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AMAZON DELIVERS DIVERSITY: GEOGRAPHICAL & SOCIAL INFLUENCES ON CORPORATE EMBEDDEDNESS

Lee-ford Tritt* & Ryan Scott Teschner**

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ABSTRACT

This is the first Article to discuss the new phenomenon in America of corporations opening second headquarters in regions that are geographically distinct from their original headquarters. Currently, this trend is most notably evidenced by Amazon.com, Inc. and its plan to create a second headquarters equal in size and importance to its original headquarters located in Seattle, Washington. Amazon’s second headquarters search provides an ideal interdisciplinary case study to explore two important and interrelated aspects of

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business law and organizational behavior theory: corporate sustainability and corporate embeddedness. Choosing a location for a second headquarters that is culturally distinct from the first could have critical consequences for a corporation. For example, employees who relocate from the first headquarters to the second could have trouble becoming embedded in the new headquarters due to cultural differences. This could affect employee productivity and retention. Similarly, the embedded culture and values of the second headquarters’ community could overtly and implicitly influence the organizational identity of the overall corporation. While corporations can be driving forces for social change, this Article looks to show how they can be changed themselves. Business research concerning headquarters location thus far has largely ignored these issues. Therefore, this Article seeks to begin a dialogue concerning how the geography of a second headquarters influences internal organization and sustainability practices, corporate embeddedness, and organizational and individual identity issues within a corporation.

INTRODUCTION

There is a new phenomenon in America of companies opening second corporate headquarters in regions that are geographically and culturally distinct from their original headquarters.¹ Currently, this trend is most notably evidenced by Amazon.com, Inc. (“Amazon”) and its plan to create a second headquarters (“HQ2”) equal in size and importance to its original headquarters (“HQ1”) located in Seattle, Washington.² The search for HQ2’s location has drawn requests for proposals from over 200 cities.³ It is no surprise that HQ2 will have


2. Amazon HQ2, AMAZON, https://www.amazon.com/?ref=qid=1704620011 (stating Amazon’s headquarters in Seattle consists of 33 buildings, 8.1 million square feet, and over 40,000 employees).

a noticeable impact upon the community in which it will be located, as it is estimated to create 50,000 jobs and a $5 billion investment in local infrastructure. What might be less evident, however, is that the change in demographics, individual employee identities, and values of the new community surrounding HQ2 will also have an impact on Amazon’s organizational identity and social networks. Accordingly, Amazon’s search for HQ2’s location provides an ideal interdisciplinary case study to explore two important, interrelated aspects of business law and organizational behavior theory.

First, Amazon has been transparent that one of its goals in its search for HQ2 is to strengthen corporate sustainability and foster positive social purposes, especially concerning LGBT issues. Therefore, this Article explores the extent to which corporations can and should be instruments of change concerning diversity, inclusion, and other identity issues—both internally and externally.

Secondly, embedded organizational norms, employees’ individual backgrounds, geographic location, and societal influences affect the operational aspects of organizations. More specifically, corporations are comprised of various races, ethnicities, genders, sexual orientations, and religions. This diverse framework of individuals is fragile, and the ability of these individuals to safely and productively sustain their identities within their workplaces is key to an organization’s success. Choosing a location for a second headquarters that is culturally distinct from the first could have critical consequences for a corporation. For example, employees who relocate from the first headquarters to the second could have trouble becoming embedded in HQ2 and the new location due to cultural differences. This could affect employee productivity and retention. Similarly, the embedded culture and values of the new second headquarters’ community could overtly and implicitly influence the organizational identity of the overall company. While companies can be a driving force for social change, they can also be changed themselves. Business research concerning headquarters location has largely ignored these issues.

4. See generally Thomas Klier & William Testa, Location Trends of Large Company Headquarters During the 1990s, 2Q ECON. PERSPS. 12 (2002) (discussing how landscapes of cities are influenced and defined by the presence of corporate headquarters).

5. See Amazon HQ2 RFP, https://www.documentcloud.org/documents/4112684-Amazons-Requirements.html (listing several features that Amazon has specifically requested HQ2 have, including, but not limited to: metropolitan areas with a population of over 1 million, a stable and business-friendly environment, within 30 miles of a population center, within 45 minutes of an international airport, proximity to major highways, access to mass transit routes, and a cultural community).


7. For the definition and discussion of embeddedness, see infra Part III.C.

this Article looks to unveil how the geography and culture of a second headquarters influences the internal organization and sustainability of a corporation, corporate embeddedness, and organizational and individual identity issues.

Considering that Amazon is one of the world’s largest corporations, any social motives behind its search for HQ2’s location and the potential consequences in picking a geographically distinct region, makes it the perfect candidate for this research. At the time this Article was written, twenty finalists have been named. To further the discussion concerning the impact that the location of a second headquarters may have on Amazon, and the impact Amazon may have on the location, this Article focuses on the city of Atlanta because it is the most geographically and culturally opposed to Amazon’s HQ1, which is located in Seattle, Washington. Even if Amazon does not choose this location, it provides an ideal hypothetical to act as a springboard for second headquarters research.

In Amazon’s request for proposals (“RFP”), it specifically mentions the following criteria for its new location:

- Metropolitan areas with a population of over 1 million
- A stable and business-friendly environment
- Within 30 miles (48 km) of a population center
- Within 45 minutes of an international airport
- Proximity to major highways and arterial roads 1–3 miles (2–5 km)


10. See e.g. Klier & Testa, supra note 4, at 14 (“Overall, then, our findings for the 1990s suggest that the largest urban areas continue to be highly preferred as headquarters locations. However, we identify a changing trend in the distribution of large headquarters across metropolitan areas. This trend implies that the second tier of metropolitan areas may begin to enjoy greater success in the competition for headquarters. The evidence shows that corporate headquarters are dispersing to mid-sized metropolitan areas and following a shifting population and markets, especially toward the South . . . What exactly are the competitive advantages of large cities? The central function of corporate headquarters is the acquiring and dissemination of information. The demand side of the profit equation requires that corporate headquarters stay abreast of emerging developments in their markets.”).

11. Creating second headquarters is a burgeoning trend, but many of the factors corporations consider for their headquarters’ locations will apply to a second headquarters’ locations. See, Murray D. Rice & Donald Lyons, Geographies of Corporate Decision-Making and Control: Development, Applications, and Future Directions in Headquarters Location Research, 4 GEOGRAPHY COMPASS 320, 328 (2010) (“However, beyond these basic facts, headquarters research has also resulted in a wealth of detailed insights into the fundamental factors that influence decision-making location, including the impact of airline connections, the availability of business services, the ability to access the firm’s own facilities, the geography of stock ownership and investment, the impact of incentives on relocations, headquarters location differences among firm types, and other considerations related to headquarters relocations.” (citations omitted)).
Access to mass transit routes
☐ Up to 8 million square feet (740,000 m²) of office space for future expansion
☐ Cultural Community Fit and Quality of Life

Although specifically missing from this list (or rumored to be included in the general “cultural fit” category), LGBT issues are also a concern for Amazon in its search for HQ2. Amazon is not quiet about its support of the LGBT community, so it seems natural that this would be one of its concerns in choosing a location. On its website, Amazon proudly announces that it provides gender transition benefits to its employees. Additionally, the website discusses Amazon’s LGBT affinity group, glamazon, which helps foster an inclusive community within Amazon and promote diversity outside Amazon. There is no question that Amazon will influence the location of HQ2 economically. The more interesting question is whether Amazon can influence the culture of this location. Perhaps Amazon could bring social change to Georgia, however, Georgia may influence Amazon as well. For example, when Delta Air Lines pulled its support of the NRA, Georgia denied the company a tax break. Georgia is known for its anti-LGBT views, so if Amazon pushes for more LGBT rights, it could face similar financial backlash from the state. The extent to which a corporation can influence its location culturally, and vice versa, needs to be explored.

The issue of whether a corporation’s culture will be impacted by its location directly relates to the potential conflicting relationship between cultural embeddedness, organizational identity, and employee identities. The location of HQ2 may impact not only Amazon’s organizational identity, but also the internal social networks of Amazon and its employees’ self-identities. These impacts may create unintended consequences stemming from the corporate boardroom.

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12. See Wong, supra note 3.
13. See O’Connell, supra note 6.
15. Id. (“Glamazon helps make Amazon a great place to work by educating and informing employees about LGBTQ+ issues and opportunities. The group mentors fellow employees (both LGBTQ+ and allies) and promotes diversity and visibility in recruiting and throughout Amazon. The group makes Amazon more visible within the LGBTQ+ community-at-large by sponsoring events and PRIDE parades around the globe.”).
16. Id. It should be noted, however, that the Georgia Governor who approved the bill that did this to Delta will not be in office by the time HQ2 is complete. See Associated Press, Georgia Punishes Delta for Crossing the NRA; Airline Insists It’s ’Not Taking Sides,’ L.A. TIMES (Mar. 2, 2018, 12:30 PM), http://www.latimes.com/business/la-fi-delta-nra-20180302-story.html; Kevin Sack & Alan Blinder, In Georgia Governor’s Race, a Defining Moment for a Southern State, N.Y. TIMES (July 28, 2018), https://www.nytimes.com/2018/07/28/us/politics/georgia-governor-race.html.
down the organizational chain to the organization’s operations and even product offerings. If Amazon wishes to continue delivering diversity, it should consider all of these factors in choosing the location for HQ2.

As the first Article to discuss the potential impacts of a second headquarters, this Article seeks to begin a dialogue that will lead to more research on these issues. Part I of this Article provides an overview of the historical development of corporate headquarters to show how Amazon’s HQ2 is making history. Part II analyzes different theories of corporate governance and how the concept of embeddedness is connected to these theories. Part III discusses the understudied aspects of headquarters location research—cultural embeddedness and social networks—which could impact the organization, its identity, and its profits. More specifically, Part III posits how the location of HQ2 will influence the social structures and embeddedness of Amazon, which directly impacts the organization, its identity, its employees’ identities, and possibly its continued success. Finally, this Article concludes by identifying specific questions for future empirical research related to these topics.

I. THE HISTORY AND SIGNIFICANCE OF CORPORATE HEADQUARTERS

To understand how the location of a corporation’s second headquarters can affect a company’s identity, it is important to consider the history and significance of this organizational structure. Organizations’ need for expansion and mobility in a growing economy sparked the trend in creating corporate headquarters. This same need may have sparked the second headquarters trend, but the impacts of having a second headquarters on the organization and its employees has not been heavily studied.18 An appreciation of the history and significance of corporate headquarters may reveal potential problems with spreading what should be the center of the corporation’s management across two culturally distinct locations.

The term “headquarters,” is defined as “a place from which a commander performs the functions of command” and “the administrative center of an

18. While establishing a second headquarters has not been extensively studied, there has been solid research concerning the relocation of headquarters, so this research may provide some limited insight by analogy. This research does not consider the potential for conflicting relationships between the cultural embeddedness and employee identities of the two headquarters. Whether relocation is for monetary reasons, a change in business practice, or a change in ownership, the typical view of corporate headquarters relocation is that it is a capital investment decision that involves explicit and implicit costs and benefits. See generally Kasim L. Alli et al., Corporate Headquarters Relocation: Evidence from the Capital Markets, 19 REAL EST. ECON. 584 (1991) (discussing the effects of location on profitability). The four groups of factors that incorporate the most commonly found determinants of firm relocation are the characteristics of the internal firm, the building, the site, and the region. J. Knoben & L. A. G. Oerlemans, Ties that Spatially Bind? A Relational Account of the Causes of Spatial Firm Mobility, 42 REGIONAL STUD. 385 (2008). Notably missing is the importance of understanding the impact that the culture and values of the second location may have on the organization, its identity and its employees.
enterprise.” Generally, a corporation’s headquarters manages the day-to-day operations to help centralize managerial and administrative functions, which is key to a corporation’s success.

To touch briefly upon the history of corporate headquarters, no semblance of modern-day business existed prior to 1850. For example, the two or three people responsible for a corporation’s future success handled all its activities: economic, administrative, operational, and entrepreneurial. In the agrarian and commercial economy of ante-bellum America, business administration did not yet exist. However, this began to change. For example, when the DuPont Company began to decline, it implemented autonomous operating divisions and general offices comprised of executives and specialists. This was one of the first recognized attempts at a structured corporate hierarchy that would handle the company’s various new product lines within centralized functional departments.

When corporations began to expand geographically by building or acquiring facilities and personnel distant from its original location, they had to create a central organization. Slowly, headquarters became a place to acquire, maintain, and retain positions that held value for the company. “These departmental headquarters soon had offices for the recruitment and training of personnel, for the inspection of product and process, for the maintenance of plant, for the improvement of processes, and, for a time, for planning new construction and purchasing supplies other than raw materials and equipment.” The solution to the struggles these early corporations faced was the development of today’s corporate headquarters, which highlights the significance of the modern-day headquarters. Corporate headquarters evolved to centralize corporate management by consolidating and structuring different departments within an organization.

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21. *Id.*
23. *Chandler, Jr., supra* note 20, at 58.
24. From a legal standpoint, the location of a corporation’s headquarters is a significant factor when determining whether a dispute may be heard in federal court. Connor D. Deverell, *Defining a Corporation’s “Principal Place of Business”: The United States Supreme Court’s Decision in Hertz Corp. v. Friend*, 56 Loy. L. Rev. 733, 733 (2010) (“[I]t is well settled that corporations perceive federal forums as friendlier than state courts. Accordingly, corporations use tactical devices to gain access to federal courts and vehemently fight remands to state courts.”). Under federal diversity jurisdiction, a corporation will be deemed a citizen of every state where it has been incorporated or has its “principal place of business.” 28 U.S.C. § 1332(c)(1) (2012). For example, if a corporation maintains headquarters in more than one state, “courts must choose between several locations.” Seungwon Chung, *The Shoe Doesn’t Fit: General Jurisdiction Should Follow Corporate Structure*, 100 Minn. L. Rev. 1599, 1600 (2016). Determining what exactly constitutes a corporation’s “principal place of business” proves to be a difficult issue. In *Hertz Corp. v. Friend*, the Court held that a corporation’s principal place of business refers “to
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However, Amazon is partaking in a new phenomenon, in which companies have begun to open second headquarters in locations different from their initial headquarters. This trend contrasts with the original reason for creating headquarters: centralization of company management. By creating HQ2, Amazon is decentralizing its organization. Because this is in direct conflict with the historical pattern of corporate management, it is important to understand the impacts of having a second headquarters. If the overt or embedded culture of HQ2, or its employees, is different from HQ1, this could have significant ramifications throughout the company. From board meetings to low-level employee interactions, clashes of opinions spanning the political and cultural spectrum may increase. Before discussing these potential ramifications, it is necessary to discuss corporate governance theories, which may drive Amazon’s decision-making.

II. THE LAW OF CORPORATE GOVERNANCE

This Part analyzes the evolution of corporate governance and its relationship to sustainability and corporate social responsibility to illustrate what factors companies consider when making corporate decisions. As a for-profit corporation, Amazon will naturally look at wealth maximization when making its HQ2 decision. However, Amazon is also a socially-conscious company that holds inclusiveness, employee satisfaction, and LGBT rights in high regard. This Part explains how embeddedness can tie into profitability and sustainability, and the possible ramifications that the location of HQ2 could have on both.

A. Shareholder Primacy

Corporate governance is the framework that outlines the division of power in a corporation. The traditional view is the shareholder primacy model, which focuses on the maximization of shareholder wealth. While there is not a
specific statute mandating the maximization of profits, it has been widely accepted that “[t]he central command of corporate governance law is that directors must serve the shareholder interest.” Directors and officers of a corporation cannot sacrifice shareholder wealth in favor of stakeholder interests, such as employee welfare and environmental concerns. As stated by economist Milton Friedman, “in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them.” The line becomes blurred as to whether a corporation may deviate from this traditional model to incorporate stakeholder values and interests when making corporate decisions.

Today, corporations have begun to deviate from the traditional view of corporate governance. There is an increase in public corporations that instead of...
just considering the interests of shareholders, also want to integrate social purposes into their business models. Because of this, the question of whether a corporation may disengage from shareholder primacy is “now a pressing matter of organization law.”\textsuperscript{33} A notable example is when Facebook’s founder, Mark Zuckerberg, released a public letter stating that Facebook does not strive to serve only the interests of its shareholders.\textsuperscript{34} Zuckerberg noted that Facebook was “built to accomplish a social mission” and that “people want to use services from companies that believe in something beyond simply maximizing profits.”\textsuperscript{35} Is shareholder primacy merely a default rule that can be altered?\textsuperscript{36} Will a corporate director or officer breach his or her fiduciary duty by deviating from shareholder maximization?\textsuperscript{37} According to Jonathan Macey, a prominent legal scholar, shareholders may opt out of shareholder primacy if they so desire.\textsuperscript{38} However, Macey argues that shareholders of public corporations do not have a strong interest in altering this “default rule.”\textsuperscript{39} Nevertheless, this supports the argument that a corporation, like Amazon, has the ability to consider stakeholder interests, not just profit maximization.

The critical problem with corporations deviating from shareholder primacy is that shareholder wealth maximization is still “the law on the books.”\textsuperscript{40} Even the American Law Institute’s Principles of Corporate Governance (“Principles”) advocate that corporations should enhance shareholder gain.\textsuperscript{41} In fact, the Principles state that the only exceptions to shareholder primacy are for compliance with the law, charitable contributions, and the devolution of resources for public, humanitarian, educational, and philanthropic purposes.\textsuperscript{42} These exceptions do not factor in the consideration of stakeholders interests or values.

In addition to their shareholders, large corporations serve millions of customers, which creates conflicting interests and obligations.\textsuperscript{43} Maximizing shareholder wealth is only one aspect of a corporation and should not dominate corporate governance because solitary focus on a corporate purpose that maximizes shareholder wealth “becomes far less simple and perhaps

\begin{itemize}
\item \textsuperscript{33} Id. at 463.
\item \textsuperscript{34} Id. at 464.
\item \textsuperscript{36} Jonathan R. Macey, \textit{A Close Read of an Excellent Commentary on Dodge v. Ford}, 3 VA. L. & BUS. REV. 177, 179 (2008).
\item \textsuperscript{37} Magaro, \textit{supra} note 29, at 1149 (“Under this view, directors are trustees of the shareholders’ property, and, therefore, have duty, first and foremost, to increase shareholder wealth.”).
\item \textsuperscript{38} Macey, \textit{supra} note 36, at 179.
\item \textsuperscript{39} Id.
\item \textsuperscript{40} Id. at 181 (noting that shareholder wealth maximization is still the law, even if not in practice).
\item \textsuperscript{41} ALI Principles of Corporate Governance § 2.01 (1994).
\item \textsuperscript{42} Macey, \textit{supra} note 36, at 178–79.
\item \textsuperscript{43} Stout, \textit{supra} note 29, at 175.
\end{itemize}
incoherent.”\textsuperscript{44} Additionally, public corporations depend on stakeholder interests, which supports a deviation from shareholder primacy. While many corporations’ main focus is to maximize shareholder wealth, there are corporations with social purposes that should be permitted to make corporate decisions in favor of these purposes.\textsuperscript{46}

B. Sustainability and Corporate Social Responsibility

Today, many corporations seek to achieve sustainability through means that are not solely geared toward the maximization of shareholder wealth. This broad concept of corporate sustainability encompasses “environmental protection, social justice and equity, and economic development.” The concept derives from shareholder primacy, corporate accountability, sustainable development, and corporate social responsibility (“CSR”). Corporate sustainability can thus be viewed as “an evolving corporate management paradigm.”\textsuperscript{47} Under this paradigm, corporations should focus on environmental and social purposes in an effort to achieve sustainability.\textsuperscript{48}

CSR is a controversial approach that allows corporations to consider non-shareholder and social interests.\textsuperscript{49} Nonetheless, many corporations widely accept and apply CSR\textsuperscript{50} because it embodies a “balanced approach to corporate governance, where stakeholder interests are given their due considerations.”\textsuperscript{51} Some may argue that CSR is a means to achieve shareholder primacy, but this does not change the fact that CSR encourages “positive labor-management relationships, environmental stewardship, corporate philanthropy, and

\textsuperscript{44} Id. (“Even the seemingly simple directive to ‘maximize shareholder wealth’ becomes far less simple and perhaps incoherent in a public firm with many shareholders with different investment time frames, tax concerns, outside investments, levels of diversification, and attitudes toward corporate social responsibility.”) (emphasis added).

\textsuperscript{45} Id. at 176.

\textsuperscript{46} An interesting argument is made by Marshall M. Magaro, who argues that corporations may be able to incorporate corporate social responsibility as a form of shareholder primacy. See Magaro, supra note 29, at 1150 (noting that constituency statutes allowing corporations to consider non-shareholder interests are necessary because “consideration of non-shareholder constituents’ interests can lead to increased long-run profitability and shareholder wealth”). However, Magaro makes it clear that this approach does not mean a director or officer has a fiduciary duty to stakeholders. Id.


\textsuperscript{48} Id.

\textsuperscript{49} See David L. Engel, An Approach to Corporate Social Responsibility, 32 STAN. L. REV. 1, 3 (1979) (discussing whether it is socially desirable for corporations to pursue social ends when it conflicts with the “presumptive” shareholder theory to maximize profits).

