject to *in personam* jurisdiction merely because the plaintiff is able to access the defendant's website. For instance, in *Hearst Corp. v. Goldberger*,[6] Hearst, the owner and publisher of Esquire magazine, sued Ari Goldberger, a New York attorney, for trademark infringement. Goldberger had established a website for his law practice called "Esquire.com." The New York court declined to exercise jurisdiction, finding that Golberger's website was informational, not targeted at New York, and therefore did not create sufficient contact with New York. Significantly, the New York court expressed its unwillingness to establish "worldwide" jurisdiction based on a "passive" or informational website:

> Upholding personal jurisdiction over Goldberger in the present case would, in effect, create national (or even worldwide) jurisdiction so that every plaintiff could sue in plaintiff's home court every out-of-state defendant who established an Internet website. The court declines to reach such a far-reaching result.[7]

A second category involves websites that feature more interactive marketing practices, including targeted solicitation, interactive response features (i.e., 800 numbers, e-mail activity, etc.), and other provisions for taking orders and making contracts. For instance, one case found minimum contact arising from trademark infringement by an Italian webpage operator. In *Playboy Enterprises, Inc. v. Chuckleberry Publishing, Inc.*,[8] the court enforced an injunction against an Italian publisher, prohibiting it from selling and distributing its Playman magazine in the U.S. Subsequent to that action, the Italian publisher created a website for the magazine and argued that merely posting

[5] Zippo Mfg. v. Zippo.com, 952 F.Supp. 1119 (Pa. 1997).

[6] Hearst v. Goldberger, 1997 W.L. 97097 (S.D.N.Y. 1997).

[7] *Id.* at 20.

[8] Playboy Enters, Inc. v. Chuckleberry Publ'g, Inc., 939 F. Supp. 1032 (S.D.N.Y. 1996).

pictorial images on the Internet, rather than physically distributing those images in the U.S., constituted a passive website and caused no contact with the U.S. The court disagreed and ruled to the contrary, finding that the interactive nature of the website, together with the defendant's non-Internet marketing promotion, met the "minimum contact" requirement for jurisdiction:

> Defendant has actively solicited United States customers to its Internet site, and in doing so has distributed its products within the United States. When a potential subscriber faxes the required form to (defendant), he receives back via e-mail a password and user name. By this process (the defendant) distributes its product within the United States. Defendant provides its website and now refuses U.S. customers.[9]

Likewise, in *Digital Equipment Corp. v. Alta Vista Technology, Inc.*,[10] Digital Equipment Corporation (Digital) purchased the trade name "Alta Vista" from defendant by contract in Massachusetts. However, defendant continued to use the name to market its Internet services to customers throughout the U.S., including Massachusetts. The court had little difficulty finding *in personam* jurisdiction over defendant's interactive site, particularly when coupled with defendant's infringement of plaintiff's trademark. The court noted defendant used the website to solicit sales and confuse customers in Massachusetts, which more than satisfied the "minimum contact" requirements of due process.

Similarly, in the leading Internet jurisdiction decision of *Zippo Mfg.*, a Pennsylvania district court was called to determine whether *in personam* jurisdiction existed over the defendant accused of trademark infringement which maintained a website with 3,000 Pennsylvania subscribers to its Internet news service. The court, in finding jurisdiction, noted that the infringements occurred in Pennsylvania, that Pennsylvania subscribers were numerous, and that contracts were made with Internet service providers in the state. The *Zippo Mfg.* court's three-part test for E-commerce website *in personam* jurisdiction has been widely followed: (1) has defendant purposely availed itself to receive benefits within the state; (2) could the defendant foresee being hauled into court in the jurisdiction; and (3) has the defendant created sufficient minimum contacts with the jurisdiction. The court answered yes to all three questions. The *Zippo*

[9] *Id.* at 1039.

[10] Digital Equip. Corp. v. Alta Vista Tech., Inc., 960 F. Supp. 456 (D. Mass. 1996).

Mfg. decision is also widely cited for its "sliding scale" principle, which focuses on the level of webpage interactivity and the nature of the interactivity. While purely informational sites should not create jurisdiction, websites that are designed to solicit and close contracts should.

A third category involves websites that would be considered "doing business" by pre-Internet due process analysis. Websites maintained by such Internet marketers as Amazon.com have broad jurisdictional exposure, which in all likelihood will include potential worldwide jurisdictional exposure.

B. International Jurisdiction

Other countries are becoming more aggressive in asserting *in personam* jurisdiction over website operators. The European Union's Brussels Convention[11] says that in business-to-consumer Internet transactions that "target" the seller, *in personam* jurisdiction will exist where the European Union (EU) consumer resides. The "targeted" test resembles the "interactive" solicitation component of *Zippo*.[12]

Other countries have gone beyond E.U. to assert jurisdiction. For instance, in a well-publicized decision, a German-based executive of CompuServe was arrested and charged with distributing pornographic material visible from CompuServe's website. The charges were ultimately compromised, but the German Parliament then passed a new law in 1997 making any website that is accessible from Germany subject to German law.[13]

C. Forum Selection Clause and Other Protection

Today, most E-commerce marketers' *terms of us* at the bottom of their homepage will include a forum-selection clause. Indeed, the clause is now considered a custom and practice in the trade and something consumers with which consumers are familiar. [14] While courts will not

[11] *Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters* (1968), 1998 O.J. (C27) 1.

[12] Council Regulation 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, 2000 O.J. (L 12) 1.

[13] Wendy Leibowitz, *National Laws Entangle the Net: It's a Small, Small, Litigious Web*, NAT'L L. J., June 30, 1997, at B07.

[14] Achieving Legal and Business Order in Cyberspace: A Report on Global Jurisdiction Issues Created by the Internet, American Bar Association Global Cyberspace Jurisdiction Project, 55 Bus. Law. 1801 (2000).

automatically follow the selection clause in all cases, most will, so long as it is "fair and reasonable," with some connection with the defendant to the forum selected. The clause should also be clear and conspicuous and easy to understand. A standard clause might provide:

> The parties agree that a condition of using this website is that any and all claims arising out of its use will be tried in the United States District Court, Eastern District of Virginia, Norfolk Division.

A related clause, the choice of laws clause, is also recommended and, likewise, subject to enforcement along the same standards.

Limiting the degree of interactivity and contract making on the webpage can also reduce jurisdictional exposure. Passive informational webpages will not be considered "minimum contact" creating merely by their accessibility. As interactivity increases to the point of contract making, jurisdiction is far more likely to be asserted. Next, Limiting the amount of non-Internet promotion and solicitation will also reduce jurisdictional exposure. The more non-Internet promotions, particularly with inventory or personnel in the jurisdiction, will be considered part of a program of "doing business." Finally, marketers might determine to decline business altogether from dangerous or litigious jurisdictions. This can be accomplished by simple refusals to deal and evidenced by a "disclaimer" indicating that the offers are not made nor the products or services available in the jurisdiction. It will be important, however, to monitor actual sales and solicitations that arise from the website. Monitoring website "hits," together with any technical filters that can be applied, will also be helpful.

III. PRIVACY OF INTERNET USER INFORMATION

Consumers, public-interest groups, Congress, and governments around the world have become increasingly concerned about the privacy of Internet user information. Privacy concerns are widely regarded as one of the key factors delaying wider use of the Internet in E-commerce. According to the most recent Federal Trade and Commerce (FTC) report[15], ninety-two percent of all consumers are concerned about the misuse of personal information collected on-line; sixty-seven percent are very concerned. These concerns have grown in part from the data mining and marketing directly to consumers based upon who clicks the website.

[15] Federal Trade Commission, *Privacy Online: Fair Information Practices in the Electronic Market Place – A Report to Congress*, (May 2000), http://www.ftc.gov/reports/privacy2000.pdf [hereinafter FTC Report].

Ninety-two percent of all websites collect personal information from consumers, using "cookies" - permanent files that can collect data about the user's identity, interests, and on-line purchases. While E-commerce marketers find it essential to gather personal information in order to better tailor their marketing to individual consumers, consumer concerns have caused Congress to consider a myriad of bills to protect consumer privacy. No less than eight bills are currently under consideration.

In the U.S., privacy on the Internet is still largely self-regulated. While one study has found that 94 percent of the top 100 websites have some type of posted privacy policies,[16] the FTC's survey found that fewer than 14 percent of all websites post a meaningful comprehensive privacy policy.[17] In an effort to get that done, and evidence it to consumers, privacy seal of approval programs have developed, the largest being maintained by the Better Business Bureau and TRUSTe, which both provide website development assistance to firms and subject websites to a privacy audit.

A. Enforcement of Privacy by FTC

However, in the U.S., Congress has not been entirely satisfied with a self-regulation approach. In 1998, it passed the Children's On-Line Protection Act (COPA),[18] requiring marketers to verify parental consent before collecting any personal information from children. Data collection must be limited, security and confidentiality maintained, and parents must be provided an opportunity to review the information collected and delete it. The practical of effect of COPPA has been the virtual elimination of most child-targeted commercial websites.

While no uniform federal statute concerning Internet privacy has yet been adopted, the FTC has studied the matter for five years, conducted surveys, and brought suit for on-line invasion of privacy. *In the Matter of GeoCities, Inc.*,[19] the Commission sued GeoCities for violating its own privacy policy. A GeoCities site offered free homepages and e-mail, but required personal information, which GeoCities' privacy policy stated would only be used internally and not sold to third parties. In fact, GeoCities sold the information to other data marketers. The FTC consent order required GeoCities to post a privacy policy giving notice of what information is collected, for what purpose, and to whom it is disclosed.

[16] Culnan, Mary J., "Privacy and the Top 100 Web Sites: Report to the Federal Trade Commission," (June 1999) http://www.msb.edu/faculty/culnanm/GIPPSoparpt.pdf

[17] FTC Report, *supra* note 15, at 4.

[18] Pub. L. 105-277, 112 Stat. 2681 (1998) (codified at 47 U.S.C. §§ 230, 231).

[19] *In re* GeoCities, Inc., 199 FTC Lexis 17 (FTC Feb.5, 1999).

The policy also had to state how consumers could remove their information from third-party databases. Clearly, GeoCities demonstrates that the FTC views a marketer's website privacy policy as a contract with consumers, and that a failure to follow the policy will be considered an unfair information practice.

B. Privacy Litigation by Private Parties

Privacy litigation has hit a high watermark, with multiple class actions now consolidated in New York[20] and Washington State,[21] all naming DoubleClick, Inc., the Internet cookie and banner ads provider, as a defendant. DoubleClick has banner ads containing cookies on over 11,000 websites throughout the country, used to create individual click histories. While DoubleClick has maintained the information collected is anonymous and does not identify the personal information of the user, that contention has been contested in litigation. Fanning the flames of controversy is DoubleClick's suggestion that it merge its on-line anonymous click information with the Abacus marketing database that includes off-line personal information. Due to litigation, DoubleClick called off its proposal to combine off-line and on-line data until government and industry leaders agree on privacy standards. Meanwhile, the consolidated class actions alleging violation of the Electronic Communication Privacy Act of 1986 and common-law privacy rights remain pending.