\textsuperscript{50} Michael J. Vargas, In Defense of E. Merrick Dodd: Corporate Social Responsibility in Modern Corporate Law and Investment Strategy, 73 BUS. LAW. 337, 363 (2018).

\textsuperscript{51} Id. at 347-48.
community engagement. This approach “threatens to change the fiduciary duties traditionally embedded in the board of directors.”

One of the main concerns in CSR is determining when it is socially desirable for a corporation to forego profit because of the social need that the corporation’s pursuit of profit will not fulfill. This inquiry, however, fails to identify that implementing CSR can increase a corporation’s profits. Because a corporation serves thousands or millions of customers and stakeholder interests—not just its shareholders’ interests—serving a social purpose can directly increase shareholder wealth. Thus, corporate governance can be reformed to include social priorities.

While CSR has gained more notoriety in recent years, it has been heavily debated since the 1930s by famous economists Berle, Means, and Dodd, as well as Milton Friedman in the 1960s. Critics of CSR allege that it gives away and reallocates the shareholders’ wealth to non-shareholder constituencies. Friedman argued that corporate managers, as agents of the shareholders, are responsible for the shareholders’ money and thus it would be “inappropriate” to endorse a social agenda. Berle once argued that a corporation’s management should only protect the shareholders. These arguments, however, do not consider the indirect benefits that can be achieved through altruistic pursuits. In contrast, Dodd argued that corporations are allowed to consider other constituencies. He noted that in addition to the goal of profit-making, corporations also provide a social service. Dodd believed that corporations have a relationship with society and are responsible for the welfare of its employees. Additionally, in the 1960s, proponents of CSR and social activists

52. Id. at 348 (“[O]ne can embrace both strands of stakeholder theory simultaneously by arguing that embracing stakeholder concerns is good both because it is good for shareholders and the larger economy and because it is the just and right thing to do.”).

53. Von Stange, supra note 27, at 462.

54. Wilson, supra note 47 and accompanying text.

55. The author concedes that there is a strong case supporting the reformation of corporate governance to include corporate social responsibility. See Engel, supra note 49, at 31-32 (discussing the plausible and most prominent case made against his proposition).

56. See Licht, supra note 26, at 699–700; see also Stephen M. Bainbridge, Interpreting Nonshareholder Constituency Statutes, 19 PEPP. L. REV. 971, 971 (1992) (“Every couple of decades the corporate social responsibility debate heats up again. While it is almost as old as the corporate form itself, the debate took its modern form in the 1930s in an exchange between Professors Adolf Berle and Merrick Dodd.”).

57. Vargas, supra note 50, at 342.


59. Id. at 439.

60. Id. at 440.

61. Licht, supra note 26, at 699–700; see also Engel, supra note 49, at 6 (noting that CSR has even dated back beyond Berle and Means).

62. Vargas, supra note 50, at 341.
recognized that corporations serve other purposes, in addition to the maximization of shareholder wealth.\(^63\)

Ultimately, CSR expands the traditional shareholder primacy view by supporting the notion that corporate directors and officers can and should consider the interests of stakeholders.\(^64\) CSR has been found to increase shareholder wealth; therefore, it is a form of shareholder primacy. It is important to understand that a corporation is not abandoning shareholder primacy just because it wants to implement CSR. At the end of the day, a corporation will not survive if it is not profitable. Because of this, corporations should focus on profit maximization in addition to serving social purposes.

Socially-conscious corporations are some of the biggest players in today’s corporate world and are continuing to grow, which supports the theory that CSR can contribute to profit maximization.\(^65\) For-profit corporations, such as Whole Foods and Google, use “traditional for-profit structures to scale their growth while implementing many untraditional practices that aren’t profit motivated.”\(^66\) These extremely profitable corporations have, in part, abandoned the traditional shareholder primacy view to consider social purposes. For example, several times a year, Whole Foods has days where it donates 5% of its net sales to local non-profits and Google strives to create an exceptional work environment for its employees.\(^67\) These “non-traditional” corporate decisions have proven to be successful, illustrating how corporations can consider CSR and the interests of its employees, as well as society, while still maximizing profits.\(^68\)

\section*{C. State Statutes}

Before analyzing the specific types of state statutes, it is important to note how state statutes impact corporations. Pursuant to the internal affairs doctrine, “only the law of the state of incorporation governs and determines issues relating to a corporation’s internal affairs.”\(^69\) The rationale behind this doctrine is that corporations should not be subject to inconsistent legal standards in multiple

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\(^{63}\) See Budzynski, supra note 58, at 441-442 (“Ralph Nader, a new voice in the corporate social responsibility debate, led the campaign and hoped it would compel corporations to ‘benefit diverse constituencies.’”).

\(^{64}\) Licht, supra note 26, at 651 (noting that stakeholders include creditors, employees, local communities, the environment, and customers just to name a few).


\(^{66}\) Id.

\(^{67}\) Id.

\(^{68}\) See Alicia E. Plerhoples, Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to New Social Enterprise Legislation, 13 TRANSACTIONS: TENN. J. BUS. L. 221, 221 (2012) (“Despite being organized as a for-profit corporation, Ben & Jerry’s employs a triple bottom line—profits mixed with social and environmental missions.”).

jurisdictions. Rather, only the state of incorporation should govern matters between the corporation and its directors, officers, and shareholders. 

State statutes are one of the main sources of corporate law. State laws regulate the critical aspects of a corporation, including the code of conduct for directors and officers, the structure of the corporation’s governance, derivative suits, and many other important provisions. Directors and officers owe fiduciary duties to the shareholders because corporate decisions directly impact the corporation’s shareholders. State statutes and case law provide the framework for shareholder derivative suits, which is a complicated and difficult process that allows shareholders to sue the controlling directors and officers of the corporation for breaches of fiduciary duties.

Derivative suits directly relate to corporate governance. If director or officer actions injure shareholders, they can sue the corporation. These suits are seen “as an invaluable procedural vehicle permitting shareholders to champion their corporation’s rights when corporate management refuses to do so.” For example, if a corporation adheres to the shareholder primacy model, the shareholders can sue the corporation if it attempts to put social interests before the shareholders’ interests, as seen in Dodge v. Ford Motor Co. However, shareholder derivative suits are rare, given the complex statutory and procedural barriers that the shareholders must overcome. For example, most states require that shareholders make a pre-suit demand on the corporation’s board of directors before the suit can proceed, unless demand is excused as futile, which can be difficult to prove.

1. Constituency Statutes

The rationale behind sustainability and CSR has led to another approach that departs from the traditional corporate governance theory of shareholder primacy: the enactment of state constituency statutes. Generally, state constituency statutes either permit or require corporations to include a “statement in the corporate charter that defines and limits the purpose for which the corporation is

70. Id. at 1112.
71. Id.
72. See Carol B. Swanson, Juggling Shareholder Rights and Strike Suits in Derivative Litigation: The ALI Drops the Ball, 77 MINN. L. REV. 1339, 1340 (1993).
73. Id.
74. See generally Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919) (finding that Mr. Ford breached his fiduciary duties when he considered employee and community interests over shareholder interest).
75. Swanson, supra note 72, at 1341 (“These competing views have spawned a variety of complex procedural requirements and equally complex judicial dilemmas regarding derivative litigation.”).
76. Id.
77. Von Stange, supra note 27, at 462 (“Constituency statutes spur this dramatic shift in corporate governance.”).
being formed.”

Constituency statutes explicitly authorize corporate directors and officers to consider stakeholder interests when making corporate business decisions. Therefore, these statutes preserve the traditional idea that a corporation should maximize shareholder wealth while allowing corporations to consider non-shareholder interests. Given the number of successful corporations that have social purposes, it is not surprising that several states have enacted constituency statutes. Constituency statutes, however, are not uniform; they vary depending on the state and the corporation.

Constituency statutes developed after the “wake of the feeding frenzy atmosphere of numerous hostile takeovers” in the 1980s. To protect themselves, corporations began to amend their charters, or articles of incorporation, to allow shareholders to consider the interests of non-shareholder constituencies “should their corporation become subject to a change of control.” Since these statutes explicitly allow directors and officers of corporations to consider a range of other factors when making business decisions, including structural and operative decisions, they raise several concerns for advocates of shareholder primacy. Many believe that constituency statutes reject or will lead to the rejection of shareholder primacy. However, one of the biggest concerns with constituency statutes is their interpretation and enforcement.

78. See Stout, supra note 29, at 169. For example, Georgia has an opt-in constituency statute. It provides that a corporation’s articles of incorporation may set forth, “[a] provision that, in discharging the duties of their respective positions and in determining what is believed to be in the best interests of the corporation, the board of directors, committees of the board of directors, and individual directors, in addition to considering the effects of any action on the corporation or its shareholders, may consider the interests of the employees, customers, suppliers, and creditors of the corporation and its subsidiaries, the communities in which offices or other establishments of the corporation and its subsidiaries are located, and all other factors such directors consider pertinent; provided, however, that any such provision shall be deemed solely to grant discretionary authority to the directors and shall not be deemed to provide to any constituency any right to be considered.” GA. CODE. ANN. § 14-2-202(b)(5) (2010) (emphasis added).

79. Id.; see also Magaro, supra note 29, at 1150 (“Several states have implemented statutes allowing directors to consider these non-shareholder constituents’ interests in the corporate decision-making process.”).

80. See Eric W. Orts, Beyond Shareholders: Interpreting Corporate Constituency Statutes, 61 GEO. WASH. L. REV. 14, 16 (1992) (“[T]he statutes purport to expand the traditional view that directors of corporations have a duty to make business decisions primarily, if not exclusively, to maximize shareholders’ wealth by explicitly permitting consideration of non-shareholder interests.”); Rhee, supra note 28 (noting that some state statutes allow the board to consider the interests of constituents).

81. But cf. Budzynski, supra note 58, at 437 (“However, few courts and legislatures have imposed a duty to stakeholder constituencies on corporate directors or managers.”).

82. See Orts, supra note 80, at 26-27 (“The interests defined vary from state to state, but always include interests beyond shareholders, the primary group to whom directors must traditionally answer.”).

83. Von Stange, supra note 27, at 467; see also Licht, supra note 26, at 701.

84. Von Stange, supra note 27, at 467.

85. Id. at 480.

86. See Bainbridge, supra note 56, at 986.

87. Id. at 974.

88. Id.
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It is uncontested that constituency statutes significantly amend traditional corporate law. The issue is that they “offer surprisingly little guidance to directors and officers faced with corporate decisions or to courts faced with reviewing those decisions.” The statutes authorize the consideration of non-shareholder interests, but how are these provisions actually enforced procedurally and substantively? It is argued that they do not create new fiduciary duties to non-shareholders. A more in-depth analysis into specific state statutes, however, is necessary to shed light on these issues.

2. State Statutes Creating New Entities

Instead of, or in addition to, constituency statutes that authorize or allow corporations to consider the interests of stakeholders, some states have created new for-profit entities. Due to an increase in CSR, states are creating corporate entities that “consider[] both social and shareholders’ interests.” Specifically, these corporations “strive to create public benefit to the community and environment or even to a corporations’ employees, supply chain, and customers.” These new corporate forms include social purpose corporations and public benefit corporations. These “social corporations” still consider profit maximization, but “their social and environmental missions are at the core of their business models.”

While these new statutes provide an alternative legislative option for corporations that want to focus on social purposes in addition to the maximization of shareholder wealth, their relatively new existence raises many

89. Id.
90. Id.
91. Id. (“Rarely is any legislative effort made to provide substantive or procedural standards for applying the statutes.”).
92. Id. at 987. (“[T]he statutes should not be interpreted as creating new director fiduciary duties running to non-shareholder constituencies and the latter should not have standing under these statutes to seek judicial review of a director’s decision.”).
94. See Ho supra note 93.
95. One example of a state that has recently enacted a separate statute establishing and governing SPCs is Washington. See WASH. REV. CODE. ANN. § 23B.25.020. SPCs allow corporations to form with the express purpose to take social benefits and purposes into account. Id. (“Every corporation governed by this chapter must be organized to carry out its business purpose under RCW 23B.03.010 in a manner intended to promote positive short-term or long-term effects of, or minimize adverse short-term or long-term effects of, the corporation’s activities upon any or all of (1) the corporation’s employees, suppliers, or customers; (2) the local, state, national, or world community; or (3) the environment.”).
96. Delaware has also recently created public benefit corporations, in additional to its general corporate law. See DEL. CODE ANN. tit. 8, § 362(a).
97. Plerhoples, supra note 68, at 223.
unanswered questions. One criticism is that the subjugation of shareholder wealth maximization might give directors too much discretion. Another criticism revolves around the potential fiduciary duties that directors and officers of these corporations have towards stakeholders. This increase in fiduciary duties could increase corporate liability. These issues will heavily depend on the language of a specific state statute.

3. **A Closer Look at Amazon’s State of Incorporation: Delaware**

It is critical to look at the law in Amazon’s state of incorporation, Delaware, to understand what drives Amazon’s decision-making. Delaware has the most developed corporate law of any state and has been referred to as “the Mother Court[] of corporate law” because it has been responsible for deciding the “most major corporate law cases in the United States, and courts in other jurisdictions have often applied Delaware precedents to non-Delaware corporations.” Delaware has developed an “extensive body of precedent,” which explains why so many corporations choose to incorporate in Delaware.

To begin, Delaware has its general corporate law, which applies to regular corporations. It has been argued that Delaware law permits a deviation from shareholder primacy through private ordering, but this is not entirely clear. Pursuant to Delaware Code section 101(b), “a corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes, except as may otherwise be provided by the Constitution or other law of this State.” Just by the statute’s plain language, this provision appears to allow a corporation to have a social purpose that deviates from shareholder wealth maximization principles. However, this raises a statutory interpretation issue because case law in Delaware has held otherwise. Therefore, it appears

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98. *See* Gomez, supra note 93.
100. *See*, e.g., Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27, 84 (1996) (“The weight of the evidence presented in this article indicates that subjecting managers to a universal stakeholder fiduciary duty is not the most efficient form of corporate governance.”).
102. *Id. at* 1346–47.
103. *Id. at* 1347.
104. *See* Yosifon, supra note 29, at 462.
105. *Id. at* 462–63.
107. The Supreme Court of Delaware held that the controlling shareholders breached their fiduciary duties by trying to incorporate a policy that was not meant for the benefit of the shareholders and did not maximize economic value. See eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010) (“Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders.”); see also Rhee, *supra* note 28, at 1959-60.
that Delaware adheres to shareholder primacy, especially in regards to for-profit corporations. Because of this, Amazon cannot make corporate decisions that blatantly favor the interests of society over shareholder wealth maximization. However, Amazon may consider social purposes that will contribute to shareholder wealth.

In 2013, Delaware amended its laws to include a subchapter dedicated to public benefit corporations (“PBCs”). A PBC is a “for-profit corporation organized under and subject to the requirements of this chapter that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner.” A “public benefit” is defined as a “positive effect (or reduction of negative effects)” on persons, entities, and communities. This can include “effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature.” In terms of fiduciary duties, directors shall manage the corporation’s affairs in a manner that balances the interests of stockholders, the interests of those materially affected by the corporation’s conduct, and the public benefits stated in the corporation’s certificate of incorporation. However, directors will not owe stakeholders any fiduciary duties, and the corporation’s certificate may even provide that a disinterested failure to satisfy section 362 will not constitute a breach of the duty of loyalty. Under this statute, Amazon would have more leeway to take social considerations into account when selecting its location for HQ2. However, this code section does not apply to Amazon because it is not a PBC, but other corporations can consider using this statute to promote social purposes.

In summary, even with Delaware’s recent enactment of PBCs, the traditional fiduciary duties that directors and officers owe to the corporation and its shareholders have not changed. However, this new law in Delaware may evidence the state’s acceptance of the corporate practice of considering social issues in addition to shareholder wealth. Thus, a general corporation, such as Amazon may be able to take social purposes into account. Amazon, however, must exercise caution because its directors and officers still owe a duty to the corporation’s shareholders, not its stakeholders.

(comparing eBay Domestic Holdings, Inc. v. Newmark to Dodge v. Ford, in that both case advocate shareholder-centrism, but do not impose a duty to maximize profits).

108. See Yosifon, supra note 29, at 480.
109. DEL. CODE ANN. tit. 8, § 362(a).
110. Id. § 362(b).
111. Id.
112. Id. § 365(a).
113. Id. § 365(c).
D. Corporate Governance and Amazon’s HQ2 Decision

After analyzing the competing models of corporate governance, Amazon’s corporate decisions regarding its search for the location of HQ2 raise several important questions. Critics believe that HQ2’s location is a race to the bottom—an attempt to undercut wages and living standards for employees. Conversely, proponents allege it is contributing to Amazon’s double bottom line—the attainment of positive social impacts in addition to profit maximization. As a for-profit corporation, Amazon will seek a location in which it can maximize profits. It may also seek a location in which it can further its social purpose of supporting the LGBT community inside and outside of Amazon. Amazon should consider internal organizational behavior and the impact that a new headquarters will have on existing employees who will relocate to HQ2, new employees, and the surrounding community. Additionally, Amazon should consider the effect the surrounding community may have on its company culture, as new employees embedded in the new location bring their community’s values to the company.

As discussed above, achieving corporate sustainability is becoming more prominent in large public corporations. Given that Amazon is a Delaware public corporation, the first question that must be addressed is whether it can incorporate social purposes and non-shareholder interests in its search for HQ2. The short answer is yes. However, there are limitations. At the end of the day, Amazon is a for-profit, public corporation that owes a duty to its investors and owners. It is unclear to what extent corporations may put non-shareholder interests over those of its shareholders. However, that does not mean Amazon must make decisions that focus only on profit maximization, because fostering social purposes may also contribute to profitability. This is clearly illustrated by the recent influx of public corporations that have begun to invest “heavily in efforts to manage their impacts on society and the environment.”114 If a corporation is publicly committed to specific social purposes, it can be inferred that its shareholders are well aware of these considerations, and perhaps even considered these social purposes when deciding to invest in the corporation.

Amazon has been very transparent in its search for HQ2’s location by inviting cities to explain why they would be the prime location for HQ2. This has sparked an inquiry into the real motives behind Amazon’s actions. However, it is important to note that what a corporation believes is beneficial to itself and to society depends on the lens the corporation is looking through. What is beneficial to one corporation may not be beneficial to another. There are several American private and public companies that are known for their religious and

114. George Serafeim et al., The Role of the Corporation in Society: Implications for Investors, CALVERT (Sept. 2015) https://www.calvert.com/includes/loadDocument.php?embed&fn=24319.pdf&dt=fundPDFs (“They are vocal about social and environmental issues, they commit more and more resources to address these concerns, and they are increasingly transparent about their impact on society and the environment.”).
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conservative beliefs, including Hobby Lobby, Chick-Fil-A, In-N-Out Burger, Alaskan Airlines, and Tyson Foods, Inc. For example, Hobby Lobby’s first mission statement was “Honoring the Lord in all we do by operating the company in a manner consistent with biblical principles.” While Hobby Lobby is a private company, there are also public companies that express and adhere to religious beliefs. The founder of Tyson Foods, Inc. publicly speaks about his Christian beliefs and how Tyson Foods, Inc. strives to be a “faith-friendly company.”

Another example of a conservative public corporation is Alaska Air Group, which provides religious notecards with verses from the Old Testament when serving meals to customers.

It is evident that transparency plays a significant role in a corporation’s success. The companies discussed above are notable examples of private and public companies that are profitable despite their sustainability initiatives of publicly embracing religious beliefs. Corporations can still thrive regardless of whether they are viewed as more liberal or conservative. This explains why Amazon has been publicly announcing its economic, corporate, and social goals for HQ2. But, considering the different social purposes and factors Amazon is trying to achieve with HQ2, will it harm Amazon financially if it picks a location that is not the most beneficial for all of its purposes and goals? What if Amazon picks a state that is more liberal or that does not offer employee protections for LGBT individuals? How would that decision impact its customer and employee relationships?

Amazon communicates with its shareholders to ensure that investors are aware of the corporate and social purposes behind all its future decisions, including the location of HQ2. For example, in Amazon’s public 1997 Letter to Shareholders, Amazon explicitly stated, “a fundamental measure of our success will be the shareholder value we create over the long term.” Amazon notified its shareholders that it makes decisions and weighs tradeoffs differently than other companies. The letter explains that because Amazon makes bold investment decisions, Amazon will share its strategic thought process with its shareholders so that they may evaluate its decisions. More importantly, Amazon states: “[w]e will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options


117. Id.


119. Id.

120. Id.
rather than cash.”

This is directly applicable to Amazon’s search for HQ2’s location and the impact it will have on its future employees and current shareholders, and emphasizes how Amazon should consider cultural fit and embeddedness. Despite this letter being written in 1997, Amazon still prioritizes its customers and employees, focusing on long-term profit maximization through bold investment decisions. Currently, Amazon’s website states, “[w]e are firm believers that the long-term interests of shareholders are tightly linked to the interests of our customers. If we do our jobs right, today’s customers will buy more tomorrow, we’ll add more customers in the process, and it will add up to more cash flow and more long-term value for our shareholders.”