More recently, in its privacy on-line report to Congress, the FTC recommends passage of a federal privacy act that requires adoption of privacy policies that comply with four fair information practices:

1. Notice, stating the type of information collected, how collected -- either by active data entry by consumers or passive collection through click stream and cookies, and how the information is used, i.e., whether it be used simply to close the order, or whether it is used or sold to third parties for marketing purposes;

2. Choice, giving the consumers an option to "opt in" or "opt out";

3. Access, allowing consumers the opportunity to see the information collected, and correct or delete it; and

4. Security, and sufficient steps to protect information collected from being secreted or misappropriated to others.[22]

[20] *In re* DoubleClick Privacy Litigation, 154 F. Supp. 2d 497 (S.D.N.Y. 2001).

[21] *In re* Intuit Privacy Litigation, 138 F. Supp. 2d 1272 (C.D. Cal. 2001).

[22] FTC Report, *supra* note 15, at 33.

C. European Union Internet Privacy Directive

In October 1998, the E.U. adopted its Commission's Council's directive[23] on protection of individuals with respect to processing of personal data. Personal data can be collected only for specified and legitimate purposes, and cannot be processed in a way incompatible with those purposes. Prior consumer consent is required, and the data must be adequate, relevant, accurate, current, and not excessive, or maintained any longer than necessary. The directive requires member states to ensure that personal data is transferred only to other countries with "adequate" privacy protection. The U.S. was not one of those countries until safe harbor privacy principles were negotiated that now allow U.S. companies to collect personal information from European consumers. The requirements are strikingly similar to the FTC's four fair information practices of notice, choice, access, and security.

IV. *INTELLECTUAL PROPERTY CONCERNS*

The Internet is the new mass market medium for the use and the abuse of intellectual property interests. Because the Internet is worldwide, infringements can occur on a global basis, greatly increasing the likelihood of injury and subsequent suits. At the same time, the Internet provides new opportunities for the application of intellectual property interests to advance the interests of marketers.

A. Trademark

The most common E-commerce litigation involves trademark disputes. Trademark infringement is the unauthorized use of a name, symbol, logo, color, design, or combination thereof which leads to consumer confusion of the origin of the goods or services which the mark is intended to designate. Internet and E-commerce cases are principally caused by registration and use of domain names that use established trademarks of other companies. The unintentional use of another's trademark usually arises from a failure to do a diligent check before registering the domain name of the website. Such registration can trigger a suit under the Trademark Dilution Act,[24] which amends the Lanham Act to

[23] European Union's (E.U.) Directive and Privacy Protection, 95/46/EC, effective October 25, 1998.

[24] 15 U.S.C. § 1125 (1996).

provide suit for famous trademarks used by others who are not in direct competition. So, for instance, in *Toys 'R' Us v. Akkaoui*,[25] the court granted an injunction directing that the defendant discontinue the use of the domain name "Adultsrus.com" because it tarnished the famous "Toys 'R' Us" trademark. Similarly, in *Hasbro, Inc. v. Internet Entertainment Group*, Ltd.,[26] the District Court enjoined defendant's use of the domain name "Candyland.com" for a sexually explicit Internet site because it diluted plaintiff's "Candyland" trademark in its board game.

Congress has moved even further to provide a remedy where a trademark has been intentionally adopted as a domain name for the purpose of extorting a settlement. The Anti-Cybersquatting Consumer Protection Act of 1999 (**Anti**-Cybersquatting Act)[27] squarely addresses the problem not only for famous names, but also for individuals' names. The critical element for a cybersquatting action is bad faith by the domain name registrar. While bad faith is absent where a typical web marketer is using a domain name for purposes of consumer solicitation, both the Dilution Act and the Anti-Cybersquatting Act put marketers on notice that they need to perform a trademark search prior to adopting a domain name with one of the registrars of the Internet Corporation of Assigned Names and Numbers (ICANN). ICANN itself also provides a solution to cybersquatting: arbitration, usually using a panel provided by the World Intellectual Property Organization.[28] Again, marketers will avoid this dispute venue by careful selection of website domain names.

Using Internet technology to drive website traffic also causes web marketers litigation exposure.

1. Deep Linking

The technology of bypassing another company's website homepage -- can lead to trademark infringement. In *Ticketmaster Corp. v. Microsoft Corp.* (1997),[29] Ticketmaster sued to enjoin Microsoft's practice of providing links into its city guide "Seattlesidewalk.com" website connecting directly to a page within Ticketmaster's website designed to promote entertainment and sporting events in Seattle. Ticketmaster likewise argued that, by bypassing Ticketmaster's homepage, Microsoft's deep linking caused potential ticket customers to miss paid advertising and

[25] Toys 'R' Us v. Akkaoui, 1996 U.S. Dist. Lexis 17090 (N.D.Cal. 1996).

[26] Hasbro, Inc. v. Internet Entm't Group, Ltd., Case No. C96-139 (W.D. Wash Feb. 5, 1996).

[27] 15 U.S.C. § 1125(d) (1999).

[28] *See* http://www.icann.org (2002).

[29] Ticketmaster Corp. v. Microsoft Corp., No. 2:97-CV-03055 (C.D. Cal. 1997).

proprietary information. Ticketmaster contends that the deep linking falsely suggested an affiliation between Microsoft's *Seattlesidewalk.com* site and Ticketmaster. After nearly two years of pre-trial preparation, the parties reached a settlement. Under the terms of a confidential agreement, Microsoft may link to Ticketmaster's website, but deep linking is forbidden.[30]

2. Metatags

The invisible code embedded in the HTML used to create websites and assist search engines to index them - has also been the focus of trademark litigation against marketers. Using another's trademark in metatags can cause consumers to believe in a false affiliation and divert potential customers. So, in *Playboy Enterprises, Inc. v. Calvin Designer Label*,[31] the court enjoined defendant's use of plaintiff's trademarks in its domain names, metatags, and homepage text. Conversely, in *Playboy Enterprises, Inc. v. Welles*,[32] Ms. Welles' use of terms indicating her past playmate status was considered a descriptive fair use and not a trademark infringement. Marketers are admonished to refrain from using others' trademarks in metatags.

3. Framing

Framing allows a website user to view the content of another's framed website while still viewing the homepage of the original framing site. Framing has also caused Internet marketers litigation. In *Washington Post Co. v. Total News, Inc.*,[33] defendant Total News, an Internet news "aggregator," was sued for trademark infringement, dilution, unfair competition, misappropriation, and false advertising. Although the case was settled, the framing was terminated. Legal commentators agree that framing is a very dangerous and invasive practice that can support a variety of legal theories of liability.[34]

[30] New York Times, Feb. 15, 1999.

[31] Playboy Enters., Inc. v. Calvin Designer Label, 985 F. Supp. 1220 (N.D. Cal 1997).

[32] Playboy Enters., Inc. v. Welles, 7 F.Supp.2d 1098 (S.D. Cal. 1998).

[33] Washington Post Co. v. Total News, Inc., Case No. 97 (S.D.N.Y. 1997).

[34] Sally Abel, *Trademark Issues in Cyberspace: The Brave New Frontier*, 1998, http://www.fenwick.com/pub/trademark_issues_in_cyberspace.htm.

4. Protecting Trademark

Website marketers are encouraged to utilize trademark protection to its maximum. The entire website can be protected as a "trade dress" if there is a unique association of color, design, shape, or graphics that separate the website and the product from competitors. Further, trademarks should be registered, and domain reserved, to protect them. Trademark registration and domain name reservation can be done on an electronic basis with substantial cost reduction today. Marketers are encouraged to take advantage of these means of protection.

B. Copyright

Copyright provides the exclusive rights to the owners of creative works of original authorship to promote creation of those works. In the United States, as mass media technology has advanced from radio to the Internet, the Copyright Act[35] has been amended to take into account such changes and create a fair balance between society's interest in information and the owner's exclusive rights.

While copyright is clearly an enforceable interest on the Internet, it has never been under such stress and attack. The Internet provides extremely easy ways for violating copyright owners' rights and a powerful means by which to copy and distribute protected works. As a result, copyright disputes concerning the Internet and E-commerce have high visibility and are also common forms of litigation. Internet marketers interested in distribution of digital audio music without copyright permission have met with solid resistance by the courts. In *UMG Recording, Inc. v. MP3.com, Inc.*,[36] MP3 was found liable for $70 million for allowing the unauthorized distribution and copying of CDs. Likewise, in *A&M Records v. Diamond Multi-Media Systems (Napster)*,[37] the now-famous on-line song trading service was found liable for contributory and vicarious copyright infringement and not eligible for the safe harbor defense recently created by the Digital Millennium Copyright Act of 1998,[38] available to Internet service providers who do not participate in the infringement and take down infringing contents, on notice from the copyright holder.

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[35] 17 U. S. C. § 101 (2002).

[36] UMG Recording, Inc. v. MP3.com, Inc., 2000 W.L. 1262568 (S.D.N.Y. 2000).

[37] A & M Records v. Diamond Multi-Media Sys. (Napster), 2000 W.P.L. 118267 (N.D. Cal. 2000).

[38] Pub. L. No. 105-304, 112 Stat. 2860 (Oct. 28, 1998) (codified at 17 U.S.C. § 1201).

The U.S. Copyright Office also recognizes that a copyright can be awarded for website design, graphic, and other creative applications. As such, any use of another's website without the owner's permission may constitute a copyright infringement.

1. Deep Linking

While the standard "hypertext link," whereby a user is transported from one website to another, is considered to be the essence of the Internet, for which all website operators give an "implied license," deep linking can trigger copyright infringement, as well as a trademark violation. For instance, in *Shetland Times v. Willis [Shetland News]*,[39] the *Shetland News* website included in its hyperlinks current headlines taken from the *Shetland Times* webpage. When the viewer clicked on the links, the reader jumped directly to a full text of the news stories that had been prepared by the *Times*, bypassing its homepage that contained paid advertising and the *Times* masthead. An injunction was entered, based upon copyright infringement and violation of unfair advertising law. The case was settled, requiring the *News* to modify its linking practice. The moral of that decision is that deep linking can cause both copyright and trademark infringement. A contract or "link license" is recommended to prevent both types of infringement actions.

2. Framing

It should be noted that in the *Washington Post Co. v. Total News* decision, plaintiff also contended that the framing created an unauthorized derivative work in violation of copyright law.

3. Protecting Copyright

To the extent a marketer's website makes a creative expression, it is subject to copyright protection and should be registered with the United States Copyright Office. Internationally, a copyright is not regulated by a uniform treaty. However, the Berne Convention on Copyright Law, ratified by approximately 100 industrial nations, requires member countries to open their courts for enforcement of all members' copyrights, so that a copyright that is established in one country can be enforced in another. Registration is therefore made available in all Berne member countries and should be pursued.

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[39] Shetland Times v. Willis [Shetland News], Scot. Sess. Cas., 1 EIPLER 723 (1996).