When Amazon launched in 1995, its mission was “to be Earth’s most customer-centric company, where customers can find and discover anything they might want to buy online, and endeavors to offer its customers the lowest possible prices.” One of Amazon’s many goals is to invest in the local communities where it operates. For example, Amazon has donated to hundreds of charitable organizations “that support people of all backgrounds and income levels.” Amazon is also committed to being sustainable by striving to “seek diverse builders from all walks of life” and encourages its employees to “bring their authentic, original, and best selves to work.” In doing so, Amazon sponsors several Affinity Groups, including: “glamazon,” “Asians@Amazon,” “Latinos@Amazon” and many more. All of these goals are explicitly set forth in Amazon’s public statement regarding its search for HQ2’s location.

Considering the above, it is evident that Amazon has incorporated sustainability initiatives into its corporate governance structure, while still adhering to a form of shareholder primacy. Amazon believes that incorporating social purposes will be beneficial to the corporation in the long run, increasing its customer base, thus maximizing shareholder profits. Amazon understands this approach may be riskier, but Amazon is willing to take this risk because of the long-term benefits that will follow. Therefore, in its search for HQ2’s location, Amazon should find the location that will best strengthen the relationship between its employees and the surrounding community. This will increase embeddedness inside and outside Amazon, which will increase job satisfaction, thus increasing productivity, positive decision-making, and product

121. Id.
124. Amazon HQ2, supra note 2.
125. Diversity at Amazon, supra note 14.
126. Id. (listing several other Affinity Groups that are sponsored by Amazon).
127. Amazon HQ2, supra note 2.
development. In turn, it can be inferred that this will increase profits. Thus, embeddedness may create a link between social purpose and profit. With this in mind, an analysis of the social impacts Amazon will have on the city it chooses will be analyzed next.

Critics of HQ2 have pointed out that it is a “race to the bottom.” For example, opponents have asked elected officials “to pledge to reject tax giveaways and monetary incentives to lure Amazon to their cities.” Several cities are offering “immense incentive packages,” which have been deemed by critics to be wasteful and counterproductive. On the other hand, proponents of HQ2 believe that these incentives will be beneficial in the long-run, as they will benefit the city as a whole, not just Amazon, which is the same rationale behind Amazon’s corporate strategy.

While Amazon has immensely expanded in recent years and provided thousands of jobs, critics point out the perceived negative impact hosting Amazon has had on Seattle, including an increased cost of living. Critics suggest that Amazon’s decisions to publicize HQ2 is nothing more than a brilliant corporate strategy underlined with ulterior motives. Is it possible that Amazon is being too transparent in its search for HQ2’s location? For example, Amazon could receive backlash for choosing a location that does not cater to one of its request for proposal factors, or that does not offer employee protections for LGBT individuals. This has already been noted by researchers who have analyzed the cities that did not become one of Amazon’s top twenty finalists.

131. Id.
133. Cohen, supra note 130 (“Many experts never believed the HQ2 competition was truly open, insisting there were only a few places that could meet the company’s stated requirements, particularly if it wanted to diversify by opening up a headquarters away from the West Coast.”).
134. See Nisen, supra note 115 (discussing how Chick-Fil-A provoked a “firestorm” of criticism after its COO, Dan Cathy, made controversial statements regarding gay marriage and the biblical definition of a family unit).
135. See Wingfield, supra note 9.
In fact, Amazon has already been receiving backlash regarding how it has created a bidding war between different cities.\textsuperscript{136}

Despite the critics of HQ2, proponents have realized that Amazon is not your average corporation. Rather, “Amazon has been unique in its ability to generate growth and jobs.”\textsuperscript{137} While some may view the search for HQ2 negatively, Amazon has the power to create over 50,000 new jobs, which will have a positive impact on the surrounding community. For example, the presence of Amazon in Seattle helped decrease the unemployment rate from 9\% in 2010 to 3.7\% today.\textsuperscript{138} Additionally, Amazon makes other social contributions in Seattle, including providing shelter for more than 350 families through a local partnership with Mary’s Place and paying millions of dollars to Seattle for affordable housing.\textsuperscript{139}

These examples relate back to the idea of the lens a corporation is looking through. Amazon has stated to its shareholders that it makes bold investment decisions and weighs tradeoffs differently than any other company. While some corporations and critics may focus only on the potential drawbacks of bringing Amazon’s HQ2 into a new city, Amazon sees it as an opportunity to grow and diversify as a corporation by bringing in new employees and expanding its customer base. However, Amazon should consider how embeddedness could affect its social purposes. For instance, the social purpose of focus in this Article is LGBT rights. If Amazon wishes to promote LGBT rights in the location of HQ2, it may have difficulties if HQ2’s location does not share the same passion for LGBT rights. New employees may not become involved in the glmamazon affinity group, and without employees to promote this group, Amazon may find itself ineffective in promoting LGBT rights in this new community.

In summary, Amazon’s public search for HQ2’s location has placed its corporate structure and social purposes into the spotlight. By doing so, Amazon has opened the door to an analysis of its social and corporate motives and how they will be impacted by the geographic location of HQ2. By choosing a location for HQ2 that has a similar culture to HQ1, Amazon can promote embeddedness within Amazon and in the surrounding community, which could positively impact Amazon’s profits. However, if Amazon chooses a culturally distinct location, it could impede its social purposes. To better understand the effects of embeddedness, this Article will next discuss the concept of embeddedness and possible outcomes of building HQ2 in a location that is culturally distinct from HQ1.

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\textsuperscript{137} \textit{Id.}
\textsuperscript{138} \textit{Id.}
\textsuperscript{139} \textit{Id.}
\end{flushright}
III. EMBEDDEDNESS AND SOCIAL STRUCTURE

The relationship between several factors significantly affects the internal organization and social structure of corporations. The most pressing factors include the individual backgrounds and identities of employees, as well as the societal influences that surround the corporation’s geographic location. Corporations are comprised of various races, ethnicities, genders, sexual orientations, religions and other commonalities. As a result, the diverse framework of individuals within a specific corporation is fragile and the ability of each individual to safely and productively sustain their identities within their workplace is key to a corporation’s success. HQ2’s regional location may have unintended consequences on an organization, its identity and its employees. Therefore, it is imperative that further empirical research be conducted in connection with quaternary location research—the study of economic geography. Because Amazon is looking at locations for HQ2 that are culturally distinct from HQ1, yet strives to hire employees with diverse backgrounds including its initiative to hire LGBT employees, Amazon may find itself in the middle of a culture clash that could affect its success. To analyze the impact a specific geographic region can have on an organization, and the impact the organization can have on the region, this Part will discuss embeddedness, identity, and social network structures. These concepts are particularly important when picking a location for a second headquarters, because two headquarters in distinct geographic locations might create different (and potentially competing) embedded corporate cultures, organizational identities, employee identities, and social networks and structures. Given the lack of empirical research in this area, this section is used as a proxy to try and simulate potential issues that may arise as a result of embeddedness, cultural identities, and social structure.

A. Embeddedness

Organizations are “connected by networks of personal relations.” As a result, implicit corporate culture, social networks, and individual behavior significantly influence social structure and decision-making within organizations. The relationship between these factors has generally evolved into

140. The term “quaternary” was introduced by J. Gottmann to refer to elite, information-based activities involving the direction of production and distribution. See Rice & Lyons, supra note 11, at 322.
141. Id. at 321 (defining the field of quaternary location studies to include “the past advancements, current challenges, and potential applications linked to the investigation of the location of headquarters and related business decision-making activities. . .”).
142. Diversity at Amazon, supra note 14.
a concept referred to as "embeddedness." The term itself originally expressed “the idea that the economy is not autonomous, as it must be in economic theory, but subordinated to politics, religion, and social relations.” Therefore, it follows that social relations become embedded in the economic system. The question then becomes: to what extent are organizations constrained by these ongoing embedded social relations?

Since the concept was first introduced, different types of embeddedness have been researched and applied to sociology and business, as the behavior of individuals is derived from economic sociology. For example, where employees are from plays a significant role in how they will perceive other social relationships within their organization. As a result, one aspect of embeddedness addresses the “internal externalities” that individuals learn from their upbringings and how they apply them to people, places, and things. In turn, these psychological forces enmesh employees into their companies. Insistence that economic behavior is inescapably embedded in networks of interpersonal relationships plays off of the idea that societal differences highly affect the outcome of an operation. When a firm makes an economic decision, it is based largely on the sentiments of those in decision-making roles. Consider the following excerpt and example of embeddedness provided by Dennis Wrong, a prominent American sociologist:

It is frequently the task of the sociologist to call attention to the intensity with which men desire and strive for the good opinion of their immediate associates in a variety of situations, particularly those where received theories or ideologies have unduly emphasized other motives... Thus, sociologists have shown that factory workers are more sensitive to the attitudes of their fellow workers than to purely economic incentives... It is certainly not my intention to criticize the findings of such studies. My objection is that... [although sociologists have criticized past efforts to single out one fundamental motive in human conduct, the desire to achieve a favorable self-image by winning approval from others frequently occupies such a position in their own thinking.]

As mentioned above, the concept of embeddedness has been applied to several different areas, including non-market forces, corporate elites, and corporate sustainability. This Article, however, specifically addresses “job embeddedness” and “social embeddedness” and how both apply to the social

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144. See Granovetter, supra note 143, at 481.
145. Id.
146. See Granovetter, supra note 143, at 481.
147. Id. at 482 (stating that the argument of embeddedness is that the behavior and institutions to be analyzed are constrained by these ongoing social relationships and therefore, to construe them as independent would be entirely misleading).
148. This term has been coined by Ryan Teschner. This term refers to the external expression of a person’s internal processes based on that person’s upbringing and life experiences.
149. See Wheeler et al., supra note 128, at E245.
151. Granovetter, supra note 147, at 483 (citing Dennis Wrong, The Oversocialized Conception of Man in Modern Sociology, 26 Am. Soc. Rev. 183, 188–89 (1961)).
structure and internal organization of a corporation as well as corporate decision making.

First, job embeddedness evaluates the social forces that interweave employees into their companies and how these forces affect internal organization, such as employee attitude and job satisfaction. Job embeddedness theorists have also recognized how community sacrifices can prove embedding. "That is, people [] stay where they live to avoid giving up family friendly neighborhoods, even 'football tickets or ballet seats that took 20 years of seniority to obtain,'" These examples of embedded influences stem from the community and outside of the workplace, including familial responsibilities and personal conflicts, known as “off-the-job embeddedness.” Thus, an employee’s family may be embedded in a geographic area (e.g., spouse owns a local business, teenagers attend magnet schools), thereby embedding the employee [] and conversely embedding the community into the organization. Though these factors may seem trivial at first glance, they bear a significant relationship to the geographic location of an employee’s organization and will affect how an employee acts within his or her organization.

Second, social embeddedness influences organizations as well. It may be no surprise that societal differences highly affect and influence social structure, especially in the form of social networking in organizations. Sociologist Mark Granovetter posits that social structure in the form of social networks affects economic outcomes. Granovetter refers to this relationship as “social embeddedness,” which is “the extent to which economic action is linked to or depends on action or institutions that are non-economic in content, goals or processes.” For example, it is evident that social networks impact and facilitate the “flow and quality of information.” This creates an interdependence between the various networks of individuals. These networks influence the organization and its employees and directly applies to corporate decision making. For example, Granovetter discusses a core principle known as “the strength of weak ties.” According to this principle, an individual’s close

152. Wheeler et al., supra note 128, at E245.
154. Id.
155. Id. at 644.
156. Id. (“Such ‘embeddedness by proxy’ (or ‘family embeddedness in community’; FEC) should not be conflated with other extra familial community forces for people may remain to avoid disrupting spousal careers or children’s schooling, but not feel community attachment.”).
158. Id. at 35.
159. Id. at 33.
160. Id. at 37.
161. Id. at 34.
friends know one another, which in turn forms a closely-knit clique. This remains true within organizations, even though close friends may be more interested than work acquaintances. Individuals can also be strongly connected to other cliques through their weak ties rather than their strong ties. As a result, these “weak ties” will influence the end product of a company and may impact the internal organization, its operations, and its products. Some sociologists tend not to research in this area, as “[t]hey have implicitly accepted the presumption of economists that ‘market processes’ are not suitable objects of sociological study because social relations play only a frictional and disruptive role, not a central one, in modern societies.”

This can be argued two ways. First, one could argue that with modernization, effect of embeddedness on economies and organizations has diminished. However, one could also argue that, in current times, it is easier to influence market processes or organizations through technology and the high speed at which information travels within different social networks. With the entrenchment of social media in today’s society, some would lean towards the second argument due to the strong correlation of negative publicity to market values. For instance, Tesla had its worst day of trading since 2016 after Elon Musk took a puff of marijuana on a podcast and after his chief accountant quit.

Further, one must also investigate the motives of employees. This must be done because “the corporate governance question of how the structure of firms will affect productivity and profit cannot be reduced to the argument that division managers should stay out of central management, given their likely opportunism on behalf of their own units, while central management should not meddle in division operating procedures, in which they would have little competency or knowledge.”

While embedded in those division level roles, one cannot assume that the employees will only act in their best interest.

The concept of embeddedness and social networks are central to Amazon’s search for HQ2’s location due to the way these concepts can affect productivity and decision making within an organization. Weber’s Theory of the Locations of Industries laid the foundation for headquarters location studies by developing the concept of a “central organizing stratum,” defined as “all those who are engaged

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162. Id.
163. Id.
164. Id.
165. Id.
166. Granovetter, supra note 143, at 504.
167. Id. 482–83.
168. Id.
170. Granovetter, supra note 157, at 43.
in the general organization and management of the exchange of goods, whether material or immaterial.”¹⁷¹ Corporate headquarters are the most elite of economic venues, encompassing activities like strategy creation and high-level business decisions. When a company such as Amazon seeks a new location for its headquarters, there is a substantial amount of data-driven decision making that must take place. Depending on the geographic region, HQ2’s future employees will become enmeshed in the company and significantly impact, as well as create, the social structure and internal organization of HQ2. Notably, “[a]s the study of quaternary phenomena has developed . . . linkage to contemporary corporate culture and embeddedness debates transcend a purely positivistic approach.”¹⁷² These links to culture are exactly what this Article seeks to explore and advocate for future empirical studies.

It has been noted that in “the social realm, economic geographers have long recognized that firm location [is] the result of a decision-making process rooted in the preferences, perceptions, and social and cultural networks of decision makers.”¹⁷³ As discussed above, off-the-job embeddedness—which means “the cumulative forces of an individual’s family, community, and non-work activities which bind an individual to his or her current location”¹⁷⁴—can be just as important as on-the-job embeddedness. Additionally, as further explained in Section C below, the future employees of HQ2 will play a significant role when it comes to making decisions within the corporation. As stated by Murray Rice and Donald Lyons, “[t]he concept of embeddedness, linked to personal relations, trust, and formal and informal deal-making, further emphasizes the importance of the social dimension as it impacts the activities of the firm.”¹⁷⁵ Therefore, the embedded cultural differences between HQ1 and HQ2 will come into play once Amazon decides the location of HQ2.

B. Potential Differences between HQ1 and HQ2

To fully appreciate how cultural differences between Amazon and the potential location of HQ2 could affect the company, this article will focus on the differences between Seattle, Washington, where HQ1 is located, and Atlanta, Georgia, one of the finalists for HQ2. Until further empirical evidence can be conducted on this issue, this section analyzes different state employment discrimination statutes and the treatment of LGBT issues. These references serve as a proxy to conduct a cursory analysis of the potential issues relating to cultural embeddedness based on various geographic regions and the interaction of

¹⁷². Rice & Lyons, supra note 11, at 321.
¹⁷³. Id. at 324.
¹⁷⁵. See Rice & Lyons, supra note 11, at 324-25.
employee identities within those regions. Each one of these statistics will come directly into play when Amazon chooses a location for HQ2, and therefore must be critically analyzed.176

1. Employment Discrimination Protection

One of the most important differences between Georgia and Washington is the employment discrimination protection each state provides. As discussed above, Amazon has made it clear that it values its employees and inclusion in its workplace. Because of this, Amazon should consider a state’s employment discrimination protection, or lack thereof.177

Under Georgia law, employers cannot discriminate based on age178 and disability.179 Additionally, employers must provide equal pay, regardless of sex.180 By contrast, under Washington law, employers cannot discriminate based

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176. The social and political contrast between these two states provides much fodder for the inquiry into how cultural differences between a company and its new headquarters location can affect the company. See e.g., Josh Green, Among Amazon HQ2 Cities, National Voters Ranked Atlanta No. 2 Most Appealing, CURBED ATLANTA (July 24, 2018, 3:54 PM), https://atlanta.curbed.com/2018/7/24/17608410/amazon-hq2-finalists-geekwire-atlanta-jeff-bezos.

177. State nondiscrimination laws are supplemented by Federal employment discrimination laws, which prohibit discrimination based on race, color, religion, national origin, sex, pregnancy, disability, and genetic information. 42 U.S.C. § 2000e-2 (Title VII); Americans with Disabilities Act of 1990, 42 U.S.C. § 12101 et seq. The Pregnancy Discrimination Act of 1978, which amended Title VII, requires employers to treat women the same, regardless of “pregnancy, child birth, or related medical conditions.” 42 U.S.C. § 2000e-2. The Genetic Information Nondiscrimination Act of 2008 prohibits employers from “fail[ing] or refus[ing] to hire, or to discharge, any employee, or otherwise to discriminate against any employee with respect to the compensation, terms, conditions, or privileges of employment of the employee, because of genetic information with respect to the employee.” Id. § 2000ff-1(a)(1) It also prohibits employers from requiring genetic testing. Id. § 2000ff-1(b).

178. GA. CODE ANN. § 34-1-2 (2018). Employers are prohibited from discriminating based on age only for the ages forty to seventy. Id. In Washington, there is no cap at age seventy. WASH. REV. CODE § 49.44.090 (2018). However, in Georgia, a violation of the age antidiscrimination statute is a misdemeanor. GA. CODE ANN. § 34-1-2(b). In Washington, it is considered an “unfair practice,” but not a misdemeanor. WASH. REV. CODE § 49.44.090.

179. GA. CODE ANN. §§ 34-6A-2–6A-4. Georgia’s disability statute specifically provides that employers may reject an applicant due to the applicant’s “communicable disease, either carried by or afflicting the applicant.” Id. § 34-6A-3. This is in sharp contrast to Washington’s prohibition of HIV or hepatitis C testing “as a condition of hiring, promotion, or continued employment” and discrimination based on HIV or hepatitis C status. WASH. REV. CODE § 49.60.172(1).

180. GA. CODE ANN. § 34-5-3.
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on age,\textsuperscript{181} creed,\textsuperscript{182} disability,\textsuperscript{183} gender identity,\textsuperscript{184} marital status,\textsuperscript{185} military status,\textsuperscript{186} HIV status, hepatitis C status,\textsuperscript{187} national origin,\textsuperscript{188} pregnancy,\textsuperscript{189} race, sex, and sexual orientation.\textsuperscript{190} Employers also must provide equal pay, regardless of gender.\textsuperscript{191} Additionally, Washington employers cannot require employees to submit genetic,\textsuperscript{192} HIV, or hepatitis C tests.\textsuperscript{193} Lastly, Washington regulates

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\item [\textsuperscript{181}] WASH. REV. CODE §§ 49.60.180, 49.44.090. Like in Georgia, the age at which employers cannot discriminate begins at forty. Id. § 49.44.090. However, unlike Georgia, there is no cap at age seventy. Thus, a misdemeanor to discriminate based on age, though, so in that respect, Georgia affords more protection against age discrimination.
\item [\textsuperscript{182}] Id. § 49.60.180.
\item [\textsuperscript{183}] Id. This includes discrimination due to use of a trained service animal. Id. The Washington Code also provides further protection to those with service animals by establishing an extra penalty, in addition to any other criminal or civil remedies or penalties, if such animal is maliciously or negligently injured or killed. Id. § 49.60.370 (providing a fine of $1,000, as well as reasonable attorney’s fees and costs if civil action is pursued). While this is not directly related to employment, it is something employers should consider. Not only are employers prohibited from discriminating due to the use of a service animal, employers must also be aware of the animal’s safety.
\item [\textsuperscript{184}] WASH. REV. CODE § 49.60.180. While this statute does not specifically list “gender identity” as one of the protected classes, the code defines “sexual orientation” as including “gender expression or identity.” Id. § 49.60.040. The State of Washington provides a comprehensive guide on gender identity and sexual orientation discrimination for employers on their website. See generally WASH. STATE HUMAN RIGHTS COMM’N, GUIDE TO SEXUAL ORIENTATION AND GENDER IDENTITY AND THE WASHINGTON STATE LAW AGAINST DISCRIMINATION (2014), https://www.hum.wa.gov/media/dynamic/files/207_Updated%20SO%20GI%20Guide.pdf (providing guidelines on Washington’s sexual orientation and gender identity antidiscrimination laws).
\item [\textsuperscript{185}] WASH. REV. CODE § 49.60.180.
\item [\textsuperscript{186}] Id. Both Georgia and Washington allow for a veteran preference in hiring. GA. CODE ANN. § 34-1-8; WASH. REV. CODE § 73.16.110. However, only Washington specifically provides that employers cannot discriminate based on “honorary discharged veteran or military status.” WASH. REV. CODE § 49.60.180. Both Washington and Georgia define veteran as someone who was honorably discharged from the military. GA. CODE ANN. § 34-1-8; WASH. REV. CODE § 73.16.110.
\item [\textsuperscript{187}] WASH. REV. CODE § 49.60.172.
\item [\textsuperscript{188}] Id. § 49.60.180.
\item [\textsuperscript{189}] Id. § 43.10.005. Even though employers in Georgia cannot discriminate on the basis of pregnancy due to Title VII, Washington law provides much more protection to pregnant women. In Washington, not only can employers not discriminate against pregnant women, they also must provide reasonable accommodation for pregnant women. These accommodations include job restructuring, such as part-time work schedules, “[s]cheduling flexibility for prenatal visits,” “[p]roviding for a temporary transfer to a less strenuous or hazardous position,” and any other reasonable accommodation the employee requests, based on the employer’s consultation with the employee’s physician and the department of labor and industries. Id. (1)(c). An employer cannot require a pregnant employee to go on leave if another reasonable accommodation is available. Id. (2)(d). These are just some of the examples of the protections Washington law has in place for pregnant women.
\item [\textsuperscript{190}] Id. § 49.60.180.
\item [\textsuperscript{191}] Id. § 49.002.175. In Washington, this law carries more weight than the equivalent law in Georgia, because in Washington, it is a misdemeanor to violate this provision. Id. In Georgia, violators of the equal pay law will receive a fine not to exceed $100, but the statute does not classify the violation as a misdemeanor. GA. CODE ANN. § 34-5-3.
\item [\textsuperscript{192}] WASH. REV. CODE § 49.44.180. This statute does not provide as much protection as the Genetic Information Nondiscrimination Act of 2008, but it was enacted four years prior to the federal act. S.B. NO. 6180, 58th Leg., Reg. Sess. (Wash. 2004). The Washington law only prohibits employers from requiring genetic testing, while the federal law also prohibits discrimination based on genetic information. 42 U.S.C § 2000ff-1 (2012).
\item [\textsuperscript{193}] WASH. REV. CODE § 49.60.172(1).
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credit\textsuperscript{194} and criminal background checks and protects those with a criminal history.\textsuperscript{195}

Washington provides wide liberal and political protection for its employees. For example, protecting employees from sexual orientation and gender identity discrimination is more in line with a liberal than a conservative viewpoint. This is evidenced by the fact that red states were some of the final states to legalize same-sex marriage, and only after being required to do so by the U.S. Supreme Court.\textsuperscript{196} The Supreme Court has not yet acknowledged sexual orientation as a protected class, so states that proscribe discrimination based on sexual orientation, like Washington, should be considered progressive.

Another example of Washington’s progressive antidiscrimination laws would be its prohibition of discrimination based on marital status. Red states tend to have traditional Christian values, which means non-married cohabitation is generally frowned upon. Georgia is no exception, and its cultural values are reflected by its laws. Thus, Georgia does not safeguard against marital status discrimination. By contrast, blue states tend to value inclusion, which means they want to ensure everyone is treated equally, irrespective of adherence to traditional Christian values. This is reflected in Washington’s law prohibiting discrimination based on marital status.

Both Washington and Georgia allow their cities to create local nondiscrimination laws.\textsuperscript{197} In Georgia, only Atlanta has such local laws.\textsuperscript{198} Atlanta’s antidiscrimination laws provide protection for sexual orientation, gender identity, race, color, creed, religion, sex, marital status, parent status, familial status, national origin, age, and disability.\textsuperscript{199} Of these, sexual orientation, gender identity, marital status, parental status, familial status, and creed go

\textsuperscript{194}.\textsuperscript{196} Id. \S 19.182.020(2). In addition to certain disclosure requirements, Washington law does not allow employers to inquire into a person’s creditworthiness for employment purposes, unless it is substantially job related or required by law. Id. \S 19.182.020(2)(c). This law makes Washington one of only thirteen states that restrict an employer’s use of credit history for employment purposes. MICROBILT, STATE LAWS LIMITING USE OF CREDIT INFORMATION FOR EMPLOYMENT 1 (2017), http://www.microbilt.com/Cms_Data/Contents/Microbilt/Media/Docs/MicroBilt-State-Laws-Limiting-Use-of-Credit-Information-For-Employment-Version-1-1-03-01-17.pdf. In addition to these thirteen states, New York City and Washington, D.C. provide credit history protection for employees. Id.

\textsuperscript{195}.\textsuperscript{197} WASH. REV. CODE \S 49.001.002. For example, Washington employers cannot inquire into an applicant’s criminal history until after the employer has determined that the applicant is qualified for the position. Id. \S 49.001.002(1).


\textsuperscript{199}. ATLANTA, GA., ORDINANCES CODE ANN. \S\S 94-111, 94-112 (2018).
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beyond Federal requirements. This illustrates that in the context of employment protection, Atlanta is more comparable to Washington than it is to the rest of Georgia. The similarities between Atlanta and Washington are encouraging for Amazon because they could induce organizational embeddedness with its new employees. One way in which employees become organizationally embedded is by sharing the same values as the corporation.\textsuperscript{200} By having multiple headquarters in locations that share similar cultures with each other and are in line with the company’s own identity, Amazon will attract people in these locations who share such values. The culture that Atlanta, Washington, and Amazon seem to embrace is one of inclusiveness, as evidenced by the extensive range of antidiscrimination laws in Washington and Atlanta and the antidiscrimination policies within Amazon.\textsuperscript{201} By strategically locating in areas that share its values, Amazon can easily foster organizational embeddedness, which will help Amazon retain valuable employees.\textsuperscript{202}

2. LGBT Rights

Because Amazon is especially invested in fostering the LGBT community inside and outside of the organization, differences in LGBT rights in Washington and Georgia are critical. If Georgia has fewer LGBT protections, or even discriminates against the LGBT community, this could affect job and off-the-job embeddedness for any LGBT individuals who work for Amazon.

To begin, these two states have handled same-sex marriage differently. Washington legalized same-sex marriage in 2012, three years before the Supreme Court decided \textit{Obergefell v. Hodges}.\textsuperscript{203} By contrast, Georgia did not legalize same-sex marriage until forced by the Supreme Court.\textsuperscript{204}

Additionally, even though Georgia has legalized same-sex marriage, it has actively fought against equal rights for married same-sex couples. For example, Georgia is attempting to pass a law that will effectively prevent same-sex couples from adopting children.\textsuperscript{205} On the other hand, Washington has made it easier for

\begin{itemize}
\item \textsuperscript{200} Kiazad et al., supra note 153, at 643.
\item \textsuperscript{201} Diversity at Amazon, supra note 14 ("Amazon is an Equal Opportunity-Affirmative Action Employer—Minority / Female / Disability / Veteran / Gender Identity / Sexual Orientation.").
\item \textsuperscript{202} Kiazad et al., supra note 153, at 649 ("O rganizational embeddedness should be the strongest (negative) predictor of turnover. As turnover involves leaving the organization (rather than job or occupation per se), resources derived from the organizational context (i.e. organization fit, links, and sacrifices) should be most subject to a primacy-of-loss effect." (emphasis added)).
\item \textsuperscript{203} 135 S. Ct. 2584 (2015) (legalizing same-sex marriage across the country); see also Tritt, supra note 17 (discussing the differences in how red and blue states treat LGBT issues, including Washington and Georgia).
\item \textsuperscript{204} Tritt, supra note 17; Same-Sex Marriage State by State, supra note 196.
\item \textsuperscript{205} S.B. 375, 2017-2018 Reg. Sess. (Ga. 2018) (allowing adoption agencies to deny couples for religious reasons); Tritt, supra note 17. Georgia is also seeking to pass a Religious Freedom Bill, S.B. 233, 2017-2018 Reg. Sess. (Ga. 2017). Some groups believe this Bill will allow LGBT discrimination throughout the state. Anti-LGBT License to Discriminate Bill (SB 233) Introduced in Georgia, GA. UNITES
\end{itemize}
same-sex couples to have children by making its Assisted Reproductive Technology ("ART") and marital presumption\(^{206}\) statutes gender-neutral to encourage the use of ART by same-sex couples.\(^{207}\) Georgia has not done either of these things to support same-sex couples.\(^{208}\)

These differences reveal a sharp contrast between how Washington and Georgia support their LGBT communities. While Washington supports LGBT rights, Georgia fights them. The state’s laws reflect the voting population, so the people of Georgia likely share these anti-LGBT sentiments. If Amazon builds HQ2 in Georgia, this anti-LGBT culture could negatively impact Amazon’s LGBT employees, causing them to become less embedded in their jobs and the surrounding area.

\(\text{C. Embeddedness Applied to Amazon}\)

This section explores the possible repercussions of building HQ2 in a different location from HQ1. Amazon has a huge decision looming, and it is imperative that it ruminate all aspects of the process, regardless of the driving factors of its decision. Amazon must put a plan in place to address each aspect of the process. In the end, embeddedness may play a more influential role in the future success of the company than financial savings on salary or site.

Georgia has limited statewide protections for LGBT people and is far behind other states with other discriminative categories, such as age, disability, compensation, gender, genetic information, harassment, national origin, pregnancy, race, religion, retaliation, sex and sexual harassment.\(^{209}\) This disparity is critical because Amazon currently asserts itself as a progressive company on its “Diversity at Amazon” webpage, stating, “[a]t Amazon, we pride ourselves on our peculiar culture. We honor and respect the differences inherent in each Amazonian, and we seek to include those perspectives as we develop new products and services for our customers around the world.”\(^{210}\) Taking it one step further, Amazon’s headquarters is located in Seattle, Washington.

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\(^{206}\) The traditional marital presumption rule presumes that a child born to the wife is the child of the husband. June Carbone & Naomi Cahn, The Past, Present and Future of the Marital Presumption, in THE INTERNATIONAL SURVEY OF FAMILY LAW 387, 387 (Bill Atkin ed., 2013); Tritt, supra note 17. This traditional presumption poses problems for same-sex couples because there may be two husbands and no wife, or two wives and no husband, rendering the presumption inapplicable.

\(^{207}\) Memorandum from Courtney Joslin, Reporter, on the Marital Presumption to the Drafting Committee, UPA Revisions 1 nn.2, 3 (Jan. 31, 2016), http://www.uniformlaws.org/shared/docs/parentage/2016jan31_AUPA_Memo_Marital%20Presumption_%20Revisions_Joslin.pdf; Tritt, supra note 17.

\(^{208}\) See Tritt, supra note 17.

\(^{209}\) See supra Part II.B.

\(^{210}\) Diversity at Amazon, supra note 14.
Employees in Washington are accustomed to a broader range of employment discrimination protections than employees in Georgia.

Based on these supplementary protections, Amazon is able to widen its potential employee base, creating a more diverse workforce. Substantial research has been conducted on the benefits of diversity in the workforce, but when Red meets Blue, there are not always smooth transitions. Likewise, international cases of retail failure are highly documented. One notable example is Wal-Mart’s experience in Germany that led to its divestiture in 2006. This was “largely attributed to a lack of understanding of the competitive discounting inherent in the German retail market, strongly entrenched supplier relationships and the subsequent psychology of the customer.” This exemplifies that a company entering new waters must fully understand the market. Similarly, a headquarters entrenched in west coast ideology may struggle to find its feet in the Deep South.

Consequently, Amazon should be aware that ideological difference that parallel location can lead to issues for relocated employees. While HQ2 has been slated to create 50,000 jobs in the new location, it cannot be assumed that Amazon will hire all of these employees locally. People with knowledge of Amazon’s structure and practices will have to be relocated to the new headquarters. One researcher defines five sets of variables which might influence employees’ willingness to move during corporate relocations. The variables are: (1) attachment to the present community; (2) demographic status; (3) attachment to the current organization (4) lack of alternative job opportunities; and (5) attraction to the new community. Imagine a board room of “equals” meeting from two separate geographic locations. The differences could be as minuscule as a penchant for the Braves over the Mariners, or they could be as drastic as stances on religion, abortion, immigration, and LGBT rights. These ideologies are often divisive, and when mixing employees from different upbringings, someone will get offended, and productivity may decrease. These differences could potentially lead to bullying, harassment, or even violence. International research on this topic is well-established, providing that manufacturing firms and service businesses need to achieve ‘embeddedness’ within their host region. This is a concept linked to harnessing localized culture, knowledge, innovation, and enhancing the depth and quality of relationships with local firms (whether partners or suppliers), customers and other organizations.

213. Alli et al., supra note 18.
214. Wood & Reynolds, supra note 212, at 1372.
215. See id.
suitable working conditions, Amazon will need to educate its employees about diversity and empathy if it chooses to locate in a state such as Georgia.

The next prediction for HQ2 is that it will not be self-contained. “The fact that most firms do not operate in isolation but are often engaged in inter-organizational relationships (IORs) and networks that influence their actions is largely neglected [by these firms].”216 This is striking since Mark Granovetter’s widely accepted scientific literature acknowledges that communications within networks can enable as well as constrain the behavior of its members.217 Furthermore, Enrico Moretti, an Economics Professor at UC-Berkeley, predicts that HQ2 will create up to 250,000 indirect jobs.218 This will include jobs in the service industry, as well as suppliers, courters, professionals, educators, and more. These jobs will support Amazon as a whole and its employees individually. When these shops, schools, and firms open, they will not have the same employee protections as those at Amazon. They will be much more congruous to the locality in both substance and scale than Amazon. Therefore, progressive Amazon employees’ spouses may have to work with or for much more conservative law firms, trades men and women, and others outside the Amazon community. This could cause strain on the spouses, which could strain Amazon’s employees’ relationships and likely impact Amazon itself.219

Additionally, people are not always welcome in foreign areas.220 New surroundings may cause discomfort for certain employees. People do not work at their best if they work in fear, and they can be frightened in new settings. Data shows that fear is still prevalent in the workplace for LGBT individuals specifically. For example, 93% of people who self-identify as LGBT live open lives, however only 55% of them are out to their bosses.221 This is concerning when such a drastic change in demographics is on the horizon for Amazon.

Another noticeable difference between the East Coast and the West Coast is that the Asian population is much more concentrated on the West Coast, especially California.222 Imagine being raised as an Asian American in California—which is known to have many communities and comforts specific to

216. Knoben et al., supra note 18, at 386.
217. Id.
219. Trouble at home could lead to less productivity in the workplace. Additionally, if the strain is bad enough, it could force employees to quit and relocate to a more suitable area.
220. For example, a discrimination lawsuit filed against a gay bar in Provincetown, a predominately gay city where the typical 90:10 straight-to-gay ratio is flipped. LIZ WINFELD, STRAIGHT TALK ABOUT GAYS IN THE WORKPLACE: CREATING AN INCLUSIVE, PRODUCTIVE ENVIRONMENT FOR EVERYONE IN YOUR ORGANIZATION 3-4 (3d ed. 2005). The bar refused to hire a straight man that applied for a bar back position. He was told that they do not hire, “straight boys.” Id.
221. Id. at 46.
222.
that culture—and then moving to a new location. You may not be able to find people of your religion; you may not be able to find grocery stores with your favorite items; and most importantly, you may not be able to pass your culture down to your children.

Numerous demographic factors need additional exploration through future research, including ethnicity, gender, disability, and a spouse’s career options. If Amazon employees are embedded in the Seattle-based culture, it will be difficult to transplant them from this setting and, instead, relocate them to an area with different undesirable factors. After all, disorder and malfeasance occur when social relations are absent. If an individual’s needs are congruent with the community environment in terms of lifestyle (family, religious, or civic organizations), then they will thrive. This is the definition of off-the-job-embeddedness. However, if off-the-job embeddedness does not exist or is reduced, it is likely to cause an unstable environment for the employees that will negatively affect the business.

Amazon needs to deliver on its promises when it decides HQ2’s location. Amazon states, “We strive to create a sense of community among employees of various backgrounds in order to foster engagement and innovation.” Likewise, Jeff Bezos, CEO of Amazon, is quoted on the “Diversity at Amazon” webpage saying:

Amazon has more than 500,000 employees around the world, and from our earliest days, we've been committed to equality in our workplace. We want our employees to be empowered to speak their minds, and to be heard. Every Amazonian should feel comfortable sharing their unique perspectives, and every Amazonian should seek out the perspectives of others. We want our employees and the communities where we operate to embrace that we are all human, we are all different, and we are all equal.

This is an altruistic stance and great for the labor force of Amazon. However, relocating to a Sanctuary City like Atlanta may have adverse effects on the home life of many employees (regardless of benefits afforded by the company). For instance, the LGBT population and lifestyle are thriving in the Midtown areas of Atlanta. However, many in this community do not feel safe once they leave the sanctuary of Midtown. Looking into this subset, the effects that

223. Id. Most of the previous research on transfer decisions outside the context of corporate relocation has almost exclusively examined male employees. While this study has more female participants than many others, females are still significantly underrepresented here.
224. Granovetter, supra note 147.
225. See Daniel C. Feldman et al., Off-the-Job Embeddedness: A Reconceptualization and Agenda for Future Research, in RESEARCH IN PERSONNEL AND HUMAN RESOURCES MANAGEMENT.
227. Anthony Michael Kreis, Amputating Rights-Making, 69 HASTINGS L.J. 95, 98 (2017) (“In 2017, Texas became the latest state to ban so-called sanctuary cities, penalizing municipalities that refuse to cooperate with federal immigration enforcement. After St. Louis adopted an ordinance in 2017 banning employment and housing discrimination against women for their reproductive healthcare decisions, Missouri’s governor called on legislators to overturn it in a special session, warning that St. Louis would become an ‘abortion sanctuary city.’ The Missouri Legislature did so, overturning the St. Louis ordinance via preemption legislation.”).
geographical change in culture can have overall are quite high. Employees that are used to the progressive West Coast/Seattle culture may become subject to harassment in the Southern parts of the country. This is a tangential factor that may not be fully considered by the corporation when weighing financial terms against social norms as they make their final decision on location.  

Amazon has two choices for HQ2’s new location. First, Amazon could build HQ2 in one of the progressive cities on the list (e.g. Boston or New York). This decision could be viewed as rewarding the city for having more LGBT rights and employee protections. Alternatively, Amazon could build HQ2 in Atlanta, Dallas, or Raleigh, where Amazon could promote social purposes like LGBT protections and positive identity perceptions within this community.  

However, if Amazon does not have a concrete strategy in place to support employees in a location with fewer employee protections than Seattle, Washington, the decision to build HQ2 in Atlanta, Dallas, or Raleigh could send the wrong message both internally and externally. While Amazon may impact the area in which HQ2 is located, the area may influence Amazon as well. This external influence could result in a less-inclusive culture within Amazon. This investment into HQ2 would not only put the company’s future on the cutting edge of technology, but also put its cultural identity on the chopping block.

228. Markus Menz et al., What Do We Know About Corporate Headquarters? A Review, Integration, and Research Agenda 18-19 (Harv. Bus. School Strategy Unit, Working Paper No. 14-016, Aug. 19, 2013) (“The literature that considers geographic aspects either examines the CHQ in a specific geographic context, reviewed earlier as the CHQ location, or explores international differences of the CHQ. There are only few studies in the latter strand. They explore international differences of the CHQ arguing that the institutional, legal, and cultural heritage of different countries will have significant effects on the CHQ. Collis and colleagues find that ‘MNCs from different countries have substantially different corporate headquarters – US headquarters are large (255 median staff for a 20,000 FTE MNC) and European headquarters smaller (124)’. Although they reveal an ‘administrative heritage’ of the CHQ, there is little knowledge on the CHQ differences across geographic regions and countries.” (citations omitted)).

229. One of these cities would come with a high price tag because salaries and real estate are at a premium in these areas. However, the location selection process benefits from close collaboration of operating unit line managers and support staff, rather than singular adherence to the insulated real estate, tax alleviating and deal making approach of the past. Chris Manning et al., Devising a Corporate Facility Location Strategy to Maximize Shareholder Wealth, 17 J. REAL EST. 321, 322 (1999) (“Direct cost savings are more readily quantified and include lowering expenses such as taxes, wages, utilities, other overhead expenses and transportation costs. Indirect cost benefits include improved educational levels, the work ethic of the labor force and improved communication with the firm.”). For this reason, Amazon may be making a financially sound decision, even if it decides to build HQ2 in one of these expensive cities.

230. One of these cities would come with a lower price tag because salaries would be lower and the company could face less liability from employment discrimination lawsuits.