But while Berne is a large convention, it does not take in most major developing countries, including China, which presents a dramatic problem of copyright infringement by pirating. A new treaty promulgated by the World Intellectual Property Organization of the United Nations (WIPO), is expected to improve copyright protection in its signatory countries.

While not required under United States law, marketers are encouraged to place a copyright notice on their website and to register their website with the United States Copyright Office. Although the notice no longer is required to create the copyright, it does provide notice that will discourage violations and can provide a basis for recovery of substantial damages if violations occur.

C. Patent

Patent law provides the right to exclude others from making, using, or selling a patented item. In the United States, a patent[40] is issued by the Patent and Trademark Office for novel inventions and applications, usually lasts between seventeen and twenty years, and can provide an asset for financing, cash flow through royalty licensing, and a potent basis for litigation. While Internet marketers may not see patent as an important item for websites, patent has increasing application to E-commerce. Since the landmark decision of *State Street Bank v. Signature Financial Group*,[41] which confirmed the availability of a "business method" patent (in that case, for financial software applications), Internet marketers have used patent law to protect their website marketing devices and business strategies. Thus, in *Amazon.com v. Barnes & Noble.com*,[42] the court granted an injunction against Barnes & Noble's use of Amazon's one-click business method. The result of the patent - Apple Computers and others now license the one-click business method from Amazon. The Patent Office has been very busy in issuing other business method patents, including patents for on-line auctions, financial transactions, consumer award systems, advertising techniques, and website engine directories. One of the problems presented with the issuance of business method patents is the difficulty in assessing their validity - largely because there is no prior art that exists. Then there is the question of whether business method patents stifle innovation. Also present is the increased threat of

[40] 35 U.S.C. § 101.

[41] State Street Bank v. Signature Fin. Group, 149 F.3d 1368, *cert. denied*, 119 S. Ct. 851 (1999).

[42] Amazon.com v. Barnes & Noble.com, 73 F. Supp. 2d 1228 (W.D. Wash. 1999).

patent infringement litigation because of the rapid development of the Internet and applications of Internet software. Congress has responded to that problem by creating a one-year safe harbor from business methods infringement actions. Clearly, Internet marketers can benefit from patent registration and should do so.

D. Trade Secrets

Internet marketers with an affection toward high technology have turned toward trade secrets in lieu of patent to protect their unique intellectual property. Trade secrets require no registration or delay, and provide protection to any secret that allows for competitive advantage. Because of the short life cycle of many Internet marketing techniques, trade secrets seem ideal. However, the Internet also provides a means for losing trade secrets in a rapid and profound way.

Once a trade secret is placed upon the Internet, it is generally lost, or its further distribution is defended many times based upon a First Amendment ground. In *Religious Technology Center v. Netcom On-Line Communication Services, Inc.*,[43] a disgruntled former church member posted on-line works, including trade secrets of the Scientology Church. Although the court found the former member liable for trade secret misappropriation, it declined to force the Internet service provider upon which the trade secret material was posted to take down the information, concluding that the trade secret's status was lost, in part on First Amendment grounds. Likewise, in *Ford Motor Co. v. Lane*,[44] the court declined to remove Ford Motor's trade secrets from an auto enthusiast's website principally used to criticize and discuss Ford products, the court noting that the website operator's First Amendment right to provide public criticism outweighs the intellectual property interests of Ford Motor. Such complaint sites have been afforded the highest level of First Amendment protection --analogous to that of print media and higher than the electronic medium of radio and television. Those cases and others provide marketers with frustration, but in the context of trade secrets, management implications are clear that marketers must restrict access to trade secrets and control their distribution on webpages and the Internet.

[43] Religious Tech. Ctr. v. Netcom On-Line Communication Servs., Inc., 923 F. Supp. 1231 (N.D. Cal. 1995).

[44] Ford Motor Co. v. Lane, 67 F. Supp. 2d 745 (E.D. Mich. 1999).

V. *OTHER MAJOR CONSIDERATIONS*

The laws and regulations that address deceptive marketing practices, such as unsubstantiated advertising claims, false endorsements, and omitted information, clearly apply to Internet advertising. In the United States, Internet advertising has been largely regulated by the Federal Trade Commission (FTC), which in the last several years has taken an offensive against misleading and deceptive on-line practices that occur in the United States.[45]

A. Unfair and Deceptive Trade Practices

The FTC's interest in preventing unfair practices is joined by the Commission's interest in regulating consumer privacy rights. The Securities Exchange Commission (SEC) has likewise responded to consumer problems in the offer and sale of stock on the Internet. While the SEC has encouraged the use of electronic databases and Internet connectivity for initial public offerings and trading, evidence shows a 400 percent increase in consumer complaints, frequently from misrepresentations by Internet brokers concerning the time of order placement. The SEC has warned consumers to be wary of *get rich quick* schemes associated with day trading and direct Internet public offerings.[46]

Implications are clear that United States web marketers must, at a minimum, ensure that the content of their website conforms to United States consumer protection regulatory guidelines. Where web marketers also target foreign markets, those laws must be considered and complied with, as well. One means in which to do that is the establishment of a local website in local language, in complete conformance to local custom and regulation. The down side of the practice is the increase in jurisdictional exposure.

An additional consideration is use of an express *choice of laws* clause, conspicuously evident on the homepage of the website, specifying the country whose law will be used to determine disputes. Note, again, a choice of law clause may not work for the web marketer selling to EU customers. Finally, besides consideration of these techniques, web

[45] Roscoe Starek & Linda Rozell, *The Federal Trade Commission's Commitment to On-Line Consumer Protection*, 15 JOHN MARSHALL J. COMPUTER & INFO. L. 679 (1997).

[46] Security and Exchange Commission, http://www.sec.gov/news/press/archive/1999press.shtm, SEC PRESS RELEASE NO. 99-9 (Jan 27, 1999).

marketers should always try to refrain from over-ambitious or misleading advertising and promotion wherever their website is accessible.

B. Contracting and E-Commerce

The formation and performance of contracts on-line go to the heart of E-commerce. In the U.S., the vast majority of contracts made via a website are governed by the Uniform Commercial Code for the sale of goods and the common law for the sale of services.

The broad and flexible definitions of the UCC, and its practically designed Article 2, seem to provide an adequate governing law for the sale of most goods on websites. There are few reported case law decisions that criticize UCC application in the E-commerce context. The same established rules of contract formation apply and make sense. Website advertisements are not considered offers unless specified otherwise. Acceptances can be made by any positive and unequivocal expression of an intent to be bound, including electronic mouse clicks or the shipment of goods. Silence is usually not acceptance, and the UCC's statute of frauds provides practical exceptions, such as the consumer's payment and acceptance of goods, and special goods categories. Congress and most states, however, determined more needed to be done to validate e-contracts.

Electronic marketers and financial institutions have long sought further confirmation of the validity of electronic contracts. Electronic data exchange, existing since the 1970s, has provided an electronic contracting framework for business-to-business Internet transactions. With the advance of E-commerce and retail sales over the Internet, a greater need was presented for an exception to the statute of frauds and a recognition of the validity of electronic contracts. The majority of states have adopted the Uniform Electronic Transaction Act, which, to a large extent, recognizes electronic contracts as satisfying statute of frauds requirements. Those laws, to the extent inconsistent, will be pre-empted by Congress' new Electronic Signature in Global & National Commerce Act (E-SIGN)[47] passed last year. The primary purpose of both statutes is to remove barriers to E-commerce by establishing legal equivalents of electronic records and signatures. Neither an electronic contract record nor an electronic signature will be denied enforceability solely because they are in electronic form. In addition, E-SIGN adds substantial consumer protection provisions that require marketers relying on E-SIGN to confirm consent to accept an electronic record in lieu of a paper record. Those marketers whose websites have relied upon the traditional UCC exception

[47] Pub. L. 106-229, 114 Stat. 464 (2000), (codified 15 U.S.C. § 7001).

to the statute of frauds will not be too concerned about E-SIGN, but applications of E-SIGN can broaden marketers' contracting opportunities on the Internet.

Another principal concern has been contract rules for sale and access to computer information. So far, two states, Virginia and Maryland, with a half-dozen or so considering it, have adopted the Uniform Computer Information Transaction Act (UCITA),[48] proposed by the National Conference of Commissioners on Uniform State Laws, in lieu of an amended Article 2B of the UCC. UCITA is lengthy, complicated, and controversial, and has drawn criticism from a large number of highly diverse critics, including the FTC, ABA, 20 Attorneys General, consumer organizations, retail and industry groups, and technology firms that utilize computer information. On the other side, the chief components of UCITA have been the large software producers. Some of UCITA's controversial provisions include approval of the "shrink-wrap" software licensing agreements, whose terms are not visible at the time a contract to purchase is made. UCITA adopts the decision of *Pro CD v. Zeidenberg* (1997),[49] holding terms need not be visible at the time of purchase so long as the consumer has a right to return. UCITA also validates "click-wrap" licenses of software via the Internet so long as the terms of the agreement are visible on the website. This position was also taken in the pre-UCITA decision of *Caspi v. The Microsoft Network LLC*,[50] confirming the validity and enforceability of a forum selection clause on Microsoft's website. UCITA also allows software vendors self-help by shutting down software after notice. Similar self-help provisions are available under the common law and the UCC, but have stirred great controversy under UCITA because of the potential for consequential damages. UCITA's sole reservation in that regard is that self-help cannot be effected if it would create grave danger to public health or safety. Finally, UCITA's controversial remedies sections generally provide for a "substantial performance," as opposed to "perfect tender" contract standard. In light of these reservations, web marketers who purchase software content or data access for these sites may at this time consider opting-out of UCITA. Whether UCITA in its current form is adopted in more jurisdictions has yet to be seen.

[48] *See* www.nccusl.org for full text; *see also* Va. Code Ann. §§ 59.1-501.1 (2000).

[49] Pro CD v. Zeidenberg, 980 F.Supp. 640, 86 F.3d 1447 (7th Cir.1997).

[50] Caspi v. Microsoft Network, LLC, 732 A.2d 528 (N.J. 1999).

C. Defamation and Product Disparagement

Publication of an untrue statement of fact that damages the reputation of a person, a business, or its products or services may be considered defamation or disparagement. Website marketers will generally be considered "publishers," and defamation which is considered "on-line libel" will be judged in the same way as marketers using other mass media. In fact, because of a webpage's vast reach, defamation and disparagement claims can be more numerous, potentially more dangerous, and lead to suits to defend in other countries. In the United States, defamation and disparagement are governed by the common law on a state-by-state basis. But Congress has intervened to protect *Internet Service Providers* (ISP) by providing absolute immunity to suits for defamation and negligence for content provided by others. Section 230 of the Communications Indecency Act of 1996,[51] a section that survived the constitutional attacks on the CDA's anti-obscenity provisions, states: "No provider or user of an interactive computer service shall be treated as a publisher or speaker of any information provided by another information content provider." [52]

Thus, the CDA makes ISPs immune, but leaves content providers to the defamation laws. So, in *Sidney Blumenthal v. Matt Drudge and America On Line*,[53] the content provider of an electronic gossip column called the Drudge Report remained liable as a defamer of a White House official, and AOL was immune from suit, even though it exercised editorial control over its website like a newspaper publisher. To the extent website marketers are active as ISPs, the CDA will provide immunity. However, as most website marketers are content providers of their sites and others, via co-branding arrangements and the like, the CDA does not offer immunity or modify defamation law.

Outside the United States, libel laws may favor plaintiffs more dramatically. The British Defamation Act of 1996 has made London the libel capital of the world because of the defamation cases issued by the high court. McDonald's won a celebrated lawsuit against website defamers. Others have sought out English courts if they can create jurisdiction. Web marketers must consider the defamation laws of other countries, particularly if they are targeting sales there. For instance, comparative advertising under French law is considered product disparagement. Marketing practices must be modified to take such different laws into account.

[51] Communications Decency Act, 47 U.S.C. § 230 (2001).

[52] *Id.*

[53] Sidney Blumenthal v. Matt Drudge, 992 F. Supp. 44 (D.D.C. 1998).

Finally, marketers frequently are confronted with consumer "complaint sites," numbering in the hundreds, over the Internet. Such sites are afforded an extremely high level of First Amendment free speech protection by the courts, and are amazingly resilient.[54] Marketers must consider a response to such "hate" sites. But a legal remedy should only be sought in the case of clear libel, copyright or trademark infringement, because firms have found non-legal actions more successful, such as the establishment of a counter-website or direct contact with the site owner.

V. *CONCLUSION*

This article has reviewed several of the salient emerging legal issues associated with website marketing. Because each legal issue has significant and different implications to marketers, management implications have also been discussed to increase protection of legal rights and reduce exposure to suits, at home and globally. However, web marketers must be vigilant of the continuing evolution of Internet marketing law in the years ahead, particularly as more and more marketing opportunities come *on-line*. Although the information contained herein concerns paid marketing issues, it does not constitute specific legal advice, for which readers should retain legal counsel.

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[54] *See, e.g.*, Ford Motor Co. v. Lane, 67 F. Supp. 2d 745 (E.D. Mich. 1999) (holding no trade secret infringement); Bally Total Fitness Holding Corp. v. Andrew S. Faber, Case No. CV98-1 (C.D. Cal. 1998) (holding no trademark infringement because no product offered).

Auditor Independence and Non-Audit Services: Are They Compatible?

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I. *INTRODUCTION*

"In the last six decades, trust in the judgment of the public accountant has helped lay the foundation for the most vibrant and resilient capital markets in the world. That trust is dependent on the fact *and* appearance of the auditor's independence from the client."[1] This made formal the fact that the Securities and Exchange Commission (SEC) was going forward with a long-standing effort to modernize the rules governing Auditor Independence. Moreover, Arthur Levitt, Chairman of the SEC, states:

> In recent years, the accounting profession has undergone tremendous change. More dual-career families, increasing mobility among professionals, and greater employment by audit clients of their auditors' partners, staff and spouses necessitate a review of the financial and employment relationship rules . . . . At the same time, consolidation, product line expansion, and globalization are fundamentally altering firm structures and revenues. As the biggest accounting firms have transformed themselves into multi-disciplinary professional service organizations, the debate over the role of the auditor - and the inherent pressures of practicing within a firm offering clients a range of non-audit services - has become more pressing.[2]

There can be no question that our changing environment presents challenges to all businesses, including audit firms. Audit firms have, of necessity, had to recruit and train information technology specialists to

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[1] *Remarks by Chairman Arthur Levitt at the Open Meeting on Proposals to Modernize Auditor Independence Rules*, SEC NEWS SUPPLEMENT, June 27, 2000.

2. *Id.*

provide effective audits.

Chairman Levitt and others had for some time been keeping a watchful eye on this process, believing that there existed the possibility that auditors might not be meeting well their audit responsibilities where consulting fees comprised a substantial portion of the total fee. It is not at all unusual for auditors to offer their clients consulting services even in the face of their responsibility to rigorously audit that same company. It seems interesting to note that since 1993, auditing revenues have grown a feeble 9% annually, while consulting and similar services have grown at the far brisker rate of 27%.[3] In a letter from the Honorable John D. Dingell, ranking member of the House Commerce Committee, to Chairman Levitt, Representative Dingell states:

> "The General Accounting Office's two-volume 1996 report, The Accounting Profession (GAO/AIMD-96-98), expressed GAO's belief that 'the SEC should take a leadership position in working with the accounting profession to enhance the auditor's independence.' At that time, the SEC Chief Accountant agreed with the auditor independence concerns identified in the GAO report and also agreed that they 'must be resolved',"[4]

Representative Dingell noted that in 1997, the SEC delegated this responsibility to a newly-formed Independence Standards Board (ISB) and observed that the ISB had done little more than hold standard setting meetings which were inconclusive and the conflicts of interest had continued to multiply and the overall problem had progressively worsened.[5]

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[3]. Bill Barker, *Are Auditors Independent?* RULE MAKER PORTFOLIO, September 8, 2000.

[4]. *See* September 5, 1996 letter from Michael H. Sutton, Chief Accountant, SEC, to Charles A. Bowsher, Comptroller General of the United States. (On file with authors).

5. Dingell Letter, SEC—PricewaterhouseCoopers; *Auditor Independence Rules*, January 6, 2000. (On file with authors).

II. BACKGROUND ON INDEPENDENCE OF AUDITORS

Concerns over *appearance* of maintaining objectivity started as far back as 1932 when the American Institute of Certified Public Accountants (AICPA) Council first considered prohibitions against auditors serving as officers or directors of clients. Such concerns were rejected as being unnecessary. Following enactment of the Securities Act of 1933, the Federal Trade Commission, which administered federal securities law until the creation of the SEC in 1934, determined that it would not consider auditors to be independent if they served as officers or directors of, or had interests in, public audit clients. This established *appearance* as an independence concept. In 1936, the SEC altered the guide somewhat by changing *any financial interest in* to *a substantial interest in* public audit clients. Subsequently the SEC removed the *substantial* requirement in 1950, and returned to the "any" financial interest test.

A. Doubt and Uncertainty Surrounding Independence

Given this atmosphere of doubt and uncertainty it is only logical that a few incidents would get the ball really rolling. So with the occurrence of situations such as: the $25 billion loss of MicroStrategy investors; the allegations levied against PricewaterhouseCoopers LLP on January 14, 1999, and the Cendant affair, to list but a few, it was obviously time to act. In early June of 2000, the Big 5 firms and the SEC agreed to a voluntary program to report past violations of the independence rules in exchange for safe-harbor protection for all but the most serious violations. Congressman Dingell does agree with a voluntary solution and states:

> Common sense tells us that the problems revealed in the PwC report are not confined to that firm. The accounting profession is now the management services industry: the profession and the companies that it is charged with auditing to protect investors and the integrity of our markets are quickly becoming wholly-owned subsidiaries of one another. Self-interest has replaced much of the profession's fidelity to the public trust. . . . I want to know what the Commission and the ISB, having taken little meaningful action to date, are

doing to clean up this mess.[6]

Federal securities laws require that financial statements filed with the SEC be certified by *independent* public accountants. The question is of course what does independent mean? The United States Supreme Court has stated that "[t]he independent public accountant . . . owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. The 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust . . . ."[7]

B. SEC and Professional Conflict on Independence

At the heart of the current independence debate is the differing opinion between the SEC and the accounting profession over what constitutes adequate independence. In an effort to more effectively address auditor independence issues, the AICPA and the SEC worked together in creating the Independence Standards Board (ISB) in October of 1997. The ISB's current priority is to establish a conceptual framework for auditor independence. According to the ISB the definition of independence does not currently require the auditor to be completely free of all the factors that might affect the ability to make unbiased audit decisions, but only free from those factors that might rise to the level of compromising that ability.[8] It would, after all, be impossible to attain total independence since the auditor's fee is paid by the audit client.

However, the SEC proposal has defined four areas where an auditor required to file financial information would not be viewed as independent. These areas are where the accountant (a) has a mutual or conflicting interest with the client, (b) audits the client's work, (c) acts as an employee or as a manager for the client or (d) acts as an advocate for the client.

C. Relationship Between Audit and Non-Audit Services

There is no question regarding the importance of independence,

6. *Id.*

7. U.S. v. Arthur Young & Co., 465 U.S. 805, 817-18 (1984).

8. Susan McGrath, *A Framework for Auditor Independence*, J. ACCT., January, 2001.

but the accounting profession and SEC do not agree on its meaning. The accounting profession, on the one hand, argues that independence means the auditor's actual independence in any particular audit. Thus they would argue against the appearance-based approach to standard setting. The SEC, on the other hand, argue that independence must necessarily include standards designed to protect the investor from having even a perception of conflict. Independence must then be gauged in terms of, not only independence in fact, but independence in appearances as well.

Non-audit services are clearly in the forefront of this quandary. The accounting profession would argue that, not only would the provision of non-audit services not endanger independence (in fact) but it probably would be a benefit. Certainly the more knowledge of the client would be beneficial to the client in the form of value-added service. The SEC would go beyond independence in fact suggesting that the public's perception is a critical aspect of independence. The ISB takes a more middle ground approach by further defining independence as more than just compliance with the independence rules and suggesting that the auditor must make a personal assessment of his or her objectivity - to determine if pressures and other factors compromise the ability to make unbiased audit decisions.[9]

III. *THE PANEL ON AUDIT EFFECTIVENESS*

Professionals are strong proponents of self-regulation. The accounting industry falls into this category by having an oversight organization called the Public Oversight Board (POB). The POB receives its funding from the American Institute of Certified Public Accountants (AICPA). Following almost two years of study, a Panel on Audit Effectiveness, comprised of eight members from the POB and normally referred to as the O'Malley committee, issued on August 31, 2000, its Report and Recommendations. Panel members were, however, unable to

7. *Id.* This reflects the ISB's belief the independence is entirely a personal matter, which varies from auditor to auditor in a given set of circumstances and is not useful in setting standards for all auditors. An exposure draft from the ISB says that "one of the most controversial aspects of the auditor independence debate is the role that 'appearance' should play in setting standards. The 'appearance' concept - though not well defined - is ingrained in the existing independence literature. Indeed, everyone who has taken an introductory auditing course knows that auditors must be independent in both fact and appearance. But what does it mean to 'appear' independent? Whose perceptions count?"

agree on whether to support or reject an exclusionary rule that would prohibit an audit firm, except in very limited circumstances, from providing non-audit and non-tax services to its public audit clients.[10]

A. Provision of Non-Audit Services to an Audit Client

The exclusionary rule ("Non-Audit Services Rule") would bar, with limited exceptions, the provision of non-audit services to an audit client by either (a) the audit firm itself or (b) any firm affiliated with the audit firm, whether by reason of a control relationship or strategic or other business alliance or other arrangement that gives the audit firm or its partners a financial stake in the provision of non-audit services to such audit client by such other firm.[11]

With an estimated 49.2 million U.S. households invested in the stock market in 1999, fair accurate financial information must be available to investors.[12] In order to maintain public confidence in the information, it is critical that auditors be independent - both in fact and in appearance. As John Whitehead, former chairman of Goldman Sachs & Company, testified, "Investors have every right to be able to depend absolutely on the integrity of the financial statements that are available to them, and if that integrity in any way falls under suspicion, then the capital markets will surely suffer if investors feel they cannot rely absolutely on the integrity of those financial statements."[13] The SEC's concern in enacting these new regulations is predicated more on the fear of a lack of appearance of

[10]. Shaun O'Malley, *Report and Recommendations*, Panel on Audit Effectiveness of the Public Oversight Board, August 31, 2000.