231. Conservative cities may instead be both beneficial for HQ2’s location and for the advancement of LGBT issues. Reverend Neil G. Cazares-Thomas, a prominent gay pastor of a “gay” megachurch in Dallas, has pressed Amazon to build HQ2 there. O’Connell, supra note 6. The Reverend believes that Amazon could bring change to Dallas, Texas by making it more LGBT-friendly. Id. American Airlines Chief Executive, Doug Parker, believes his company has done more for LGBT rights because its headquarters is in conservative Fort Worth, Texas. Id. Additionally, there is a financial benefit to building HQ2 in one of these locations. Salaries would be lower, and the company would face less liability from employment discrimination lawsuits. This location choice would adhere to the shareholder primacy model, while still allowing Amazon to promote LGBT rights.
Therefore, when selecting HQ2’s location, Amazon must carefully consider all the social and cultural factors in play, as well as the pros and cons of choosing a more conservative or liberal city.

CONCLUSION

Amazon is just one of several American corporations partaking in the trend of opening a second headquarters in a geographically distinct location from its first headquarters. Amazon’s consideration of Atlanta, Georgia for the location of HQ2 makes for a great case study on how cultural embeddedness and identity can affect a company that is considering a location with a culture polarized to that of the company’s own culture. The intertwining of corporate sustainability and embeddedness is ripe for more research. Specifically, this Article calls for empirical research on these issues:

(1) Should socially conscious companies like Amazon incorporate as a Social Purpose Corporation or Public Benefit Corporation?

(2) How well defined must a social corporate mission statement be in order to minimize liability for leadership’s discretionary activity?

(3) Would a change in location affect the social values of a corporation and its sustainability endeavors?

(4) How do employees who move from HQ1 to HQ2 prioritize their social values after they move?

(5) How do second headquarters affect organizational and decision-making dynamics within a company?

(6) What are the differences in embeddedness between HQ1 and HQ2, once it opens?

(7) Is the cultural risk of creating a second headquarters in a geographically distinct location worth the reward for companies with a great need for expansion?

(8) How is embeddedness affected by opening a second headquarters (both on-the-job and off-the-job embeddedness)? What are the differences in embeddedness between Amazon’s HQ1 and HQ2, once it opens?

(9) To what extent do internal externalities play a role in corporate actions, including corporate decision-making, hiring, profitability and product development?

(10) Can corporations change the social values and culture of a community?
THE ANTITRUST CASE AGAINST FACEBOOK:
A MONOPOLIST’S JOURNEY TOWARDS
PERVASIVE SURVEILLANCE IN SPITE OF
CONSUMERS’ PREFERENCE FOR PRIVACY

Dina Srinivasan*

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The Facebook, Inc. (“Facebook”) social network, this era’s new communications service, plays an important role in the lives of 2+ billion people across the world. Though the market was highly competitive in the beginning, it has since consolidated in Facebook’s favor. Today, using Facebook means to accept a product linked to broad-scale commercial surveillance—a paradox in a democracy. This Paper argues that Facebook’s ability to extract this qualitative exchange from consumers is merely this titan’s form of monopoly rents. The history of early competition, Facebook’s market entry, and Facebook’s subsequent rise tells the story of Facebook’s monopoly power. However, the history which elucidates this firm’s dominance also presents a story of anticompetitive conduct. Facebook’s pattern of false statements and misleading conduct induced consumers to trust and choose Facebook, to the detriment of market competitors and consumers’ own welfare.

INTRODUCTION

Social networks, considered electronic communication service providers, have become a primary way that American consumers communicate. Facebook is the reigning platform, not only in the lives of Americans, but in the lives of 2.2 billion people worldwide. Though the social network market was highly competitive in the beginning, the market has since consolidated in Facebook’s favor. Consumers effectively face a singular choice—use Facebook and submit to the quality and stipulations of Facebook’s product or forgo all use of the only social network used by most of their friends, family, and acquaintances.


4. In 2007, there were hundreds of social networks, including competitive offerings from Google, Yahoo, and of course, MySpace. See generally Danah M. Boyd & Nicole B. Ellison, Social Network Sites: Definition, History, and Scholarship, 13 J. OF COMPUTER-MEDIATED COMM. 210 (2007).
When Facebook entered the market, the consumer’s privacy was paramount. The company prioritized privacy, as did its users—many of whom chose the platform over others due to Facebook’s avowed commitment to preserving their privacy. Today, however, accepting Facebook’s policies in order to use its service means accepting broad-scale commercial surveillance.

Facebook knows consumers’ identities by virtue of its position as this century’s new communications network and leverages this knowledge to build dossiers on consumers that are unrivaled in the private market. For Max Schrems, then a 23-year-old law student who used European law to petition Facebook for a copy of his data, his Facebook file as of 2011 was 1,200 pages long. That was before Facebook started monitoring and recording users’ activities not just on the singular Facebook domain, but on millions of independently owned websites and mobile applications. Facebook’s surveillance apparatus captures what people read, shop for, and even think online. For Americans that use an Android phone, Facebook apparently also scrapes a record of a user’s cellular phone calls—effectively rendering use of


the Facebook social network app to the equivalent of having a pen register on one’s device. Surveillance translates to influence, on many levels. As we learned recently, information gathered thereby can be misappropriated to influence political elections.

Facebook also sells advertising to marketers. In the digital advertising market, the ability to conduct unprecedented commercial surveillance is a bedrock of Facebook’s current revenues and profits. Facebook generates nearly all of its revenues from the sale of advertising, and the prices of ads sold today directly correlate with data derived from tracking consumers. Facebook leverages information it knows about users to sell more impression-targeted ads.


9. Data derived from surveillance is used to create psychographic profiles of individual consumers. Whereas demographic data refers to the variables of age, income, and education, psychographic data refers to the broader range of data sets that reflect a consumer’s personality, opinions, attitudes, interests, values, past activity, and general lifestyle. Psychographic data is used by companies to determine which piece of content, advertisement, or even price, to display to a particular consumer, in an attempt to influence consumer outcome. For a study of how psychographically targeted advertising changes the outcome of consumer behavior, see, e.g., S. C. Matz, M. Kosinski, G. Nave, & D. J. Stillwell, Psychological Targeting as an Effective Approach to Digital Mass Persuasion, PNAS (Nov. 2017), http://www.pnas.org/content/early/2017/11/07/1710966114.short. For background on psychographics, see generally, William D. Wells, Psychographics: A Critical Review, 12 J. OF MARKETING RES. 196 (1975), www.jstor.org/stable/3150443.

10. After the conclusion of the 2016 U.S. presidential election, Facebook disclosed to congressional investigators that it had sold to a Russian company, Internet Research Agency (IRA), ads which psychographically targeted American voters, and that up to approximately 126 million people could have been exposed to such ads. See Dylan Byers, Facebook Estimates 126 Million People Were Served Content from Russia-linked Pages, CNN.COM (Oct. 31, 2017), https://money.cnn.com/2017/10/30/media/russia-facebook-126-million-users/index.html; Facebook, Google and Twitter Executives on Russian Disinformation, C-SPAN.ORG (Oct. 31, 2017), https://www.c-span.org/video/?436454-1/facebook-google-twitter-executives-testify-russia-election-ads. In March 2018, it was revealed that Facebook data, including Like data, on more than 87 million users was misappropriated and used by political consulting firm Cambridge Analytica to psychographically target voters during the presidential race. For The New York Times story that cascaded response from U.S. and British lawmakers (in Britain, for alleged interference in the “Brexit” campaign) and resulted eventually in Facebook founder and chief executive officer Mark Zuckerberg’s live testimony before Congress, see Matthew Rosenberg, Nicholas Confessore & Carole Cadwalladr, How Trump Consultants Exploited the Facebook Data of Millions, N.Y. TIMES (March 17, 2018), https://www.nytimes.com/2018/03/17/us/politics/cambridge-analytica-trump-campaign.html.


12. Consider comments of Dave Wehner, the chief financial officer of Facebook, on Facebook’s Q2 earnings call, with respect to how privacy (or, a reduction in user data) is inversely correlated with Facebook revenues. Facebook Inc. Q2 2018 Earnings Conference Call, INVESTOR.FACEBOOK.COM (July 25, 2018), https://s21.q4cdn.com/399680738/files/doc_financials/2018/Q2/Q218-earnings-call-transcript [hereinafter “Facebook Q2 Earnings”].
and more action-based ads. Facebook then uses this capability to sell advertising on behalf of other market participants—like Hearst, The Washington Post, or Time, Inc. Facebook’s power here is so absolute that the duopoly of Facebook and Google accounts for 90-99% of year-over-year growth in the U.S. digital advertising market.

But in a country anchored by democratic values and fear of tyranny derived from breaching individual civil liberties, why does the free market today offer no real alternative to the exchange of free use of social media for pervasive surveillance? Why is it that thousands of Facebook competitors on the advertising side—traditional publishers of content, such as magazines and newspapers—also coordinate with Facebook to allow Facebook to watch and monitor their own customers? Why must consumers consent to identical Facebook terms in the privacy policies of other sellers of digital advertising? Does the free market today reflect consumer welfare, or does it enable a monopolist to offer inferior quality products by coordinating with other market participants?

Colloquially, and in the press, Facebook is a monopoly. Members of Congress, reporters, academics, and even initial founders of Facebook are

13. For example, if one advertising company has 5,000 data points per consumer, including the data points for age and propensity for depression, then that company can fulfill more orders for a campaign targeted to 20-year-olds that read about suicide than can another company that reaches the same audience but does not possess said user data points. I acknowledge that tailored advertising can reflect either a positive or negative product evolution for consumers, and I do not wish to enter this parallel debate. Rather, I wish to focus on the successful operation, or lack thereof, of consumer preference and choice in the market—a paramount concern in economics.


15. In a note to clients on 4/26/17, respected industry analyst Brian Wieser calculated that Facebook and Google accounted for 77% of the industry’s gross revenues in 2016, 99% of the growth in the U.S. digital ad market, and that “the average growth rate for every other company in the sector was close to 0.” Facebook alone accounted for 77% of the industry’s year-over-year growth. See Alex Heath, Facebook and Google Completely Dominate the Digital Ad Industry, BUSINESSINSIDER.COM (April 26, 2017), http://www.businessinsider.com/facebook-and-google-dominate-ad-industry-with-a-combined-99-of-growth-2017-4. Wieser estimated that Facebook and Google contributed 90% to the U.S. digital ad market’s growth in 2018. Sarah Slais, Digital Ad Market Soars to $88 Billion, Facebook and Google Contribute 90% of Growth, ADEXCHANGER.COM (May 10, 2018), https://adexchanger.com/online-advertising/digital-ad-market-soars-to-88-billion-facebook-and-google-contribute-90-of-growth/.

speaking of Facebook’s monopoly power and questioning the need for regulation.\textsuperscript{17} However, from an academic standpoint, the intellectual and legal case of monopoly has not yet been made,\textsuperscript{18} perhaps due to the nature of Facebook’s product being still “free” to the consumer. The fact that the product is free falsely diverts attention from what antitrust policymakers and economists are most comfortable paying attention to: price. Nevertheless, antitrust law and economics concern quality inasmuch as they do price. As I will argue in this Paper, Facebook is a monopolist, and what Facebook extracts overtly from consumers today, from a quality perspective, is a direct function of Facebook’s monopoly power.

The fact that the dominant player in the market conducts wide-scale commercial surveillance begs a question—how did the market get here? This Paper first explores this question by revisiting the rich record of the market’s history. In so doing, I conclude that Facebook’s ability to monitor and record consumers’ digital activity reflects Facebook’s ability to extract monopoly rents in the social media market. In Part I, I revisit the history of social networking and discuss how privacy was once a crucial promise made to secure a competitive advantage. Facebook foreclosed competition in a contested market with superior representations of protecting consumer privacy, including the specific promise not to track and monitor consumers’ digital footprints.\textsuperscript{19}

For a decade, the competitive market then enjoined Facebook’s ability to initiate commercial surveillance. Facebook tried to renege on its promise not to track users in 2007, and again in 2010, but the market was competitive enough with adequate consumer choice to thwart Facebook’s attempts.\textsuperscript{20} Only after an historic public offering, the acquisition of over a billion users, and the exit of competitors, was Facebook finally able to add the condition of surveillance to


\textsuperscript{17} Hearing on Facebook, supra note 16.

\textsuperscript{18} In the absence of clear rationale for how to interpret the paradoxes of Big Tech, there emerges a parallel push to reconsider antitrust law’s coupling with economic rationale. \textit{See, e.g.}, Lina Khan, \textit{The New Brandeis Movement: America’s Antimonopoly Debate}, 9 J. OF EUR. COMPETITION L. & PRACTICE 131 (2018), https://doi.org/10.1093/jeclap/lpy020 (referring to the movement as the “New Brandeis School,” which urges that antitrust regulation should focus not only on consumer welfare but also the structure of markets to avoid mere concentrations of economic power). For coverage of the debate in the wider media, see Lynch, supra note 16. Others argue that economic thinking merely needs to be stretched to understand the 21st century’s modern economy market problems. \textit{See generally} Jonathan B. Baker, Jonathan Sallet & Fiona Scott Morton, \textit{Introduction: Unlocking Antitrust Enforcement}, 127 YALE L.J. 1916 (2018).

\textsuperscript{19} \textit{See infra} note 42, FACEBOOK PRIVACY POLICY (2004).

\textsuperscript{20} \textit{Infra} Parts II A, II B.
its mandatory terms. In Part II, I argue that this pattern of events reflects Facebook’s monopoly power.

Part III argues that the circumstantial, or structural, evidence of Facebook’s market dominance also explains Facebook’s monopolistic power exhibited today. On the one hand, Facebook is a market in and of itself. Ninety-nine percent of adults in the U.S. that use social media use Facebook. The reason for this is that Facebook is a “closed” communications network and users must join simply to access the network. Not all social networks are closed—LinkedIn, for example, disseminates user communications across its own network but also Twitter. But, Facebook, with a hold on the market and greatest number of users, declines the path of interconnection, or inter-operability. Consumers cannot forgo Facebook, in much the same way an earlier generation was beholden in the early 20th century to another communications behemoth, AT&T—another company that leveraged a closed-network approach to protect market share and foreclose competition in the telephone network market. However, even if one does include other social networks as part of a relevant market, Facebook still dominates with over 80% of total consumer time spent across various social networks.

The story of Facebook’s market entry, and the evolution of its commercial surveillance, raises another relevant question under antitrust law. Under Section 2 of the Sherman Act, this country’s antitrust statute, it is illegal for a company to acquire monopoly power by engaging in conduct outside the bounds of “competition on the merits.” Facebook engaged in a decade-long pattern of false statements and misleading conduct that may have induced users to trust and choose Facebook over alternatives in the market. Facebook also thereby secured the coordination of independent publishers and other businesses while perpetuating the belief that Facebook did not and would not leverage their coordination for surveillance. Facebook’s conduct may have artificially shifted the demand curve for the Facebook social network to the right, effectively accelerating the direct network effects that would lock in Facebook and foreclose competition. Part IV explores Facebook’s pattern of conduct and argues that it was anticompetitive.

21. See infra Part II C.
22. See infra Part III.
25. United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001) (finding Microsoft conduct outside the scope of “competition on the merits” to be anticompetitive).
26. Misleading conduct is of particular concern in markets with direct network effects. See generally PHILLIP E. AREEDA & HERBERT HOVENKAMP, FUNDAMENTALS OF ANTITRUST LAW § 350 (4th Ed. 2015) (Areeda and Hovenkamp explain that a “monopolist’s misrepresentations encouraging
In digital markets where consumers do not pay a price, antitrust enforcement must become comfortable with a paradigm that focuses on quality. Never before have we had to grapple with one of the most valuable companies in the world, a half trillion-dollar market cap company,\textsuperscript{27} that provides important communications services to over 2 billion consumers but charges no price. Policymakers and antitrust enforcers today can refer to the record in order to understand the consumer valuing privacy while still ceding control over their personal data, the flawed market structure that allows for the perpetuation of present circumstances, and the remedy which can restore competition in communications markets.

I. PRIVACY WAS ONCE A CRUCIAL FORM OF COMPETITION

To appreciate Facebook’s monopoly power in the social network market today, one must begin by revisiting the story of Facebook’s rise. In the beginning, the social media market reflected the type of competitive markets one reads about in textbooks. Dozens of companies competed furiously in an attempt to win market share. In a market where all competing products were priced at zero, startups competed not on price, but on quality. Privacy levels quickly emerged as an important quality attribute.\textsuperscript{28}

Facebook was not the world’s first major social network—MySpace was. In fact, in the market’s early years, MySpace dominated. Founded in 2003, MySpace quickly became an internet darling, especially in the wake of the dot-com bust of 2001. Within two years, in a heated bidding war between two media conglomerates, Rupert Murdoch’s News Corp. and Sumner Redstone’s Viacom, MySpace was acquired by News Corp. for $580 million dollars.\textsuperscript{29} By 2006, MySpace overtook Google to become the most visited website in the U.S.\textsuperscript{30} With a hundred million users, MySpace then signed a $900 million

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\textsuperscript{28} For other discussions regarding competition based on quality rather than price, see Maurice E. Stucke & Ariel Ezrachi, \textit{When Competition Fails to Optimize Quality: A Look at Search Engines}, 18 YALE J. OF L. & TECH. 70 (2016).


advertising deal with Google.\textsuperscript{31} By 2007, dozens of competitors existed, but none matched the scale and growth of MySpace.\textsuperscript{32} Journalists referred to the next generation, not as “millennials,” but as the “MySpace generation.”\textsuperscript{33}

Though it looked as though MySpace had tipped the scales, and that it would inevitably become the de facto social media platform, it would not.\textsuperscript{34} Mark Zuckerberg, the founder and chief executive officer of Facebook, and other enterprising entrepreneurs, had an opportunity for market entry to subvert MySpace’s early gains. When Facebook rolled into the market, users, parents, and critics were simultaneously gripped by an apprehension with social media, caused primarily by MySpace.\textsuperscript{35} One could not ignore the barrage of negative MySpace headlines in the media, permeating radio stations, television broadcasts, and newspaper reporting, across the country.\textsuperscript{36} MySpace was


\textsuperscript{32} Other social networking sites included SixDegrees.com, which launched 1997 and shut down 2001; Friendster, which launched 2002 and at one point, Friendster had over 115 million users and was the most used social network in Asia; Orkut, which was founded by Google in 2004 and shut down 2014; Flip.com, which was founded by Conde Nast in 2006 and shut down December 2008; Bebo, which was founded in 2005 and at one point was the most used social network in the U.K. and was purchased by AOL in 2008 for $850 million, but in 2010 AOL announced it would shut down or sell the site; Mixi, which was founded in 2004 and at one point was the largest social networking site in Japan; CyWorld, which was founded in 1999 and was once the primary social network in Korea, but declined after Facebook entered the market in 2009; hi5, which was launched 2004 and was a leading social network site in Spanish-speaking countries, including Mexico, Argentina, and Venezuela and is still in business; BlackPlanet, which was founded in 1999; a social network for African-Americans and is still in business; MiGente, which was founded 2001 for Latinos and is still operating; and Yahoo 360, which was Yahoo’s effort at a social networking site with a soft-launch in 2005 that did not result in a full product launch.


\textsuperscript{35} See CHARLES KRINSKY, THE ASGATE RESEARCH COMPANION TO MORAL PANICS (2016).

blamed for sexual assaults, suicides, and murders, allegedly triggered by open communications on the platform. Parents were concerned that MySpace was not safe for children, and national and local news blamed the platform’s openness and lack of privacy. Academia echoed this sentiment with consumer surveys demonstrating that social media users were concerned about privacy and that “MySpace, the largest social networking site in the world, has a poor reputation in terms of trust.”

Indeed, Facebook’s disintermediation of MySpace’s rise is the story of just how important Facebook’s qualitative differentiation was. Since MySpace was already free, Facebook had to entice users with something unique. Thus, Facebook entered the market presenting itself, among other things, as a privacy-centered alternative. MySpace made little to no effort to address concerns around privacy, while Facebook appeared to take privacy seriously. Whereas MySpace was open to anyone who wanted to join, Facebook was closed to all but those who could validate their identity with a university-issued “.edu” email address. After joining, Facebook users encountered strict privacy settings—for example, the default setting was that only one’s university classmates or one’s friends could see one’s profile. On the other hand, on MySpace the default setting was more open—anyone could see one’s profile. This is relevant because studies show that consumers do not change a website’s default settings because it is cumbersome and time-consuming—the modern-day equivalent of leaving the VCR clock blinking. A social network’s default settings are therefore an important initial sales pitch.


40. Wendy E. Mackay, Triggers and Barriers to Customizing Software, CONF. ON HUMAN FACTORS IN COMPUTING SYS., 153–160 (1991). See also Catherine Dwyer, Digital Relationships in the “Myspace” Generation: Results From a Qualitative Study, 40TH ANNUAL HAW. INT’L CONF. ON SYS. SCI., 19 (2007) (after interviewing undergraduates that use social media and instant messenger applications, authors pointed out that most interviewees did not customize the privacy settings of their chosen platforms.); Ralph Gross & Alessandro Acquisti, Proceeding of the Ass’n for Computing Machinery Workshop, Information Revelation and Privacy in Online Social Networks 71–80 (2005) (authors studied the behavior of more than 4,000 students on Facebook and found that only 1.2% of users studied changed their privacy settings).
privacy policy that put privacy at the center of the user experience.-only some 950 words long, the initial policy took only a few minutes to read. Indeed, just as the liberal return policy is designed to engender trust among prospective customers in e-commerce, so was Facebook’s privacy policy designed to engender trust with early adopters of social media. The opening sentence proclaimed: “Because we want to demonstrate our commitment to our users’ privacy, we will disclose our information and privacy practices False.” Therein, Facebook made important representations regarding what it would and would not do. One important representation—whose evolution is the focus of this Paper —was the promise to not usurp privacy by using tracking technology. Facebook promised: “We do not and will not use cookies to collect private information from any user.”