[11]. *Id.* at 118. The "Non-Audit Services Rule" would define the category of services to be barred as including everything other than the work involved in performing an audit and other work that is integral to the function of an audit. In general, the touchstone for deciding whether a service other than the straight-forward audit itself should be excluded from Non-Audit Services is whether the service is rendered principally to the client's audit committee, acting on behalf of investors, to facilitate, or improve the quality of, the audit and the financial reporting process rather than being rendered principally to provide assistance to management in the performance of its duties. The range of services, skills and personnel thus permitted to be employed in furtherance of the financial reporting process is in no way limited. The Non-Audit Services Rule adopted by the SEC would provide general guidelines to the ISB in writing detailed rules of implementation, which the Panel expects would evolve over time as the nature of the audit and the services changed.

[12]. Inv. Co. Inst. and Sec. Indus. Ass'n, *Bull Market, Other Developments Fuel Growth in Equity Ownership.* (Available at www.sia.com/html/pr834.html.)

[13]. 17 C.F.R §§ 210, 240 (Testimony of John Whitehead, retired Chairman, Goldman Sachs & Company before the SEC, September 13, 2000).

independence than a lack of independence in fact, is evidenced by the fact that the SEC, despite its concern as evidenced by the new standards, has not brought a single case in which it alleges that audit failure was the result of lack of auditor independence. Additionally, in its own studies, the SEC has found that rather than compromising audit quality, the provision of non-audit services had a positive effect on audit quality.[14]

B. Acting in Ways to Serve the Public Interest

Under the auditing profession's code of professional conduct, members are required "to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism."[15] Accordingly, accountants and accounting firms were interested in and concerned about the new regulations. Nearly 3000 accounting professionals took the time to respond to the SEC's proposed draft of the new regulations. Not all supported the SEC's proposal.[16] In October 2000, Barry Melancon, President and CEO of the American Institute of Certified Public Accountants, stated that although the SEC's actions were intended to increase auditor independence, "the actual effect would be to weaken the quality of financial reporting, limit companies' choices of outside professionals and damage the economic vitality of many CPA firms without any positive effect on independence."[17]

IV. *REVIEW OF SEC'S FINAL REGULATIONS*

The Securities and Exchange Commission issued the final regulations on November 21, 2000 that were published in the Federal Register on December 5, 2000, effective on February 5, 2001.[18] Some parts of the regulations have transition periods during which the old regulations will continue to apply to the provision of auditing services.

[14]. Barry Melancon, *The Proposed SEC Rule on Auditor Independence and Its Consequences*, J. ACCT., October 2000.

[15]. American Institute of Certified Public Accountants Professional Standards: Code of Professional Conduct.

[16]. 17 C.F.R §§ 210 & 240.

[17]. Melancon, *supra* note 14.

[18]. 17 C.F.R. § 210 (2002) (Regulation S-X, Rule 2-10(b)).

A. Coverage of the New Regulations

The new regulations promulgated by the SEC cover a variety of areas including:

> (1) financial relationships between auditors and audit clients;
> (2) employment relationships between auditors and audit clients;
> (3) business relationships between auditors and audit clients;
> (4) provision of certain non-audit services that might negatively impact auditor independence; and,
> (5) contingent fee arrangements between auditors and audit clients.[19]

The heart of the new regulations is the general independence standard that emphasizes the continued importance of independence *in appearance* as well as independence *in fact*. Under this standard, independence would be impaired, "[i]f the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement."[20] The broad regulation leaves wide latitude for the SEC in its interpretation and application of this rule, a fact that disturbs many in the accounting profession. In some cases, particularly in financial and employment relationships, the new rules actually reduce the previous restrictions on such activities by limiting the number of restricted individuals.

B. Pertinent Parts of the New Regulations

Rule 2.01(c)(1)[21] loosens the previous restrictions on financial relationships between auditors and clients by limiting the circle of people who may not have direct or indirect investments in the audit client without affecting auditor independence. This section of the new regulations covers numerous possible financial auditor-client relationships, including such

[19]. *Id.*
[20]. 17 C.F.R. § 210 (2002) Regulation S-X, Rule 2-10(b).
[21]. *Id.*

things as loans, insurance policies, and unsolicited gifts. The new regulations use the term *covered persons* and *immediate family members* in conjunction with financial relationships. *Covered persons* will include the audit team, partners and managers if they provide ten or more hours of non-audit services to the client, and partners in the office of the lead engagement partner. "Immediate family members" now include spouses, spousal equivalents, and dependents.

Rule 2.01(c)(2)[22] loosens the former employment restrictions between auditors and audit clients. With the increasing number of dual-paycheck families, this section of the rules now limits employment relationships to close family members of "covered persons" who might be employed by the client in an accounting or financial oversight role including being able to exercise more than minimal influence on the contents of the accounting records or the financial statements or the persons who prepare those records or statements.

Rule 2.01(c)(3)[23] prohibits direct or material indirect business relationships between the accounting firm or any covered person within the firm and the audit client or any decision-making individual associated with the client. Normal business relationships between or among these parties in the ordinary course of business are still permitted.

Rule 2.0(c)(4)[24] identifies nine non-audit services that either impair or may impair auditor independence. In some cases, independence may not be impaired if certain conditions are met. The nine non-audit services include bookkeeping and other services related to the company's accounting records, financial information systems design and implementation, appraisal or valuation services and fairness opinions, actuarial services, internal audit services, management functions, human resources, broker-dealer services, and legal services.[25] The SEC regulation on contingent fees mirrors the AICPA's Rule 302 with the addition of a restriction on accountants receiving commissions from audit clients or providing services or products to such clients for a commission.

The new regulations continue to discuss such items as inadvertent loss of independence of which the covered person is unaware and disclosures that must now be made in annual proxy statements. The proxy statements must now disclose a breakdown of fees into fees for audit

[22]. *Id.*
[23]. *Id.*
[24]. 17 C.F.R. § 210 (2002) Regulation S-X, Rule 2.0(c)(4).
[25]. 17 C.F.R. § 210 (2002) Regulation S-X, Rule 2.01(c)(4).

services, fees for information technology services, and fees for all other services. Additional responsibility is placed indirectly on the audit committee in that the proxy statement must now disclose whether the audit committee (or the board of directors if there is no audit committee) considered the possible effects of non-audit services and fees for such services on auditor independence.

The effects of the enactment of the new regulations on auditor independence could be far reaching. While the SEC has direct jurisdiction only over registered companies (those that are publicly traded and listed on the stock exchanges), it is likely that these new regulations will set in motion a wave of regulations by state boards of accountancy that will affect many companies that are not registered.[26] The old argument of "Big GAAP vs. Little GAAP" (Generally Accepted Accounting Principles) over whether small or closely-held companies or both must follow the same, often complex and expensive, accounting rules as larger, publicly-traded companies will certainly be raised. Banks and other creditors may well expect their clients to abide by the new regulations in the preparation of annual financial statements. Companies being audited for the Employee Income Retirement Act of 1974[27] and governmental contracts will certainly be expected to follow the new rules. Because a compilation is the only level of service that can be performed without independence, even companies whose financials are subjected to a review rather than to a more costly audit will find the CPAs providing these services subject to the more stringent rules under the new SEC regulations.

V. *CONCLUSION*

Accounting firms have much to lose. A greater portion of the revenues of the large accounting firms today are derived from non-audit services than in the past.[28] However, while the audit firms clearly stand to lose revenue, many in the accounting profession believe that the public interest will suffer as well. Among the possible negative effects of the new SEC regulations are:

[26]. Melancon, *supra* note 14.
[27]. 29 U.S.C. § 1101 (2000).
[28]. *Special Supplement: Annual Survey of National Accounting Firms – 2000*, PUBLIC ACCOUNTING REPORT, March 31, 2000.

-Loss of synergism through restrictions of services that may be offered to a client;
-Reduction of the knowledge base at accounting firms as the consulting services are separated from auditing services;
-Loss of technology skills needed for auditing, as technology experts are lost due to the spin off of non-auditing consulting services;
-Inability to recruit strong candidates;
-Decreased independence between auditing clients and auditors as firms rely more heavily on auditing revenues;
-Increased costs of monitoring compliance with the new rules; and
-Increased governmental regulation and reduced consumer choice.[29]

The new regulations have been finalized and are now in place, but the debate will continue. The SEC can be expected to continue to assert its position of authority as the final rule maker while the accounting profession will continue to assert its position that as a profession it is capable of self-regulation. Audits will continue to increase in importance as the tool that ensures accurate, meaningful financial information to the ever-increasing investing public. Both sides will continue to argue that its position best serves the public interest and the efficiency of the capital markets. Perhaps only time will tell which side is right. In the meantime, as the "big boys" verbally slug it out, the investing public quietly waits.

[29]. Melancon, *supra* note 14.

What's Race Got to Do with It?
A Theory of Jury Decision-Making

*Sharlene A. McEvoy**

I. *INTRODUCTION*

The conventional wisdom offered by scholars and pundits during the weekend preceding the announcement of the jury's verdict in the O.J. Simpson criminal trial in late September 1995 argued that the majority of the jurors were black and that this factor would lead the jury to vote for an acquittal in the case. When the "not guilty" verdict was read, the conventional wisdom appeared to be confirmed but other factors related to the makeup of the jury were overlooked.

Long before he joined the Simpson defense team, F. Lee Bailey said, "The case is decided once the jury is selected." Trial lawyers claim that they want a jury that is fair and impartial but in fact they want a panel that leans in their direction.[1] As the Simpson case went to trial in the winter of 1995, there was much speculation about the jurors who comprised the jury pool. The prosecutor's office filed the case in South Central Los Angeles where the veniremen were largely lower income minorities. As jury selection began, observers handicapped the jury, speculating on which jurors would favor the prosecution or the defense.

When the jury was finally chosen, it consisted of twelve regulars and twelve alternates. As the case dragged on for ten months, one by one, the original jurors were removed for a variety of reasons and ten of the twelve alternates were seated. The jury that ultimately decided Simpson's fate on the first Monday in October 1995, after less than five hours of deliberation was comprised of ten women and two men. Ten of the jurors were black and the racial make up of the jury is often cited as the reason why the verdict was decided as it was. If the conventional wisdom was correct, there should have been little doubt as to the outcome. Yet between Friday and Tuesday, October 2, 1995, it was not clear that an acquittal was inevitable. In fact, there have been studies, which show that black juries are not reluctant to convict black defendants.

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[1] Sheila Anne Feeney, *Twelve Good Reasons*, NEW YORK LIVE, July 25, 1993, at 4.

It is the theory of this paper that the racial makeup of the Simpson criminal jury had less to do with the outcome of the case than the sex, age and occupation of the jurors. These three factors are more valid predictors of outcomes in trials.

It has been argued that if a lawyer finds himself representing a person who is a member of a clearly identifiable ethnic group and comes upon a person in the jury pool who is also a member of this group, it is a mistake to accept that juror.[2]

> Clearly this person identifies with the client and may never perhaps be in complete sympathy with him but the problem is that he will be quite self-conscious of the great similarity between himself and the client. For that reason, he will want to demonstrate to his fellow jurors his fairness and impartiality. In his desire to convey this image, he actually leans to the other side and becomes the opponent's juror.[3]

Since this did not happen in the Simpson case, there must be another explanation for the result. The conventional wisdom posited that since black jurors made up a majority of the members of the panel, there was no self-conscious identification. The two white jurors, both of whom voted "guilty" on the first ballot, later agreed to go along with the majority. Pundits also believed that the verdict was affected by a negative reaction to prosecutor Marcia Clark's theory of the case: namely that murder victim Nicole Brown Simpson was an abused wife, an argument that Clark believed would resonate with the largely female jury. Neither of these views can account for the outcome. The reason for the verdict in this and other cases lies in the sex, age and occupation of the jurors.

[2]. ALAN E. MORRILL, TRIAL DIPLOMACY 18 (1973).
[3]. *Id.*

TABLE ONE

O. J. SIMPSON CRIMINAL TRIAL JURY-OCTOBER 1995

JUROR	AGE	OCCUPATION
DBW	50	Vendor
SBW	24	Hospital Employee
DWW	60	Gas Company Employee
SWM	32	Soda Deliveryman
MBW	37	Postal Employee
MBM	43	Marketing Representative
SBW	44	Repairer of Computers for Courts
SBW	38	Environmental Health Specialist
DBW	52	Clerk
MBW	28	Postal Employee
SWW	22	Insurance Claims Processor
MBW	71	Retired Cleaning Officer

Each letter in Column 1 (Juror) of tables one through five of this article denotes a characteristic of a juror. The **First Letter indicates** Marital Status: D = Divorced, S = Single, M = Married. The **Second Letter indicates race**: B = Black, W = White. The **Third Letter** indicates gender: M = Male, W = Woman.

A. Sex Factor

The Simpson criminal trial jury was comprised of ten women and two men. At the outset, based on the gender of the jury, the panel leaned toward the defense. Most female jurors have a tendency to be less forgiving of their own sex, but they have a tendency to believe a male defendant if he presents a good appearance. O. J. Simpson was a handsome, former athlete who presented an exceptionally good appearance in court. Therefore female jurors would look on him favorably.

Women are also extremely judgmental of the behavior of other women. This judgmental attitude is particularly true of older women. One of the victims in the case was an attractive young woman. The ages of the female members of the jury were: 50, 24, 60, 37, 44, 38, 52, 28, 22 and 71. All but three of the female jurors were older than Nicole Brown Simpson at the time of her murder. The average age of the female jurors was 42.6 years. This age factor worked in favor of a

defense verdict especially in a case in which the prosecutor's theory of the case was the abuse of a young female.

Studies have shown that male jurors in a case will favor a female defendant especially if she is attractive. As one author has noted, "The typical training of the male is to favor the woman with a bit more courteousness and respect. The male looks more to the woman as the keeper of the keys to virtue in our society. Virtue, of course, includes veracity, which will give the edge to a woman in disputed questions of fact in the hands of a male juror.[4] Were the two male jurors leaning toward the prosecution? The answer is "No" because there are two other factors that must be considered: age and occupation.

B Age Factor

The age of the Simpson criminal jury also worked in favor of the defense. Studies have shown that jurors between the ages of 30 and 50 are considered favorable to the defense while the prosecution favors young men 20-30 and men over the age of 50. There were two men on the Simpson criminal jury whose ages were 32 and 43. Both ages were within the parameters of the ages sought by the defense.

In addition to the fact that the average age of the woman jurors was 42.6, four of the women fell within the 30-50 year old age group, the target group sympathetic to the defense. Thus, six of the twelve jurors fell into the age group favorable to the defense.

C. Occupational Factor

Among the occupations said to be favorable to the defense are artists, musicians, laborers, mechanics, salesmen, office workers, actors, writers and union members. Favoring the prosecution are a wider array of occupations including bankers, bank employees, managers, low salaried white collar workers, retired police officers, military men, school teachers, clergy men's wives, utility company employees, insurance men, farmers, accountants, former investigators or adjusters, corporate executives, former court officials, die-makers, cabinet-makers, and any person who has to be particular about his work.

The occupations of the jurors who ultimately reached a verdict in the Simpson case were vendor, hospital employee, gas company employee, soda delivery man, postal employee, marketing representative, computer repairer, environmental health specialist, clerk

[4]. Hiroshi Fukurai & Edgar W. Butler, *Sources of Racial Disenfranchisement in the Jury and Jury Selection System*, NAT'L BLACK L.J., 238, 269-70 (1993).

and retired cleaning officer. Of the twelve occupations, eight favored the defense.

Sex, age and occupation, all favored the defense. It was no surprise then that the defendant was found not guilty.

II. *TESTING THE HYPOTHESIS ON OTHER JURIES*

Does the above analysis hold true for all juries? It is difficult to find data about the sex, occupation and age for most juries unless they are serving on a celebrated case for which the press has published information. There are a few juries for which such data is available. One such case involved sportscaster Marv Albert who, in 1996, was accused of sexual abuse of a female companion.

A. The Marv Albert Trial

TABLE TWO

THE MARV ALBERT JURY

SEX	AGE	OCCUPATION
W	60	Navy Systems Analyst
M	30	Space & Defense System Analyst
W	60	Program Manager
W	27	School Social Worker
W	37	Case Manager
M	49	Heating/Air Conditioning Technician.
M	42	Engineer
W	32	Communications Specialist
W	36	Communications Consultant
M	33	Sales Representative
M	54	Health Sciences Specialist
W	36	Project Manager.

The Albert jury was composed of seven women and five men. By sex then the jury leaned in favor of the defense. By age, the jury also leaned toward the defense because jurors aged 30-50 are said to be pro-defense. On Albert's jury there were eight jurors that fell within those age parameters. Moreover, by age there was only one juror whose age was favorable to the prosecution. Only one juror was under 30 and that was a female. The other two jurors were 60-year-old

females, who were bound to favor the defendant because Albert's accuser was young female who alleged sexual misconduct.

As to occupation, the Albert jury leaned in favor of the prosecutor because only five occupations favored the defense: school social worker, heating and air conditioning technician, communications specialist and consultant, and the sales representative.

Thus by sex and age, the jury leaned toward the defendant while by occupation it was pro-prosecution. As it turned out, this jury did not have the opportunity to reach a verdict because Albert agreed to a plea bargain shortly after the trial began. Yet in subsequent interviews, the jurors indicated they would have voted for an acquittal.

B. The Leroy Reed Trial

The next venue in which this theory was tested was a Public Broadcasting System program made in 1985 called "Inside the Jury" in which for the first time cameras were allowed in the room as a jury deliberated the outcome of a criminal case: *State of Wisconsin vs. Leroy Reed*.[5] Leroy Reed was prosecuted for being a felon in possession of a gun. When the deliberation began, the name and occupation, but not the ages of each juror appeared on screen as he or she gave a first comment on the case. The approximate age of each juror could be gleaned by the individual's appearance.

TABLE THREE

THE LEROY REED TRIAL

SEX	AGE	OCCUPATION
WM	20s	Toolmaker
WM	30s	English Professor
WM	30s	Doctor
BF	30s	High School Teacher
WF	20s	School Psychologist
WF	50s	High School Teacher, Naturalist
WF	60s	Housewife
WF	60s	Food Service Worker
WM	30s	Data Analyst
WM	60s	Fireman
BM	40s	Laborer
WM	30s	Product Analyst

[5] Frontline, *Inside the Jury: State of Wisconsin v. Leroy Reed*, Public Broadcasting Station, 1985 (Documentary).

The jury was comprised of seven men and five women so it leaned toward the prosecution by sex. Moreover, the defendant was not an attractive male like O.J. Simpson. There were two African-American members on the panel but in their initial comments, neither favored the defendant. In fact, the black male who said that he was an experienced juror, having sat on four juries, stated that the defendant was "guilty as sin."

By age the jury leaned toward the defendant with six jurors in the 30-50 age group. The only over-50-year male, did indeed, favor the prosecution and voted three times for a guilty verdict until he reluctantly capitulated to the will of the majority, confessing that he would "never feel right about it." The other juror who voted in favor of the prosecution on the first two ballots was a 20ish toolmaker. Both his age and occupation pegged him as pro-prosecution.

What of the occupations? The jurors who favored the defendant included an English professor, doctor, laborer, food service worker, school psychologist, data and product analyst, and housewife. Among the occupations said to favor the prosecutor were the toolmaker and two school teachers. The two teachers were women, one in her 20s and the other in her 50s. Thus, while their occupation favored the prosecutor, their sex and age did not.

Of the two jurors who voted for the prosecution on two ballots, each had two or three factors that favored the prosecution. The toolmaker was a male in his twenties, and with all three factors favoring the prosecution, he voted twice for a guilty verdict. The other holdout had two factors favoring the prosecutor: He was a 50+ year-old male who was a fireman. While a fireman is not a pro-prosecution occupation, two factors made him favor a guilty verdict, his sex and age.

Eventually all the jurors voted for an acquittal for the defendant after two-and-a-half hours of deliberation.

C. The John Gotti Trial

It took six weeks of *voir dire* in the summer of 1986 to assemble a jury to try mobster John Gotti and six defendants on federal charges of racketeering, loan sharking, illegal gambling hijacking, robbery and three murders. More than six hundred veniremen filled out questionnaires to screen out those who were patently ineligible to serve. U.S. District Court Judge Eugene H. Nickerson questioned the rest.[6]

[6] Leonard Buder, *Gotti Trial Opening Statements Today*, N.Y. TIMES, Sept. 25, 1986, at A12.

The jury in the Gotti case was equally divided among men and women, with six each. Was this jury pro-prosecution or pro-defendant? Without revealing the outcome of this case, it is instructive to apply the paradigm we have been using in this case. With the jury divided six each for men and women, there was no advantage for the defendant by sex.

The ages of the jurors definitely favored the defendant with ten of twelve within the age parameters of 30-50. Only one juror favored the prosecutor by age, the 65-year-old white male. The other juror that fell within the age favorable to the prosecution was a 24-year-old woman. Next, the occupations of the jurors that favored the defense were a chauffeur, office assistant to a publisher, bar owner, train operator, electrical employee, mail handler, and assistant buyer. The occupations that favored the prosecution were accountant, bookkeeper, data processing manager and supervisor of accounts receivable. Thus by occupation, the jury leaned in favor of the defendant. In the paradigm advanced in this paper, by age and occupation the jury favored the defendant Gotti.