Without understanding tracking technology, it is impossible to understand how Facebook would eventually leverage its power to degrade user privacy and build a business model affecting data and advertising inventory across millions of independent businesses. The most common tracking methodology to surveil users leveraged the use of “cookies”, small text files that websites can install on users’ computers. At a simple level, a cookie enables a website to identify a browser using a unique identifier, in order to remember a previous action on the part of the user. Cookies can be used to remember historical actions—such as if a user had put items into a shopping cart, if a user had already logged-in, or what a user normally enters in a form field. On an individual level, cookies can add to a user’s welfare by allowing a website to improve the quality of the site’s user experience.

41. Chris Kelly, who later ran for governor of California, was hired as Facebook’s chief privacy officer in September of 2005.
43. See id. (“We use session ID cookies to confirm that users are logged in. These cookies terminate once the users close the browser. We do not and will not use cookies to collect private information from any user.”); see also Facebook Privacy Policy, FACEBOOK.COM (effective February 27, 2006), http://www.facebook.com:80/policy.php [http://web.archive.org/web/20060222121022/http://www.facebook.com:80/policy.php] (“We use session ID cookies to confirm that users are logged in. These cookies terminate once the user closes the browser. By default, we use a persistent cookie that stores your login ID (but not your password) to make it easier for you to login when you come back to Facebook.”); Facebook Privacy Policy, FACEBOOK.COM (effective Sept. 12, 2007), http://www.facebook.com/policy.php [http://web.archive.org/web/20070912083143/http://www.facebook.com/policy.php] [hereinafter FACEBOOK PRIVACY POLICY (2007)] (“When you enter Facebook, we collect your browser type and IP address. False . We use session ID cookies to confirm that users are logged in. These cookies terminate once the user closes the browser. By default, we use a persistent cookie that stores your login ID (but not your password) to make it easier for you to login when you come back to Facebook.”).
44. Facebook Privacy Policy (2004), supra note 42.
Cookies, however, can also be used to determine what a user was researching, reading, or buying on a site. When a user types a website URL into a browser (such as nytimes.com), the user’s computer initiates an HTTP request with the website’s server. The website’s server then sends back an HTTP response that allows the user to see the webpage. During HTTP responses, servers can also send back and implant cookies on a user’s device. The cookies thumb-print a user’s device with a unique identifier, or a “cookie ID” (for example, 123456789). These cookies can then be “read” by the issuing company during a user’s subsequent HTTP requests. When read, the user’s cookies provide the user’s cookie ID, and other elements of the HTTP request can provide specific information regarding the user’s browser session, including: the specific URL the user is visiting (for example, goodmenproject.com/marriage-2/Coming-Out-To-Your-Wife/), the time the user is visiting said URL, and the IP address of the user (which discloses the user’s geographic location). In this way, a company can use cookies to know (and therefore remember) the fact that user 123456789 was reading the article “Coming Out to Your Wife” on a Sunday morning at 5:30 a.m. from Wichita, KS.

Widespread commercial surveillance of consumer behavior across the internet, however, was inhibited by two restraining facts. First, a company could only read its own cookies. Second, a company could read cookies only when a user initiates an HTTP request to the company’s server. For example, if The New York Times wrote a cookie onto a user’s device, the Times could not read its cookies when the user was on wsj.com. In other words, The Times could know what users were doing on nytimes.com but not on other properties. A company could circumvent these built-in privacy protections by installing a piece of their own code on other websites, that would invisibly generate an HTTP request on behalf of the user to the company’s server. Of course, no publisher would want another publisher to be tracking the behavior of its own customers. In order to develop complete and accurate profiles of users, there would need to be cooperation among thousands of sites which would otherwise be competitive. At one point, competitors and competition kept horizontal cookie collusion in check.

When Facebook first entered the market, and for the next ten years, Facebook promised to not surveil users for commercial purposes. This promise was not de minimis. As an electronic communications service provider, Facebook knew people’s real identities and therefore could correlate

anonymous cookie IDs with real world identities. You weren’t just 123456789
reading the article titled “Coming Out to Your Wife,” you were Jacob
Greenberg of Wichita, KS reading “Coming Out to Your Wife.” Additionally,
numerous studies showed that consumers were concerned about privacy and
objected to behavioral (or psychographic) targeted digital advertising. Aside
from broader objections to surveillance, which is known to quell research and
speech, surveillance had immediate practical implications within the household.
If a company could know that Ms. Mitchell was shopping for that Star Wars
Lego set that was all the rage that season, it could incessantly display on the
family computer ads for the same toy, which could potentially ruin for young
Sam what Santa Claus was bringing for Christmas.

Although this Paper focuses on the evolution of the promise not to surveil
users outside of Facebook, for which there is a rich historical record of
Facebook’s conduct both pre and post market dominance, it is worth noting that
Facebook made other significant privacy representations upon entering the
market. For example, Facebook initially gave users the ability to opt out of
having their information shared with third-parties, including advertisers or
marketers, or to prohibit Facebook from collecting additional information about
themselves from third-parties. Facebook also initially promised that users
could modify or remove information Facebook had about them at any time.
These promises combined signaled to users that, unlike other social networks,
Facebook offered its members “very granular and powerful control on the
privacy . . . of their personal information.” The combination of Facebook’s
closed network approach and strict default privacy settings made people believe
that Facebook, and not MySpace, was the trustworthy choice.

Facebook’s short privacy policy, default privacy settings, and outward
signaling as privacy-centric, were strategic decisions that played an important
role in attracting users to the platform. David Kirkpatrick, who chronicles

47. Online privacy and the ability to browse, read, shop, and think online without being watched
has been a consumer concern since the turn of this century. See Chris Jay Hoofnagle, Jennifer Urban &
Online Privacy Protection. 47 J. OF BROADCASTING & ELECT. MEDIA 3 (2003); Schwartz, supra note 46
(2001 survey by Public Opinion Strategies, a Republican polling organization, showed 67% of
Americans said “online privacy” was a “big concern”); U.S. Internet Users Ready to Limit Online
users-ready-limit-online-tracking-ads.aspx (2010 USA. Today/Gallup poll showed Americans were
aware of cookies and behavioral advertising, 67% said marketers should not be able to conduct
behaviorally targeted advertising, and 61% said free internet services do not justify the practice).

48. For a general overview of Facebook’s progressive deterioration of user privacy, see Jennifer
Shore & Jill Steinman, Did You Really Agree to That? The Evolution of Facebook’s Privacy Policy,

49. FACEBOOK PRIVACY POLICY (2004), supra note 42.

“Imagined Communities”].
Facebook’s history in his book *The Facebook Effect*, summarizes, “Privacy . . . has been a major concern of Facebook’s users from the beginning.”51 For example, for Katherine Losse, one of Facebook’s first employees, Facebook’s unique stance on privacy was a critical part of her decision to join a social media platform. She explained, “The privacy protections of the restricted network . . . made it feel, surprisingly, okay.”52 Accordingly, early consumer studies revealed that the broader population possessed similar feelings for privacy concerns.53 The majority of Americans polled in one 2004 national consumer study said privacy was a “really important issue that [they] care about often.”54 Another survey focused on early Facebook users’ attitudes towards privacy and concluded that Facebook users cared about privacy policy more than terrorism.55 Others in academia studied and compared MySpace users’ satisfaction with MySpace’s privacy settings with Facebook users’ satisfaction with Facebook’s privacy settings and concluded that users generally preferred Facebook’s settings over MySpace’s settings.56

Indeed, increased levels of privacy are broadly understood to be the mechanism that induces people to trust and then communicate over a particular communications channel. For example, social exchange theory, with a foot simultaneously in economics, psychology and sociology, studies human communications and explains that people communicate and form relationships through a simple cost-benefit analysis57: the benefit is the opportunity to socialize, and the cost is the risk associated with trusting someone. Privacy increases trust and reduces risk, thereby causing humans to communicate more. In the real word, the lack of a permanent record ensures some level of privacy.58 Online, a social network that wants users to choose its platform over others could generate superior trust through superior promises of privacy.

Privacy continues to play an important role in the current, though less competitive, social media market. SnapChat is the only social network post-2010 to have gained significant ad option with users in the United States.59 Like Facebook once did, SnapChat competes on quality, and importantly, on privacy

51. See Kirkpatrick, supra note 39 at 13.
52. See Losse, supra note 39 at XV.
54. Id.
55. See Acquisti & Gross, *Imagined Communities*, supra note 50 at 6.
56. See Acquisti & Gross, *Imagined Communities*, supra note 50 at 16; Dwyer, Hiltz & Passerini, supra note 38 at 339.
59. See STATISTA.COM, infra note 237.
levels. For example, one of the central draws of SnapChat is the fact that SnapChat communications appear for a fixed period of time, then disappear, being also deleted from SnapChat’s servers.\(^{60}\) The impermanency of the record ensures a high degree of privacy. Additionally, when Facebook users discovered in early 2017 that Facebook was collecting and sharing user data in ways previously not known or understood, users instigated a #deleteFacebook movement, and millions flocked to startup competitor Vero Social that promised significantly higher levels of privacy.\(^{61}\)

The fact that communications markets turn on privacy is history repeating itself. Wireless telegraphy, before eventually being used to facilitate what we know today as the modern radio, initially stalled as a technology because of its inability to facilitate private communications.\(^{62}\) Moreover, this nation’s historic antitrust case against and eventual break-up of AT&T in the telephone network market was instigated in part by an equipment competitor’s desire to offer telephone equipment that offered a higher level of privacy in communications.\(^{63}\) Until 1956, customers of AT&T’s telephone service were required to use AT&T telephone equipment to make and receive calls. Equipment manufacturer Hush-A-Phone marketed a cup-like device that attached to AT&T equipment to reduce the risk of conversations being overheard. Consumers purchased over 125,000 Hush-A-Phones to make for “privacy in communications” and in 1948, Hush-A-Phone filed a complaint with the Federal Communications Commission requesting that the FCC compel AT&T to officially permit customers’ use of Hush-A-Phone equipment.\(^{64}\) Hush-A-Phone eventually prevailed and this opened the door to competition in the market for telephone equipment.\(^{65}\)

In the early 2000s, Facebook entered the social media market, disintermediated MySpace’s momentum, and started to consolidate the social network market by offering consumers an alternative service of superior quality. Other qualitative features, like Facebook’s user interface design, real-name policy, and college launch strategy, also played a role in making


\(^{63}\) JEAN-JACQUES LAFFONT & JEAN TIBOLE, COMPETITION IN TELECOMMUNICATIONS 18 (1999).

\(^{64}\) For the court of appeals decision, see Hush-A-Phone v. United States, 238 F.2d 266 (D.C. Cir. 1956).

\(^{65}\) Id.
Facebook’s platform attractive to users. Regardless, the fact remains that superior privacy levels played a central role in this narrative. Propelled then by direct network effects, whereby each additional user that chose Facebook made the Facebook network more attractive to the next incremental user, Facebook started to consolidate the social network market at a rapid rate, taking market share from MySpace, Friendster, and competitive offerings from Google and AOL. At the end of 2004, MySpace had 5 million users and Facebook had 1 million users. In 2006, when some 250 million people around the world used a social network, 100 million used MySpace, 12 million used Facebook, and the rest were dispersed across numerous competitors. Then, in 2007, user growth at MySpace started to decelerate, while growth at Facebook accelerated. By mid 2007, Facebook had overtaken MySpace as the most visited social media network in the U.S. One year later, MySpace stopped growing, while Facebook was registering half-a-million new users per day. Today, of course, MySpace, Orkut, Bebo, and other competitors, are relics of the early history of social media. Facebook dominates the life of the average American—99% of adults that use any form of social media use Facebook, and the average American now spends over an hour per day on Facebook applications.

II. THE PARADOX OF SURVEILLANCE REFLECTS MONOPOLY POWER

Monopoly power refers specifically to the power to control a market—that is, the power in a market to raise price above or reduce quality below competitive levels. From a legal standpoint, the question of whether a company has monopoly power in a market is answered through direct or competitive levels.

66. For example, Sean Parker, Facebook’s first president, has explained that Facebook’s strategy in first dominating the social media market, and general product development, were important reasons that users chose Facebook over MySpace. Alexia Tsotis, Sean Parker on Why MySpace Lost to Facebook, TECHCRUNCH.COM (June 28, 2011), https://techcrunch.com/2011/06/28/ sean-parker-on-why-myspace-lost-to-facebook/. Others have partly attributed Facebook’s superior product to superior design. See, for e.g., Jenna McWilliams, How Facebook Beats MySpace, THE GUARDIAN (June 23, 2009), https://www.theguardian.com/commentisfree/cifamerica/2009/jun/23/facebook-myspace-social-networks.


68. Id.


70. Id.


indirect evidence. Indirect evidence focuses on a company’s percent share of a relevant market, amongst other structural factors that indicate a company’s hold on a market (e.g., entry barriers). Direct evidence, on the other hand, demonstrates a company’s acquired ability to increase price above or decrease quality below levels unsustainable in a previous competitive environment. Under the direct evidence approach, the strongest type of evidence is evidence of price or quality levels pre-power, an event or point in time which results in power, and evidence of price increases or quality degradations that would have previously been unsustainable. This fact-based, retrospective before-and-after analysis—though somewhat rare in antitrust cases—is particularly relevant in Facebook’s case.

Part II now tells the story of how it came to be that Facebook extracts from consumers an exchange founded on surveillance. Contrary to what many believe, digital surveillance is not simply the inevitable byproduct of how the internet works. Rather, promises of privacy were the deciding factors that tipped the early market in Facebook’s favor, away from MySpace. Facebook’s conduct, from 2004-2012, provides the benchmark of quality—at least with respect to commercial surveillance—that the restraining forces of competition demanded. By 2014, competitors had exited the market, Google’s competitive offering Orkut shut down, and Facebook’s monopoly was complete due to the exit of competition combined with the protection of the barrier to entry that results from a product with over a billion users on a closed communications network. Subsequently, in 2014, Facebook leveraged its market power in a consolidated market to successfully degrade privacy to levels unsustainable in the earlier competitive market when market participants were subject to consumer privacy demands. Facebook rapidly unraveled its promise not to conduct commercial surveillance by using the technical framework it built over the years by perpetuating the belief that it would not leverage such a framework for a commercial purpose.

A. Pre-Power: Failure of Beacon and Early Misrepresentations

By 2007, people were sharing more baby pictures and personal family and friend photos on Facebook than they were on any other social media site—

74. See du Pont, 351 U.S. at 391 (explaining that “monopoly power is the power to control prices”); Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911).
MySpace was edgy, Facebook was wholesome.\textsuperscript{77} Then on November 6, 2007, with growing momentum in the market, Facebook reneged on the promise not to surveil users outside of Facebook through the release of an advertising product called “Beacon.”\textsuperscript{78} Beacon was a direct product license to third-parties that openly allowed Facebook to monitor and record user activity off of Facebook, and reflects Facebook’s first attempt to track users on the sites of independent businesses.\textsuperscript{79} But Beacon was immediately controversial. Its ultimate failure is evidence of what competition demanded of Facebook from a privacy perspective.

Launched in conjunction with a handful of third-parties, including Blockbuster and The New York Times, Facebook provided Beacon participants a piece of Facebook code to install on their own sites.\textsuperscript{80} When a user triggered an action on a participating site (say, rented a movie or read an article), the website then presented the user with a pop-up box requesting permission to share the user’s activity on Facebook.\textsuperscript{81} Many people today would remember being once jarred by the pop-up requesting permission to share one’s reading or browsing activity with Facebook. The user could decline permission by selecting the “No, Thanks” option.\textsuperscript{82} If the user did not click the “No, Thanks” button, Facebook received information about the user’s activity (title of movie rented or article read).\textsuperscript{83} Then, Facebook would publish the activity on the user’s Facebook page, calling the publication a “social advertisement.”\textsuperscript{84} For Beacon participants, like The New York Times or Conde Nast, the social sharing of user activity was a type of free marketing.


\textsuperscript{79} NEWSROOM.FB.COM, supra note 78.

\textsuperscript{80} Id.

\textsuperscript{81} Michael Arrington, Ok Here’s At Least Part of What Facebook is Announcing on Tuesday: Project Beacon, TECHCRUNCH.COM (Nov. 2, 2007), https://techcrunch.com/2007/11/02/ok-heres-at-least-part-of-what-facebook-is-announcing-on-tuesday/.

\textsuperscript{82} Users could have opted-in (via Facebook settings) to always include activity on third-party sites on their News Feed, opted-out to never include it, or opted-in to include it only if the user did not opt-out when given the pop-up confirmation (default). For a short history of Beacon’s changing user-interface against a backdrop of consumer uproar, see Louise Story, The Evolution of Facebook’s Beacon, N.Y. TIMES (Nov. 29, 2007), https://bits.blogs.nytimes.com/2007/11/29/the-evolution-of-facebook-beacon/.

\textsuperscript{83} According to Facebook at the time, Facebook tracked and recorded the activity only of logged-in users who did not click the “No, Thanks” button.

\textsuperscript{84} See Arrington, supra note 81.
Screenshot of the Beacon pop-up displayed to users on third-party sites.85

Beacon was a transparent attempt to get users to consent to sharing information about their activity on third-party sites with Facebook. However, the mere presence of Facebook’s code on these sites made it technically possible for Facebook to track users’ activities on these sites, even if the user did not grant Facebook permission to do so. This is because, when a user visited a Beacon site (e.g., blockbuster.com), regardless of whether the user consented or not, Facebook code initiated an HTTP request on behalf of the user to Facebook’s servers. Through this newly opened connection, Facebook could write cookies on user computers during HTTP responses, or read cookies during HTTP requests. The requests and cookies could reveal the specific page a user was on—effectively allowing Facebook to accomplish surveillance on the users that had clicked “No, Thanks.”

At the time, Facebook claimed that Beacon only tracked and monitored the activities of consenting users, and that Facebook code was not used to conduct less overt surveillance through cookies. For example, in a follow-up to emerging, strong, user push-back on the new Beacon product,86 The New York Times interviewed Facebook’s vice president of marketing and operations, Chamath Palihapitiya.87 The reporter asked, “If I buy tickets on Fandango, and decline to publish the purchase to my friends on Facebook, does Facebook still receive the information about my purchase?” Palihapitiya answered, “Absolutely not. One of the things we are still trying to do is dispel a lot of misinformation that is being propagated unnecessarily.”88 Facebook represented that it did not receive information about users that declined to share information about their activity.

Only hours after Palihaptiya’s comments in the Times, Stefan Berteau, a senior research engineer at California’s Threat Research Group, examined the actual contents of Facebook’s HTTP requests and responses that were normally

85. Id.
88. Id.
invisible to users, and revealed that Palihapitiya’s representations were not true. While Facebook claimed that Beacon trackers did not transmit user information to Facebook if users clicked “No, Thanks”, the contents of the cookie files did just that. Berteau further revealed that Beacon trackers were also used to log the activity of users who logged-out of Facebook or did not have a Facebook account. Furthermore, if a logged-out user ever clicked the “Remember Me” checkbox when logging-in, Facebook actively associated cookies with a user’s Facebook ID number. In other words, Facebook linked normally anonymized cookie data back to the identities of real people—a connection Facebook could make because it operated the social network.

Indeed, Facebook’s Privacy Policy at the time did not obtain user consent for this practice. As displayed on November 29, 2007, Facebook claimed that it only used cookies to “confirm that users are logged in” and that “[t]hese cookies terminate once the user closes the browser.” Within a few days, Facebook confirmed Berteau’s findings, contradicting its own earlier representations about user privacy. For the first time, Facebook had been publicly caught using cookies for broader surveillance despite the promise it did not and would not do so.

Almost immediately, Facebook faced user protest, petitions from advocate groups, and class action lawsuits. A MoveOn.org petition garnered 50,000 signatures within days. Class-action lawsuits on behalf of users were filed in Texas and California. The page of another petition called “Facebook, stop invading my privacy,” stated: “A lot of us love Facebook—it’s helping to revolutionize the way we connect with each other. But they need to take

90. Id. (Berteau showed, for example, that if a user saved a recipe on Epicurious to a favorites folder, and explicitly declined to have this information publish to his Facebook profile, the Beacon program wouldn’t publish it, but would nonetheless share the information about what the user was doing on the Epicurious website with Facebook). See also Juan Carlos Perez, Facebook’s Beacon More Intrusive than Previously Thought, PCWORLD.COM (Nov. 30, 2007), https://www.pcmag.com/article/140182/article.html.
91. See Berteau, supra note 89; Perez, supra note 90.
93. See Perez, supra note 90.
94. See O’Neill, supra note 86;
privacy seriously.” Facebook was founded upon the qualitative promise of no surveillance outside of Facebook and users did not want this to change. Consumer resistance is early proof of consumers’ preference for no surveillance.