For this jury another factor was the nationality of the jurors. The ethnic background of the jury included three jurors of Irish or part Irish descent, four jurors of Italian or part Italian descent. The other nationalities included one Austrian (whose husband was Italian), one Puerto Rican, one born in Great Britain, and one of German/Swedish background. The nationalities of two jurors were not disclosed. According to the conventional wisdom of jury selection, Irish, Italians, and those of Hispanic origin favor the defense in criminal cases.[7] The jurors of English, German or Scandinavian descent favor the prosecution. While there were two jurors whose ethnic backgrounds favored the prosecution, their ethnic background was neutralized by their ages which favored the defendant, and their occupations: electrical employee and an Italian husband who owned a bar.

The outcome of the Gotti criminal prosecution, which also included several other defendants,[8] was an acquittal for the mob kingpin. While the Mafia chieftain had acquired the moniker the "Teflon Don" for his ability to elude conviction for various charges (until he was betrayed by the testimony of Sammy "the Bull" Gravano, a former associate), Gotti's success in eluding conviction received a great assist from the fact that the jury leaned toward him by virtue of age, sex and occupation.

[7] Fukurai & Butler, *supra* note 4, at 270.

[8] The other defendants were Leonard DiMaria, 45; Nicolas Corozzo, 46; Eugene Gotti, 39 (John Gotti's brother); John Carneglia, 42; Anthony Rampino, 46, and Wilfred Johnson, 51.

The twelve-member jury that heard the case, consisted of the following:

TABLE FOUR

THE JOHN GOTTI TRIAL – 1986[9]

JUROR	AGE	OCCUPATION
MWM Irish	65	Retired Chauffeur, Former Cook, 3 Children, World War II Veteran
SWM Italian	35	College Graduate, Office Assistant at Publishing Company, Living in Suburbs
SWM Italian	24	College Graduate, Auditor, Living in City
MWW Italian	47	Bookkeeper, Living in suburbs for 3 years, High School, 3 children
MWW Austrian	39	Husband is Italian, Owns Bar, 1 child, Live in Suburbs
HM b. Puerto Rico	36	Train Operator, Former Marine, Attended High School
MWM b. England	34	Electrical Engineer, High School graduate, 1 child, Live in suburbs
SWW Irish/Italian	45	Mail Handler--1 year of College Owned house in suburbs, 3 Children
SBW	31	Assistant buyer, Master's Degree, Urban area
MWM Irish	45	Data Processing Manager, Marine Veterans, 2 years of College, 4 children, Live in suburbs
MWM German/Swedish	48	Oil business--Married to Registered Nurse, 2 children – suburbs
MBW	33	Supervisor, Accounts Receivable College Graduate, Live in urban area

D. The Timothy McVeigh Jury

One of the most notorious and dastardly criminal acts of the last decade was the bombing of the Murrah Building in Oklahoma City in 1995. The federal building and its 169 victims were the targets of alleged bomber Timothy McVeigh. Since destruction of a federal building is a federal crime, the trial was held in federal court. After a

[9] Buder, *supra* note 6.

motion for a change of venue, the trial was held at the U.S. District Court in Denver, Colorado.

This jury offered very little comfort for the defense as the jury included eight men and five women. Women are preferred jurors if the defendant is a man, and there were only five women who served on this jury.

There is incomplete data as to the ages of the jury, but four of the juror's ages favored the prosecutor. There were two jurors in their twenties and two in their sixties.

Occupations of the jurors, which included a teacher, stockbroker, engineer, retired Air Force officer, property manager and nurse favored the prosecution. The pro-defense occupations included a landscaper, appliance salesman, maintenance man and a Sears's employee. Again the pro-defense occupations were trumped by other factors. For example, the Sears' employee was a white male in his 60s so two factors favored the prosecution. The landscaper was a male in his 20s. Thus, while there were some elements favorable to the defendant, they were outweighed by pro-prosecution elements. As a result, it was no surprise that this jury convicted McVeigh.

TABLE FIVE

THE OKLAHOMA CITY BOMBING JURY[10]

JUROR	AGE	OCCUPATION
WW		Grandmother
WW		Teacher Learning Disabled
Children		
HM	20s	Landscaper
WM	60s	Sears EE
WM	40s	Former Appliance Person, Vietnam Veteran
WM		Computer technician
WW		Registered Nurse
WM		Maintenance Man
WM	35	Methodist - Property Manager
WW	20s	Once Worker in Stockbroker's Office
WW		Restaurant business
WM	30s	Engineer
WM	50s	Air Force Retiree, Computer Programmer

[10]. Jo Thomas, *Lawyers in Oklahoma Bombing Hope Rapport with Jurors Pays Off Later*, N.Y. TIMES, Apr. 5, 1997, at 8.

III. *CONCLUSION*

In 1936, famed criminal defense lawyer, Clarence Darrow wrote an article in *Esquire Magazine* on the art of picking a jury. Darrow wrote that defense lawyers would be *guilty of malpractice* for not giving the nod to an Irishman certain to identify with an accused criminal. He also urged his colleagues in the defense bar to pack the jury with Jews and agnostics.[11]

As one author has stated, jury selection and behavior have "vexed attorneys, beguiled court buffs and miffed potential jurors since the first court gavel descended, generating not only studies and papers but also a folklore rife with stereotype mythologies and superstitions"[12] For example, the conventional wisdom that there is prejudice by blacks for blacks is undermined by actual trial results. Former Brooklyn judge and prosecutor, Alan Broomer has stated, "The blacks and Puerto Ricans are just as conservative as the whites – even more so."[13] If it were true, then all black defendants would be acquitted by black and Hispanic juries and that is not the case.

While there are many books and articles that attempt to explain the behavior of juries in terms of race,[14] non-racial factors are far more predictive of outcome. Lawyers try to narrow the odds of a successful outcome of a criminal case by hiring jury consultants to help predict which jurors would be best suited to vote for an acquittal.[15] As

[11]. *Insde the Oklahoma Jury*, NEWSWEEK, May 5, 1997, at 8.

[12]. Feeney, *supra* note 1, at 4.

[13]. *Id.*

[14]. *Id.* at 5.

[15]. Much has been written on this issue. *See generally, e.g.*, HARRY KALVEN & HANS ZEISEL, THE AMERICAN JURY (1966); RITA J. SIMON, THE JURY: ITS ROLE IN AMERICAN SOCIETY (1980); Albert W. Alshuler, *The Supreme Court and the Jury: Voir Dire, Peremptory Challenges and the Review of Jury Verdicts*, 56 U. CHI. L. REV. 153 (1989); Paul Butler, *Racially Biased Jury Nullification: Black Power in the Criminal Justice System*, 105 YALE L.J. 677 (1995); Kenneth Conboy, *The Race Factor and By Jury*, 20 FORDHAM URB. L.J. 551 (1993); Hiroshi Fukurai & Edgar W. Butler, *supra* note 4; James J. Gobert, *In Search of the Impartial Jury*, 79 J.L. CRIM. 269 (1988); Shuri L. Johnson, *Black Innocence and the White Jury*, 83 MICH. L. REV. 1611 (1985); Scott Kafker, *The Right to Venue and the Right to an Impartial Jury: Resolving the Conflict in the Federal Constitution* 52 U. CHI. L. REV. 729 (1985); Nancy J. King, *Post Conviction Review of Jury Discrimination: Measuring the Effects of Juror, Race on Jury Decisions*, 92 MICH. L. REV. 63 (1993); Peter M. Kougasion, *Should Judges Consider the Demographics of the Jury Pool in Deciding Change of Venue Applications* 20 FORDHAM URB. L.J. 531 (1993); Robert U. MacCoun, *Experimental Research on Jury Decision-Making*, 30 JURIMETRICS J. 223 (1990); Newton N. Minow & Fred H. Cate, *Who Is an Impartial Juror in an Age of Mass Media*, 40 AM. U. L. REV. 631 (1991); Frank Twerkheimer, *The Rodney King Verdict: Why and Where To From Here?* 1992 WIS. L. REV. 849; Barbara Underwood, *Ending Race Discrimination in Jury Selection, Whose Right Is It Anyway?* 92 COLUM. L. REV 725 (1992); *Out of the Frying Pan or Into the*

some lawyers have found, the odds of success are no better when the case is placed in the hands of psychologists, sociologists, graphologists and other "ologists." Based on the evidence adduced above, it is far better to rely on the factors of sex, age and occupation.

Fire? Race and Choice of Venue After Rodney King, 106 HARV. L. REV. 705 (1993); *Race and Perception in the Courtroom: Non Verbal Behaviors and Attribution in the Criminal Justice System*, Note, 67 TUL. L. REV. 2335 (1993).

Rule 10(b)(5) and The Suitability of Investments

Robert G. Hutter*

I. *INTRODUCTION*

In his classic song, *Alice's Restaurant*, Arlo Guthrie writes "You can get anything you want at Alice's Restaurant." Today's full-service financial firm operates in much the same way. In addition to the standard fare of stocks and bonds, one can buy on margin, sell short, write puts and calls, buy and sell mutual funds and participate in numerous other forms of derivative investments. The boom in the stock market since 1982 has created a *wealth effect* for a constantly growing segment of the population. As more and more consumers become investors, the pool of *unsophisticated* investors is larger than ever. Many of these investors are being subjected to strong sales pitches for high-commission financial products which may be unsuitable for the particular investor's tax situation, risk profile and long-term investment goals.

Each of the following scenarios occur day after day. In the first example, a recently widowed ninety-one year old woman walks in to a Florida Bank with the certified copy of her husband's death certificate necessary to convert the savings account jointly owned by the couple during her husband's lifetime to her own separate account. She is soon referred to a friendly customer service employee of the bank. Over a cup of coffee the customer service employee soon discovers that the widow and her late husband have accumulated nearly $800,000 in stocks, mostly utilities purchased years ago, and a number of long-term Certificates of Deposit held in another bank. The widow's late husband made most of the financial decisions for the couple. The customer service employee expresses her concern over the task facing the widow in handling such a large living estate and offers the bank's expertise in setting up a revocable living trust with the bank as sole trustee and investment advisor. Shortly after the trust is set up, the stocks and long-term CD's are liquidated and the proceeds reinvested in the bank's trust pool yielding between five and six percent annually. The CD's were subjected to a forfeiture of six months interest as a

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penalty for early withdrawal and in the next tax year the widow was presented with a capital gains tax bill of nearly $75,000 from the stocks sold.

In the second example, elderly New York widow has a bank savings account containing over $220,000. The widow has a forty-three year old semi-retarded son who is employed part-time as an office messenger. She has mentioned to one of the bank tellers at her local bank her concerns for her son's well-being when she passes. The teller mentions that an investment advisor for the bank visits the branch every other Tuesday and schedules an appointment for the widow. After the meeting, the investment advisor has the widow transfer the balance of the savings account into the bank's tax-deferred mutual fund. This recommendation was made despite the fact the widow had not had sufficient income to necessitate the filing of federal or state income tax since she retired fifteen years ago. In fact, he never even inquired if she filed income tax returns. The paper discusses the right of these elderly widows and other persons to bring a claim under Rule 10(b)(5) regarding the suitability of their investments.

II. THE POLICY OF SECURITIES REGULATION

Mention of Rule 10(b)(5) typically evokes thoughts of trading on inside information. The rule states that:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme or artifice to defraud,
>
> (b) To make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[1]

[1] Securities and Exchange Act of 1934, Ch. 404, Title 1, Section 10(b).

While situations involving insider trading are the most common under Rule 10(b)(5), the rule has also been invoked in cases of churning[2] and claims dealing with the suitability of a particular investment.

A. Suitability Claims under Rule 10(b)(5)

The origins for the application of Rule 10(b)(5) to suitability claims lie in the rules of the various stock exchanges, specifically the New York Stock Exchange's (NYSE) "Know Your Customer Rule" and the National Association of Securities Dealers Rules (NASD) of Fair Practice. The NYSE rule states that "[e]very member organization is required [to use] due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization."[3] The NASD rule states:

> In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and to his financial situation and needs.[4]

Courts have held that the NYSE and NASD rules do not create a private cause of action for investors.[5] The courts, however, have found that the anti-fraud provisions of Rule 10(b)(5) give rise to an implied right of action in cases of suitability claims.[6] Under this implied right of action an investor can establish liability by demonstrating that the broker did not accurately convey the risks of the purchased securities or recommended a course of trading that was at odds with the investors stated objectives.[7] Suitability has been applied

[2] Churning is the buying and selling of investments at a rapid pace for the primary purpose of charging and collecting additional commissions by the broker/investment agent.

[3] NYSE Rule 405 (1), 2 N.Y.S.E. Guide CCH ¶ 2405 at 3696 (1994).

[4] NASD Rules of Fair Practice, Art. III, § 2(a).

[5] Jablon v. Dean Whitter & Co., 614 F.2d 677 (9th Cir. 1980); *see also* Picard v. Wall St. Disc. Corp., 526 F. Supp. 1248 (S.D.N.Y. 1981); Pierson v. Dean, Witter, Reynolds, Inc., 551 F. Supp. 497 (C.D. Ill. 1982).

[6] Clark v. John Lamula Investors, Inc., 583 F.2d 594 (2nd Cir. 1978).

[7] Cruse v. Equitable Sec. of New York, Inc., 678 F. Supp. 1023 (S.D.N.Y. 1987).

to two distinct types of claims:[8] claims based upon misrepresentations or omission, and claims based upon fraudulent practice.

B. The Elements of a Claim for Misrepresentations

Before an investor can recover under Rule 10(b)(5) based upon misrepresentations or omissions, he or she must establish the following elements: (1) the broker knew or reasonably believed that the securities purchased were unsuitable given the investor's objectives; (2) the broker, with scienter, made material misrepresentations (or, owing a duty to the investor, failed to disclose material information) relating to the suitability of the investments; and (3) the investor justifiably relied, to his or her detriment, on the broker's fraudulent conduct.[9]

Scienter is not defined in these types of cases in the traditional sense. For most Courts applying this standard, scienter has hinged on the factual question of the unsuitability of the recommended securities. Where an investor has established that the securities in question were too risky considering the investor's objectives, courts have found scienter based on the broker's affirmative recommendation of the unsuitable securities.[10]. In the case of omissions, courts have held that the "duty to disclose" is premised upon a duty to disclose arising from a "relationship of trust and confidence."[11] In other words, the court requires a fiduciary relationship between buyer and investment advisor/broker beyond the function in which the investment advisor/broker is merely executing a trade on behalf of the client based solely on the investment decision made by the client alone. Courts do not recognize a general duty between all participants in all market transactions.[12]

Justifiable reliance usually involves a consideration of the level of sophistication of the investor, the duration of the relationship between the investor and the investment advisor/broker, whether or not a fiduciary relationship has arisen and the specific nature of the misrepresentations or omissions.

In the case of claims based upon fraudulent practice, courts require that the following elements be established:[13] (1) the broker recommended securities were unsuitable considering the investor's

[8]. Lyle Roberts, *Suitability Claims Under Rule 10(b)(5): Are Public Entities Sophisticated Enough to Use Derivatives?* 63 U. CHI. L. REV. 801 (1996).

[9]. Brown v. E.F. Hutton Group, Inc., 991 F.2d 1020 (2nd Cir. 1993).

[10]. Boettcher & Company, Inc. v. Munson, 854 P.2d 199 (Colo. 1993).

[11]. Chiarella v. U.S., 445 U.S. 222 (1980).

[12]. *Id.*

[13]. O'Connor v. R.F. Lafferty & Co., 965 F.2d 893 (10th Cir. 1992).

objectives, (2) the broker purchased or recommended the securities with scienter, and (3) the broker exercised control over the investor's account. Courts have held that control is established either by the broker's discretionary authority to buy and sell securities on behalf of the investor or by a finding that the investor routinely followed the broker's recommendations.[14]

III. *DECISIONS INVOLVING SUITABILITY CLAIMS*

Each decision involving a suitability claim turns on the individual facts of the particular case before the court. There is no set pattern for decisions, and brokers seem to prevail as often investors. Two cases are discussed below to give the reader a flavor of the facts and issues presented for argument.

A. Special Trust as Grounds for Lack of Suitability

In *T-Bill Option Club v. Brown & Company Securities Corporation*,[15] plaintiff was an investment partnership that traded in stock options and other securities. One of the partners responded to an advertisement in *Barron's* which stated in part:

> There are two kinds of investors in the world. Those with experience. And hose searching for it. If you are one of the few with experience, one of the few who does not need his hand held, Brown and Company can offer you margin and commission rates that are lower than you might think possible. We can offer such savings by dealing only with investors who make their own investment decisions. And do not need someone to make decisions for them.[16]

In addition, the Customer Agreement provided that Brown and Company (Brown) would "not offer or provide any opinions, judgment or information concerning the nature, value, potential or suitability of any investment."[17] The partnership maintained a margin account and had the great misfortune of being heavily invested at the time of the stock market crash of October 1987. The value of the securities in the

[14]. Mihara v. Dean Witter & Co., 619 F.2d 814 (9th Cir. 1980).

[15]. 23 F.3d 410 (7th Cir. 1994).

[16]. *Id.*

[17]. *Id.*

partnership's portfolio fell greatly during this time to the point where a maintenance deficiency was created. The account was closed and plaintiff's later sued claiming the account had actually been deficient for approximately ten days prior to the margin call. The partnership claimed its losses were the fault of Brown because the failure to make an earlier margin call had deepened the amount of loss. In addition, the plaintiff tried to raise the issue of suitability on the grounds that defendant was a fiduciary with respect to the partnership's account. In its opinion deciding against the partnership, the court found that a broker is an agent whose fiduciary duty is limited to actions occurring within the scope of his agency. Furthermore, the scope of the duty owed by a broker carrying a nondiscretionary account for a customer is an exceedingly narrow one, consisting at the most of a duty to properly carry out transactions ordered by the customer. The court found that, except for its duty to execute faithfully the transactions the partnership ordered, Brown did not occupy a position of special trust or confidence which would justify relief on the grounds of lack of suitability.[18]

B. Defending Against a Claim for Suitability

In *Vucinich v. Paine, Webber, Jackson & Curtis, Inc.*,[19] plaintiff was a forty-five year old housewife who was married to a self-employed operator of a gas station. She had four children. In 1976, Jennie Vucinich inherited $40,000 in common stocks from her parents plus $20,000 in cash from the sale of her parents' home. Since she was not a sophisticated investor she opened an account with defendant. She informed defendant's agent that she was interested in capital appreciation and was not interested in short-term, high-risk investments. The $20,000 was invested in a tax-deferred annuity and she was advised by the broker to sell the common stocks and go into "short selling." Defendant's agent failed to explain the risks of short selling to the plaintiff. The broker selected the stocks to be sold short. She finally closed her account in September, 1980. From 1976 to September 1980, the size of the account had dropped from $40,000 to $8,273.93. When asked why so much of her money had been lost, the broker replied "if I knew how to make money in the stock market, I would not be working as a broker."[19]

The court found that Jennie Vucinich was not experienced in the market, was unaware of the risks of the short selling and relied

[18] *Id.*

[19] 803 F.2d 454 (9th Cir. 1986).

[19] *Id.*

extensively on the advice of her broker. The court found that to ward off a claim of suitability the defendant would be required to prove:

> that a short sale involved her borrowing stock that Paine, Webber had on hand; that maintenance of a short sale position required being able to meet margin calls; that her collateral would be drawn on by Paine, Webber and used up until it fell to the 50 percent margin requirement; that she would have to pay dividends if the borrowed stock paid dividends; that she would have to pay interest regularly as a debtor for the stock borrowed; that the certain payment of interest and the probable payment of dividends would deplete her collateral and increase her vulnerability to a margin call, that short sales carry risks substantially different from ownership of common stocks, and that short selling is not normally what is meant by the phrase *capital gains objective*.[20]

Other than the claim that the investment advisor was not a fiduciary in the selection of investment, the most common defense set up against suitability claims is that they are not timely. Often claims are not brought until the investment sours or long after the particular investment was purchased. Courts have held that the statute of limitations begins at the date of purchase of the allegedly unsuitable investment rather than time the unsuitability is discovered by the investor.

IV. *CONCLUSION*

The two scenarios are actual experiences of clients of the author. Financial products today are sold more on the basis of marketing than financial suitability. The author's contends that investments sold by investment brokers to unwary and unsophisticated investors should contain by implication an element of analysis for client suitability.

The Certified Financial Planner (CFP) Board of Standards in Denver, Colorado is a nonprofit professional regulatory organization founded in 1985 to benefit the public by fostering professional standards in personal financial planning. The CFP Board of Standards

[20] *Id.* (emphasis added).

has adopted a Code of Ethics and Professional Responsibility (Code). Principle 7 of the CFP Code is entitled Diligence and states:

> [a] CFP designee shall act diligently in providing professional services. Diligence is the provision of services in a reasonably prompt and thorough manner. Diligence also includes proper planning for and supervision of the rendering of professional services.

Rule 703 of the CFP Code states that "[a] financial planning practitioner shall make and/or implement recommendations which are suitable for the client." The Code goes further to state in Rule 704 that:

> Consistent with the nature and scope of the engagement, a CFP designee shall make a reasonable investigation regarding the financial products recommended to clients. Such an investigation may be made by the CFP designee or by others provided the CFP acts reasonably in relying upon such investigation.

Investment brokers are generally paid on a commission basis. Under this compensation system "few brokers are immune to consider their financial interest from time to time while they are advising clients. Being at once a salesman and a counselor is too much of a burden for most mortals."[21] Unless and until the suitability problem receives as much attention from financial advisors as efforts at product promotion, abuses will occur in the financial services industry. Perhaps it is time the broad provisions of Rule 10(b)(5) should be extended by the courts to create an implied warranty of suitability.

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[21] William Poser, *Options Account Fraud: Securities Churning in a New Context*, 39 BUS. LAW. 571 (1984).

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