Rejection of Facebook surveillance on third-party sites was part of a wider rejection of all third-party cookie tracking as consumers tried to stop this type of commercial surveillance that the advertising industry coordinated to impose on consumers. A 2005 industry study showed that 67% of Americans wanted to protect their privacy and prevent tracking. Some advertising companies paid businesses for the ability to install their own code on the business’ websites to track the business’ customers. One such company was Seevast. Seevast’s code triggered an open connection between a business’ website visitors and Seevast’s servers, which Seevast used to install cookies on, and retrieve cookies from, the business’ users.

Unlike companies like Seevast, Facebook knew users’ real identities, and nearly fifty million people had a Facebook account. Facebook’s surveillance, unlike Seevast’s, could be tied not only to random cookie variables, but to peoples’ real names. In other words, Facebook could leverage the ability to identify people through use of the century’s new communications technology, to conduct a particularly invasive, and permanent, form of surveillance. Additionally, Facebook did not have to pay companies, it could simply leverage the power to give away something valuable for free.

In the face of backlash, some Beacon participants pulled out of the Beacon program, effectively declining to extract consent from their own website visitors to Facebook’s surveillance mechanism. The growing e-retailer Overstock, one of the initial companies to sign up for Beacon, pulled out. Their

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98. For example, consumers’ cookie deletion rates rose at a rapid clip starting in 2004 when the advertising industry started to use cookies for tracking. Subsequently, the digital ad industry association group Interactive Advertising Bureau (IAB) and Safecount announced an initiative to cut cookie deletion rates. See Mickey Khan, Rising Cookie Rejection Bites into Metrics, DMNEWS.COM (July 11, 2005), https://www.dmnews.com/customer-experience/news/13074659/rising-cookie-rejection-bites-into-metrics. See also Chris Jay Hoofnagle, Jennifer King, Su Li & Joseph Turow, How Different are Young Adults from Older Adults When It Comes to Information Privacy Attitudes and Policies? (2010), https://repository.upenn.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1413&context=asc_papers (finding that 39% of American Internet users delete all their cookies “often”).

99. See Khan, supra note 97 (citing study from online market researcher InsightExpress).


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senior vice president of corporate affairs said, “we need to make sure that the Facebook community is accepting of this new type of advertising.”

In a competitive market, Facebook likely worried that strong user discontent about privacy would disrupt its momentum. While MySpace faced stagnating user growth, it still had double Facebook’s number of users. Google’s Orkut had lost steam, but Google and MySpace recently announced they would join forces on Google’s new OpenSocial initiative. Orkut, Friendster, and Netscape co-founder Marc Andreessen announced support for OpenSocial. In the U.K., a key battleground for the social media market, MySpace and Bebo still had the most users. Additionally, competitors displayed an appreciation of having to compete with Facebook on matters related to user privacy. One such savvy competitor was MySpace’s parent company, News Corp. An analyst with Jupiter Research remarked to CNN Money, “News Corp. and Fox recognize the importance of allowing people to be alone with their friends, so they do not feel like they are being looked at by Big Brother. They understand how many competitors they have nipping at their heels right now, so they are doing everything they can not to alienate users.”

With numerous competitors nipping at Facebook’s heels, Facebook retreated almost immediately after launching Beacon. Zuckerberg apologized and announced that Facebook would allow users to opt-out of the Beacon program. But consumers did not accept Facebook’s opt-out scheme, which required them to navigate Facebook’s default privacy settings. Consumer uproar persisted, and, by September of the following year, Facebook revealed it

103. See Sloane, supra note 101.
would shut down Beacon entirely. Zuckerberg would later call Beacon a “mistake.”

Facebook’s retreat with Beacon is evidence of what competition demanded of Facebook at the time. Following subsequent calls for regulation, Randall Rothenberg, the President and CEO of the Internet Advertising Bureau, the industry’s trade association, wrote an op-ed in The Wall Street Journal, proclaiming that users’ ability to resist Facebook’s privacy changes was testament to the free market’s ability to regulate itself. Rothenberg, of course, was wrong.

On the heels the Beacon controversy, and competitors’ rising awareness of the importance of privacy to consumers, Facebook took the unprecedented step of announcing that future privacy changes would be subject to user approval. Under a newly announced democratic process, incorporated into Facebook’s governing documents, Facebook bound itself to allowing users to vote on future changes to important documents that contractually change user privacy—including the Privacy Policy, and other policies such as the Statement of Rights and Responsibilities and The Facebook Principles. Facebook’s press release announced that the voting procedure “offers its users around the world an unprecedented role in determining the future policies governing the service.”

In a rarely given public press conference, Zuckerberg explained that Facebook was doing this because social media users “feel a visceral connection to their rights. . . . We are one of the only services on the web where people are sharing pretty personal and intimate information . . . We’re making it so that we can’t

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110. Randall Rothenberg, Facebook’s Flap, WALL STREET J. (Dec. 14, 2007), https://www.wsj.com/articles/SB119760316554728877?mod=searchresults&page=3&pos=16 (writing “Internet consumers have shown themselves willing and able to police the medium on their own. Just ask Facebook: Consumer regulation proved itself to be a far more effective, efficient, economically productive and unforgiving mechanism than federal regulation ever will be.”).


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just put in a new terms of service without everyone’s permission. We think these changes will increase the bonding and trust users place in the service.”

The promise to let users vote on future privacy changes assured users that Facebook would not leverage its growing power to undermine users’ privacy without users’ meaningful consent. Facebook was already earning healthy profits on its exchange with users. In 2009, Facebook earned $229 million in profits on $777 million in revenues. In 2010, it earned $606 million on $1.974 billion. Profit margins were 29% and 30% respectively—not quite as high as today’s 47% but healthy nonetheless. But as Facebook’s market power grew through the foreclosure of competition and the lock-in of network effects, Facebook would eventually abolish this newly announced voting procedure and reinstate the scope, scale, and invasiveness of Beacon’s mission. Today, Facebook surveillance is a mandatory tie-in with a third-party’s (e.g., The New York Times) use and license of other Facebook business products (Like buttons, Logins, etc.).

B. Pre-Power: More Backtracking and Pattern of Conduct

This section traces the subsequent development of Facebook’s “social plugin” products on the heels of Beacon’s retreat. This early history of Facebook plugins is relevant to an antitrust inquiry for three reasons. First, history reveals that competition continued to restrain Facebook’s ability to initiate surveillance. Second, Facebook’s surveillance framework today requires the coordination of millions of independent third-parties. Facebook induced publishers and others to first coordinate with Facebook upon the representation that Facebook would not leverage their coordination for commercial surveillance. Third, the record opens the door to consider in Part IV whether Facebook’s pattern of conduct reflects an anticompetitive acquisition of monopoly power under Section 2 of the Sherman Act.

The relevant history of Facebook social plugins centers around the “Like” button—introduced early in 2010, at Facebook’s annual F8 developer conference. The Facebook Like buttons, and even the Login buttons, are


115. Id.

116. John D. Sutter, Facebook Makes It Easier for Users to Share Interests Across Web, CNN.COM (April 21, 2010), http://www.cnn.com/2010/TECH/04/21/facebook.changes.fl/index.html. Like buttons are small buttons, which often display the text ‘Like’ alongside a blue thumbs-up icon. Third-parties could install the buttons on their websites. A news website, for example, might display Like buttons near articles. Readers could click on the button to indicate support for an article’s point of view. When clicked, the button counter might increase by one, the user be given an opportunity to comment, and the

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products offered to publishers and other independent businesses to improve site functionality and increase revenue. For publishers, the Like buttons, offered a turn-key review and distribution mechanism. Facebook explained, “[e]ach Like creates distribution on Facebook, which brings more Facebook users back to the article on your site.” Because online publishers generate incremental revenue for each click on an article, more user visits meant more money. According to Facebook, installation of social plugins increased traffic on average by 200%. Thousands of publishers (competitors of Facebook for digital ad dollars), and other websites and apps, hoping for incremental ad revenue, flocked to install the Facebook Like button. All a third-party had to do was install a single line of HTML Facebook code into their application. Within the first week of availability, more than 50,000 sites added social plugins. Thousands of publishers (competitors of Facebook for digital ad dollars), and other websites and apps, hoping for incremental ad revenue, flocked to install the Facebook Like button. All a third-party had to do was install a single line of HTML Facebook code into their application. Within the first week of availability, more than 50,000 sites added social plugins. CNN, The New York Times, The Wall Street Journal, Slate, and ABC were among the many initial adopters.

Facebook social plugins opened a vulnerability between users’ devices and Facebook’s servers much in the same way that Beacon did a few years earlier. Like Beacon, social plugins required independent businesses to install Facebook code on their websites, which opened a backdoor communication between users’ devices and Facebook’s servers. Meaning, the Like button was not simply a static image that one hard-coded into their website. If The New article be published to the user’s News Feed. For users, the Like button was marketed as a communications tool—enabling users to “easily share interesting content with friends.” See Facebook Platform Showcase, FACEBOOK.COM (Dec. 5, 2010), http://developers.facebook.com/showcase/news?p=wallstreetjournal, See also Like Button for the Web, FACEBOOK.COM (2018), https://developers.facebook.com/docs/plugins/like.

117. The Facebook Login plugin (called Registration Plugin at the time) was another plugin launched December 2008 that allowed third-parties to deploy Facebook’s user registration and sign-in, as opposed to their own. More seamless sign-in meant more sign-ins, which often meant more revenue. See Jessica E. Vascellaro, Facebook Plans Enhanced Ties to Outside Services, WALL STREET J. (July 24, 2008), https://www.wsj.com/articles/SB1216872516394803777?mod=searchresults&page=1&pos=17.


119. Id.

York Times had installed Like buttons, and the user visited nytimes.com, while the user initiated an HTTP request with a Times server, the nytimes.com response would include Facebook code that would then automatically initiate a separate request from the user to Facebook—for the purpose of retrieving and displaying a Like button. As was the case with Beacon, if it so wanted, Facebook could leverage third-party initiated requests to glean users’ data, and to write and/or read tracking cookies.  

For many years, Facebook perpetuated the belief it would not leverage backdoor access, the way it had with Beacon, to conduct surveillance for commercial purposes. Consumers had shown an aversion to the idea of Facebook tracking them while not on Facebook. The steady stream of public claims that Facebook did not and would not use the network of code for social plugins to monitor and track consumer behavior prompted consumers to continue to trust and therefore choose Facebook over alternatives in the market. But Facebook’s claims were also important in soliciting the coordination of third-parties to spread the presence of Facebook code across the internet. Many third-parties, publishers for example, competed with Facebook on the advertising side of the market. They licensed and installed social plugins as a means to distribute their own content. Surveillance of their own readers, however, could be used against them to undercut the value of and pricing power over their own proprietary readers. Specifically, if Facebook could compile a list of people that read the Journal, even those who did not use Facebook, it could simply sell the ability to retarget “Journal readers” with ads across the internet for a fraction of the cost that the Journal charged.

When Zuckerberg first announced the Like buttons at the 2010 developer’s conference, he did not mention that Like buttons could be used to track users. At the time, Facebook was under intense privacy scrutiny, some politicians threatened investigations, and Facebook faced competition over privacy. MySpace announced it was now offering superior privacy controls in an attempt to get privacy-concerned users to switch. Facebook was on a pre-IPO mission to get users to choose Facebook over alternatives in the market, and in May 2010, Zuckerberg convened a press conference to address privacy

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123. Cookies set during the retrieval of third-party functionality are called third-party cookies (or TPCs). For a definitional break-down of third-party cookies, first-party cookies, and session cookies, see Jessica Davies, Know Your Cookies: A Guide to Internet Ad Trackers, DIGIDAY.COM (Nov. 1, 2017), https://digiday.com/media/know-cookies-guide-internet-ad-trackers/.

124. Facebook surveillance of users on independent publisher sites and apps benefits Facebook advertising revenue in two ways. One, Facebook can leverage the data to better target users (or conduct superior attribution for) on Facebook’s own properties. Two, Facebook can leverage the data to directly target a publisher’s readers and price undercut a publisher’s ad rates.

concerns. The consumer technology publication CNET covered Facebook’s Like button launch and addressed users’ concerns around Like buttons being used to decrease user privacy. One issue, even absent the topic of cookies, was that the presence of Like buttons on other sites enabled Facebook to receive any internet users’ URLs as they moved around the internet, and Facebook’s privacy policy did not appear to obtain users’ consent for this practice. Facebook responded by saying that its privacy statement was “not as clear as it should be, and we’ll fix that.” Barry Schnitt, a Facebook spokesman, then allayed concerns by explaining that Facebook plug-ins work like any other plug-ins on the internet, Facebook does not use social plug-in data for advertising, and Facebook may use received data to catch bugs in its software.

But in November of 2011, Dutch researcher Arnold Roosendaal exposed Facebook’s hidden activity with Like buttons in the way that Berteau did earlier with Beacon. Shortly after launching the Like buttons, Roosendaal published a paper showing that Facebook was using the Like button code now installed on third-party sites to write and read user cookies. Roosendaal showed that each time a Facebook user visited a site with a Like button, Facebook retrieved the user’s Facebook website login cookies, which contained the user’s unique identifying number, traceable to his or her real identity. Facebook again was leveraging login cookies from the communications network to conduct detailed surveillance possibly for the advertising side of its business. In addition to a user’s ID number, Facebook retrieved the specific URL the user was on, which revealed the title of an article the user was reading or the name of the product a

126. On May 26, 2010, Facebook convened a press conference at its Palo Alto headquarter. There, in response to Julia Boorstin, CNBC: How does this controversy and your new approach to privacy affect your approach to revenue and your business model?, Zuckerberg said: “So it might be kind of crazy. . . to people. . . I don’t know. It might seem weird. I don’t actually know exactly what the external perception of this is. But I always read these articles that are like “OK you guys must be doing this because it’s going to make you more money.” And honestly for people inside the company that could not ring less true.” KIRKPATRICK, supra note 39; Jessica E. Vascellaro, Facebook Grapples with Privacy Issues, WALL STREET J. (May 19, 2010), https://www.wsj.com/articles/SB10001424052748704912004575252723109845974. U.S. senators Charles Schumer (D-N.Y.), Michael Bennet (D-Col.), Mark Begich (Alaska) and Al Franken (D-Minn.) wrote an open letter to Facebook founder and CEO Mark Zuckerberg addressing privacy concerns. See generally Senators’ Letter to Facebook, POLITICO (Apr. 27, 2010), https://www.politico.com/story/2010/04/senators-letter-to-facebook-036406.
127. Id. (for example, CNET pointed out that Facebook’s FAQ stated, “No data is shared about you when you see a social plug-in on an external website,” and that Facebook’s privacy policy also did not appear to obtain users’ consent.)
128. Id.
129. Id.
130. Id.
132. Id.
user was buying. Roosendaal then demonstrated that Facebook used these open connections to write cookies and surveil the behavior of people that did not even have Facebook accounts.

The Wall Street Journal published the results of its own investigative study confirming Roosendaal’s findings. The study, led by a former Google engineer, examined the presence of social widgets on the world’s top 1,000 most-visited sites. The Journal concluded that Facebook buttons had been added to millions of websites, including a third of the top 1,000 most-visited sites. Facebook knew when a user reads an article about “filing for bankruptcy” on MSNBC.com or about depression on a small blog, even if the user didn’t click any Like button.

With a finger on the pulse of Americans’ sentiment towards tracking, the Journal recommended users log-out of Facebook to stop Facebook from tracking them and gave Facebook an opportunity to comment. Bret Taylor, Facebook’s chief technology officer at the time, responded definitively to the privacy breach allegations, “We don’t use them for tracking and they’re not intended for tracking.” Taylor clarified that Facebook places cookies on the computers of people that visit facebook.com to protect users’ Facebook accounts from cyber-attacks.

The Journal also gave Facebook an opportunity to answer to Roosendaal’s allegation that Facebook was tracking people that did not even have a Facebook account. Facebook said that Roosendaal had found a “bug,” and that it had therefore discontinued this practice.

But the issue—as important as it was—was not put to rest. Later that year, in September of 2011, Nik Cubrilovic, an Australian internet security contractor, followed up on Roosendaal’s and the Journal’s discoveries, and published an article showing that Facebook Like and other plugins were still tracking user activity outside of Facebook even if users had completely logged out of Facebook. Normally, when a user logs out of a service, the service’s login cookies terminate. But Facebook’s cookies weren’t terminating, they were persistent and still able to identify and track people. Mainstream media picked up on Cubrilovic’s reporting in an effort to hold Facebook accountable.

133. Amir Efrati, ‘Like’ Button Follows Web Users, WALL STREET J. (May 18, 2011), https://www.wsj.com/articles/SB10001424052748704281504576329441432995616 (The WSJ study also found that Facebook trackers could continue to track internet users even if users had closed their browsers or turned off their computers.). See also Reed Albergotti, Facebook to Target Ads Based on Web Browsing, WALL STREET J. (June 12, 2014), www.wsj.com/articles/facebook-to-give-advertisers-data-about-users-web-browsing-1402561120.

134. Efrati, supra note 133.

135. Id.

136. Id.

In coverage about Facebook’s “alleged cookie snooping,” the Huffington Post asked, “Is Facebook tracking which websites users visit even after they’ve logged out of the service?”

Facebook again acted quickly to pacify the growing drumbeat of public concern over Facebook’s intentions with regards to leveraging social plugin code for surveillance. A Facebook spokesperson, Facebook engineers, and the Facebook privacy policy were put forth to dispel worry. In one instance, Facebook responded to a CBS News inquiry with a statement that, “Facebook does not track users across the web. . . . No information we receive when you see a social plugin is used to target ads, [and] we delete or anonymize this information within 90 days False.”

Elsewhere, Facebook engineers responded directly in the comments section of blogs and articles. Facebook engineer Arturo Bejar pleaded with users, “please know that . . . when you’re logged in (or out) we don’t use our cookies to track you on social plugins to target ads or sell your information . . . We use your logged in cookies . . . for safety and protection.” When pressed by news outlet ZDNet for an official statement, a Facebook spokesperson directed the reporter to Bejar’s statement. The New York Times also disseminated Facebook’s representations to the public.

Facebook’s reasoning though—regarding users’ safety and protection—still called into question why Facebook cookies contained users’ Facebook ID numbers. Normally, a company might include user ID numbers in cookies if it intended to conduct individual tracking. Thus, in direct response to Cubrilovic’s allegations, Facebook promised to change how its cookies worked so that users’ ID numbers were not embedded in cookies after users logged out. The removal of account ID numbers from cookies ensured that Facebook could not conduct de-anonymized user surveillance in spite of claims of its intentions not to do so.

138. Gilbert, supra note 137.
140. See Protalinski, supra note 137 (Facebook spokesperson replied to a journalist’s request for comment by pointing to Facebook engineer’s public blog comments).
141. Id.
142. Id.
144. See Protalinski, supra note 137.
145. See Alan Henry, Facebook Is Tracking Your Every Move on the Web; Here’s How to Stop It, LIFEHACKER.COM (Sept. 26, 2011) https://lifehacker.com/5843969/facebook-is-tracking-your-every-move-on-the-web-heres-how-to-stop-it.
If Facebook, or any other company, did want to conduct mass commercial surveillance on users, one precondition would be the pervasive consent and coordination of third-parties (e.g., *The New York Times* and Overstock). One way a company could do this would be to do so overtly, as Facebook had with Beacon—simply ask users with a pop-up box if they want to share what they are reading or buying on other sites with Facebook. But this direct, overt, attempt at getting users to share their information had failed. Another way Facebook could go about accomplishing the same end would be to get third-parties to install Facebook code for an independent product, like the Like buttons, then eventually leverage use and dependence of Like buttons (or other social plugins) to later extract a new use permission.

For the American consumer, this architecture of interests in the market was precarious. Independent businesses were creating consumer privacy vulnerabilities for their own financial gain; and, it all rested on Facebook living up to its word. This fact did not wash over the reporters that sought to hold Facebook accountable to its representations. In December of 2012, *The Wall Street Journal* revisited the issue, to point out that Facebook plugins now appeared on two-thirds of websites surveyed. But Facebook again publicly assured that it only uses data from unchecked Like buttons for security purposes and to fix bugs in its software. Noticeably absent from Facebook’s public statement was the fact that Facebook also filed a patent application the year prior, on September 22, 2011, for a “method . . . for tracking information about the activities of users of a social networking system while on another domain.”

Michael Arrington, veteran tech blogger, caught it and called it “Brutal Dishonesty.”

If Facebook wanted to eventually usurp privacy by using the back-end code from Like buttons or other social plugins, it faced a roadblock—the user referendum process for privacy changes introduced a few years earlier. Thus, while publicly representing that it only used social plugin data for users’ safety and protection and generally deflecting concern over Facebook intentions, Facebook simultaneously dismantled the user voting process. In late 2012, with over a billion users, and an historic initial public offering now under its belt, Facebook addressed this roadblock expediently. Facebook proposed major changes that could pave the way for Facebook to decrease user privacy. One provision proposed was the abolishment altogether of future referendums for

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privacy changes. After soliciting user feedback, and receiving push-back, Facebook submitted the proposed changes to a vote. Eighty-eight percent of users voted against Facebook’s proposed privacy changes.

But Facebook shrugged. At this point, users had high switching costs and the fine print of the governing documents requiring referendums had a kill switch. In order for a user vote to be binding, 30% of users would have had to vote in the election. With over a billion users, and only some 589,000 votes casted, Facebook discarded the results of the election. Facebook then moved forward with privacy erosions and the abolishment of the referendum process. Many users protested that Facebook had not informed them of the upcoming election, either by notifying them upon a Facebook login or by simply sending them an email. Other users claimed to receive an email notifying them of a vote, but not informing them how and where to vote. It was an election where Facebook didn’t want anyone voting.

C. Post-Power: Deterioration of the Promise Not to Track

“We give lots of f*** about your privacy, so we wrote this. Read it, so you know what the f*** we’re going to do with the s*** you post . . .”

—Comments by Facebook employees in 2011 parodying the genuineness of Facebook’s concern for user privacy; specifically, the Facebook user privacy policy.

By early 2014, rivals that initially competed with Facebook including MySpace, Friendster, Mixi, Cyworld, hi5, BlackPlanet, Yahoo’s 360, AOL’s Bebo, and dozens of others, had exited the market. Google—Facebook’s rival and nemesis—announced it would shut down its competitive social network Orkut. By June of 2014, Orkut had exited the market, effectively ceding the social media market to Facebook. For Facebook, the network effects of over a billion users on a closed communications protocol further locked-in the market in its favor. With countless friends and family connected to a given consumer, the cost of foregoing Facebook for the consumer grew in

149. See ANTONIO GARCIA MARTINEZ, CHAOS MONKEYS: OBSCENE FORTUNE AND RANDOM FAILURE IN SILICON VALLEY (2016).
151. Id.
152. Id.
155. See supra text accompanying notes 69-70.
156. See Huet, supra note 76.
proportion with Facebook’s growth. For Facebook, these circumstances—the exit of competition and the lock-in of consumers—greenlit a change in conduct.

Facebook’s monopoly power gave it the ability to further deteriorate privacy and extract more of the user’s data—which, as Dave Wehner, chief financial officer of Facebook, clarified on Facebook’s Q2 2018 earnings call, is directly correlated with higher ad revenues.157 Part I of this Paper detailed Facebook’s initial commitment to privacy, and Sections A and B surveyed Facebook’s inability to extract a condition of surveillance in a competitive market. Section C traces Facebook’s ability to reverse course post-power—direct evidence of monopoly power. First, Facebook initiates user surveillance for commercial ad purposes. Second, Facebook ties user identification with cookies to conduct more intrusive surveillance. Third, Facebook then circumvents user attempts to opt-out or block Facebook’s quality degradations. The three quality deteriorations can be understood as the monopoly rents Facebook is able to command in the market today. Absent competition, Facebook is able to degrade quality levels below that which was required in a competitive market, and financially profit from this conduct.

Facebook’s quality deterioration led to an interesting phenomenon—decreasing user satisfaction, despite Facebook’s continued ability to retain and grow its user base. According to the American Consumer Satisfaction Index (ASCI), social media is amongst the lowest scoring of all industries surveyed. With an industry average of 72, social media’s ASCI score is lower than even health insurance and airlines.158 Facebook, with a score of 67, and a trailing average of 66, has an ASCI score lower than almost every American airline—and is also lower than the average industry benchmarks of 95% of the industries covered by the ASCI study. This paradox defies the law of demand—which says that given a constant price, a decrease in quality must necessarily lead to a decrease in buyer consumption.

I. Facebook Initiates Commercial Surveillance

In June of 2014, Facebook announced it would leverage its code presence on third-party applications to track consumers, enabling it to surveil the specific online behavior of this country’s citizens despite widespread preference to the contrary.159 Facebook would do precisely what it had spent seven years

157. Facebook Q2 Earnings, supra note 12.
promising it did not and would not do, and finally accomplished what the previous competitive market had restrained it from doing. With a relatively quick software update, Facebook would leverage the code on third-party sites and apps used to deliver other Facebook products—Like buttons, Login buttons, conversion tracking pixels, retargeting pixels, and the Facebook software development kit—for the additional new purpose of tracking users.

In a previously competitive market, Facebook was not able to get away with this qualitative degradation. Now Facebook could significantly degrade its quality because consumers no longer had alternative social networks to turn to.

Facebook had repeatedly pacified privacy concerns by representing that any data gleaned from the presence of Facebook code on third-party sites was not to be used for “commercial purposes” but rather for users’ own “safety and protection.” But now Facebook changed course and announced that the data derived from tracking consumers would augment Facebook ad targeting, attribution, and measurement. In other words, this deterioration of privacy would be directly related to increased revenue and profits. First, Facebook would use data from this commercial surveillance to enhance its ad targeting algorithms, which meant that Facebook ads could be more targeted and reach a larger relevant advertising base than those of other ad sellers in the market—such as The New York Times or Hearst. Second, data from commercial surveillance would allow Facebook to get paid for more advertising through increased attribution. A significant percentage of marketers only pay Facebook if ads result in a specific measurable outcome (i.e., a click on an ad or a sale of a product). Facebook calls these action-based ads. Attribution refers to the process of identifying the set of user actions that lead to a desired result.

Increased commercial surveillance allows Facebook to fine-tune attribution


160. The Facebook conversion tracking pixel is a piece of Facebook code that advertisers affix to their websites to enable Facebook to report back to the advertisers whether a Facebook ad campaign is yielding traffic and sales; in other words, it a piece of code that allows the advertiser to measure the return-on-investment of Facebook ad campaigns. The announcement that Facebook would use data it retrieves from its conversion tracking pixels also upset advertisers. The tracking pixel was there to report to the paying advertiser whether the ads were working. Now, Facebook could use data garnered from one campaign to sell advertising to competitors. For example, Facebook could use data from the Facebook conversion tracking pixels on Audi’s website (to measure Audi’s ad campaign), to better sell advertising to Mercedes (by targeting users who previously looked at Audis on Audi’s website).


162. See id. (Facebook is using the passive data, where users go on their PCs and phones, to make its own ads smarter). See also, Parmy Olson, Facebook Moves to Become the World’s Most Powerful Data Broker, FORBES MAGAZINE (April 30, 2014), https://www.forbes.com/sites/parmyolson/2014/04/30/facebook-moves-to-become-the-worlds-most-powerful-data-broker/#662d16d40206 (Facebook uses personal data as “leverage with advertisers who are desperate to better-target their ads”).

models and claim credit for more actions, which further increases Facebook’s ad revenues.

When Facebook reversed course in 2014, unlike when it tried to do so earlier, Facebook code was deployed across millions of sites and mobile apps, and the intentions of the code were altered in one fell swoop. Over the course of the seven years that Facebook represented it would not use social widgets to track consumers, millions of websites had signed up for and installed Facebook plugins.¹⁶⁴ Not including mobile apps, this included approximately 30% of the top 1 million of the most-visited websites,¹⁶⁵ including news websites like The Wall Street Journal, The Washington Post, and The San Francisco Chronicle. Facebook laid the groundwork for tracking by requiring third-parties to install Facebook code in order to license Facebook’s other products. For independent publishers and retailers, Facebook would thereafter tie surveillance of their own customers with the continued use and license of Facebook’s social network products for businesses.

Proprietary access to subscribers and the identities of readers and visitors is a highly guarded asset historically by subscription businesses. It is unlikely that publishers would have shared this information unless they were under the belief that Facebook was a content distribution platform and traffic generator, not a surreptitious aggregator of consumer data for Facebook’s own internal, and competitive, advertising sales efforts. Facebook obtained the initial cooperation of third-party businesses through the inducements of content distribution and the convenience of single login. Now Facebook would receive the ability to monitor the behavior of their customers—competitors with Facebook in the digital advertising market—by changing the fine print of permissions. Facebook increasingly knew as much about The Wall Street Journal’s readers as the Journal did itself. Furthermore, unlike the Journal, Facebook now knew which Journal readers were avid ESPN readers, giving it the capability to bundle and sell targeted audiences, which further commoditized the value of competitors’ inventory. Under the new regime, when a consumer visited a website with a Facebook plugin, Facebook piggy-backed onto the requests and responses necessary to simply display the plugins, to now also surveil the users of competitor ad sellers—rendering the Facebook code a Trojan Horse of sorts.

From the consumer’s perspective, consumers could choose whether to reveal information on Facebook itself, and they did.¹⁶⁶ Now, consumer choice,

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¹⁶⁴ See BUILTWITH.COM, supra note 6.


¹⁶⁶ See Acquisti & Gross, Imagined Communities, supra note 50 at 13 (e.g., Acquisti & Gross’ study of what Facebook users do to satisfy their desire for privacy revealed that users “claim to manage their privacy fears by controlling the information they reveal”).
even the choice not to use Facebook, no longer mattered. In the earlier competitive market, the cooperation of third-parties, on which Facebook’s tracking depended, was predicated on how consumers felt about the proposition. As discussed above, previously, when consumers protested, participating companies stopped coordinating with Facebook.\footnote{167} In 2014, unlike in 2007, Facebook did not have only a handful of third-parties working with it. Facebook had a substantial portion of the horizontal market coordinating with it for some functionality or another—whether for user-registration or article sharing. These independent businesses now had their own switching costs. They had built their businesses over the last seven years to depend on Facebook code, and now, that reliance was correlated with their own revenue performance.\footnote{168} Finally, the conscientious objector no longer had any power to alter the direction of the wider market.

Reflecting its ability to influence market actors in the ecosystem, Facebook then required all businesses to change their own privacy policies to extract from their own users the consent to have Facebook track them for commercial purposes. For convenience, Facebook provides exact copy-and-paste legal language to use:\footnote{169}

“Third parties, including Facebook, may use cookies, web beacons, and other storage technologies to collect or receive information from your websites, apps and elsewhere on the internet and use that information to provide measurement services, target ads . . . ”

This is how consumers went from having a preference of privacy to having nearly every competitor in the market extract from them identical and uniform consent for Facebook’s commercial surveillance practices.

2. Facebook Leverages Consumer Identity for Stronger Surveillance

Facebook further deteriorated user privacy by tying the newly announced tracking of consumer behavior across the wider internet with the real, stable, human identities that Facebook knew because of its position in the social network market.\footnote{170} When the restraining forces of competition worked,
Facebook had to remove user IDs from cookies to ensure that Facebook could not conduct de-anonymized surveillance.¹⁷¹ Now, with the foreclosure of competition, Facebook would reinstate invasive identity monitoring.¹⁷² This reinstatement is further evidence of Facebook’s monopolistic market power.¹⁷³

By augmenting tracking with consumer identification, Facebook also circumvented users’ attempts to limit tracking by deleting cookies (or resetting a mobile device’s advertising identifier). Clearing cookies expunges cookie variables from a user’s device and breaks the link between one’s device and the cookie’s memory.¹⁷⁴ For example, suppose The New York Times wanted to surveil a user via cookie ID 123456789. If a user deleted the cookie, the next time the user visited nytimes.com, the Times’ server would try to identify the user but find no cookie. The profile The Times had compiled on user 123456789 would thereafter be worthless. The ability to correlate tracking data to one’s identity now circumvented the ability of consumers to wipe their slate clean—

¹⁷¹ See Henry, supra note 145.
¹⁷² For an advertising competitor’s perspective on Facebook’s decision to tie Facebook IDs with tracking cookies, see Olson, supra note 162 (where Mark DiMassimo, CEO of the ad agency DiMassimo Goldstein, explains “Facebook [now] knows who you are”).
¹⁷³ Part IV of this paper examines whether Facebook illegally acquired monopoly power in the social network market. A separate issue to be examined is whether, by bundling social network user IDs into its own advertising inventory and the inventory of other market actors like Hearth, Facebook is illegally “leveraging” its monopoly position in the social network market to inappropriately monopolize the advertising market. Though the Supreme Court curtailed Section 2 “leveraging” theory in Verizon v. Trinko, some Courts have interpreted Trinko to leave the door open to some types of leveraging claims. Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004); Z-Tel Communications, Inc. v. SBC Communications, Inc., 331 F. Supp. 2d 513 (E.D. Tex. 2004). The Areeda treatise contends the Sherman Act permits “leveraging” claims where (a) a firm uses monopoly power in market A, (b) to place rivals in market B at a competitive disadvantage (by raising B’s costs or decreasing the quality of B’s product), and (c) higher prices, reduced output, or reduced quality (normally associated with monopoly power) results in market B. In the technical sense, the authors of the Areeda treatise argue that proof of (c) meets the definition of “monopolization” or “attempt to monopolize” within the literal language of §2, that monopoly market share is not necessary to a finding of “monopolization” or “attempt to monopolize”, and that therefore, “leveraging” is an unnecessary distinguishable §2 theory. AREEDA & HOVENKAMP, §652, supra note 26. Furthermore, Facebook’s tracking of consumers on third-party sites and leveraging of user IDs may be challenged as illegally maintaining and perpetuating the Facebook monopoly. New entrants in the social media market that also rely on attracting advertisers cannot compete with Facebook’s commercial surveillance. Consider, for example, the fact that Facebook monetizes U.S. & Canada users at a $17.07 average revenue per user (ARPU), but that Snapchat can only monetize North American users at a $1.81 ARPU (even though Snapchat users only spend half the amount of time on Snapchat than they do on Facebook). See Alexei Oreskovic, Look at the Big Gap Between Snapchat’s Revenue Per User and Facebook’s, BUSINESSINSIDER.COM (May 10, 2017), https://www.businessinsider.com/snapchat-arpu-versus-facebook-arpu-charts-2017-5.
Facebook, unlike The New York Times, could immediately match observed behavior with a stable identity. The social network had a real-name policy, and occasionally required users to prove their names with state-issued identification. To Facebook, it was not user 123456789 that was reading Coming Out to Your Wife, it was simply Jacob Greenberg. If the user deleted Facebook cookies, the profile Facebook had compiled could still live on under the user’s real-name profile. Furthermore, Facebook could re-cookie a user the next time the user visited the Facebook social network, which users did multiple times per day.

With code that used a persistent singular identification mechanism now pervasive across competing websites and apps, Facebook could connect the dots on consumers as they moved from site to site, and from computer to mobile phone, to compile rich dossiers on users. Facebook was the single eye that could see what John Doe was doing on both The New York Times and on The Wall Street Journal. The competitive market once ensured that competitors on the advertising side of the business did not track and monitor what users were doing across the horizontal market. The unique ability to conduct horizontal surveillance, for both Facebook and Google, explains the current duopoly in digital advertising, where nearly all industry growth goes to only two companies. Both companies, however, only achieve this end by leveraging a monopoly position in another market—for Facebook, the social network market, and for Google, the search market.

Armed with data derived from Facebook’s new surveillance capabilities, Facebook could bill advertisers for more conversions, and sell advertising based on surveillance data. For example, if Sally Smith read on the family’s shared computer an article about marital problems on a small hometown news site, Facebook could know and save it to Smith’s dossier. When Smith wakes up the next morning refreshed from a night’s sleep, the marital drama now tucked in the past, and logs onto Facebook, she might now be presented with an ad from a divorce lawyer in her Facebook News Feed. Alternatively, her husband might have woken up, logged opened ESPN on the same computer, and himself been presented with an ad for a divorce lawyer. Behind the scenes in both cases, Facebook data derived from Facebook surveillance is the facilitator.

175. For Facebook’s name policy, see What Names Are Allowed on Facebook?, FACEBOOK.COM, https://www.facebook.com/help/112146705538576 (stating that “The name on your profile should be the name that your friends call you in everyday life. This name should also appear on an ID or document from our ID list.”). Sometimes, Facebook has required users to prove their identity by submitting a copy of government-issued identification. See, e.g., Hamm Samwich, A Drag Queen’s Open Letter to Facebook, HUFFINGTON POST (Sept. 18, 2014), https://www.huffingtonpost.com/hamm-samwich/nominative-dysphoria-a-dr_b_5839148.html.

176. See generally Rodgers, supra note 170 (explaining that the Facebook ID, uses the “login” as the “foundation” of tracking, measurement, and ad personalization).

177. See Delo, supra note 161.
3. Facebook Circumvents Consumer Attempts to Opt-Out

Consumers did not want Facebook to track their behavior across the Internet,\(^178\) so they tried to circumvent Facebook’s new quality deteriorations. On the one hand, this consumer behavior is further evidence of users’ preference for no surveillance. On the other, Facebook’s behavior is evidence of Facebook using its market power to forcibly impose on consumers that which they are still—in a consolidated market—trying to resist. First, Facebook itself did not and does not allow consumers to opt-out of the new off-site tracking. Second, Facebook chose to ignore consumers’ explicit requests, enacted via the browsers’ Do No Track option, to not be tracked. Third, when consumers installed ad blockers to circumvent tracking and targeted advertising, Facebook responded by circumventing the users’ installed ad blockers.

First, Facebook did not give users the option to opt-out of Facebook’s tracking and monitoring of their online behavior.\(^179\) Instead, Facebook informed users they could stop Facebook from showing them ads based on this new surveillance data by opting out on the Digital Advertising Alliance (or DAA) website. The DAA is an industry alliance formed in response to FTC investigations into the industry’s privacy practices and reflects an industry effort to police itself. The DAA’s stated mission is to give consumers the choice to opt out of behaviorally targeted advertising.\(^180\) Facebook, Google and others are alliance members. On the DAA’s website, the opt-out process was, conveniently, painstakingly inconvenient—the user had to go through a multiple-step process for each Facebook account, browser, and device in each household. One might recall the inconvenience consumers faced opting out of direct marketing calls before adoption of the Do Not Call list. For a household of three, opting out required going through the opt-out process about nine times—just for Facebook.\(^181\) If the consumer did go through the DAA’s opt-out process, the DAA website often informed the consumer that the opt-out


\(^179\) See Angwin, supra note 146.


\(^181\) Assuming 3 configurations per person (for example, 2 browsers & 1 mobile device).
requests “were not completed. This may be the result of a temporary technical issue.”

Furthermore, the DAA’s opt-out solution only worked if a consumer set her browser security settings to permit third-party cookies—the very mechanism that allows companies like Facebook to do what the consumer was now trying to avoid. Almost to the point of comedy, the DAA’s website then informed users that if they cleared their cookies (to rid tracking cookies), doing so would inadvertently have the effect of allowing Facebook to track them all over again. Even if the consumer succeeding at opting out, he only opted out of being shown targeted advertising, not of Facebook surveillance.

Second, Facebook also circumvented those users who had explicitly set their browser privacy settings to Do Not Track. Since the DAA’s solution did not provide users with meaningful choice, many users instead activated the Do Not Track settings in their web browsers. The Do Not Track setting in browsers was another industry response to threatened regulatory action. Back in 2010, the FTC toyed with the idea of creating a singular national “Do Not Track” list for digital advertising companies, to parallel the Do Not Call list for telemarketers. Such a Do Not Track list would have given consumers a “kill switch,” which would turn off tracking across the horizontal market.

In an effort to ward off regulation, various industry players promised to give users Do Not Track opt-outs. Microsoft updated the Internet Explorer browser to provide users with a Do Not Track setting. Other browsers—Firefox, Safari, Opera, and Chrome—also adopted the Do Not Track protocol.

With Safari, for example, a user could go to Preferences Settings, toggle to the Privacy tab, then select the checkbox “Ask websites not to track me.” The Do Not Track protocol though didn’t technically block companies from tracking users. Rather, a user’s browser would simply send a message notifying companies

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182. This has been my experience as a consumer from 2016 to today. My request to opt-out has resulted in an error message stating that the DAA could not process my request. When I try to opt out of Facebook tracking, the DAA presents the following message: “Opt-out requests for 1 participating companies were not completed. This may be the result of a temporary technical issue. Select “Try Again” to request opt outs from those companies again. Click “Understand Your Choices” for more information.” See DAA Webchoices Browser Check, Digital Advertising Alliance, http://optout.aboutads.info/?c=2&lang=EN (accessed Sept. 2, 2018).

183. See id.

184. Id.

185. See Kenneth Corbin, FTC Mulls Browser-Based Block for Online Ads, INTERNETNEWS.COM (July 28, 2010), http://www.internetnews.com/ec-news/article.php/3895496/FTC+Mulls+BrowserBased+Block+for+Online+Ads.htm.


187. Safari Privacy Settings (Open Safari application; then open “Preferences” from the menu bar; then enter the “Privacy” settings; then check the “Ask websites not to track me” box).
that he or she does not wish to be tracked.\footnote{188} It was simply a polite request, which a company could choose whether or not to heed.

In another demonstration of market power, Facebook would ignore users’ activation of Do No Track.\footnote{189} In 2013, Erin Egan, the chief privacy officer of Facebook, explained that Facebook would bypass consumer Do Not Track settings because Facebook does not track consumers for advertising purposes, in effect arguing that consumers do not understand what Do Not Track means.\footnote{190} “We don’t use that data for an advertising purpose,” she emphasized. In 2014, after Facebook changed course and began tracking consumers for commercial purposes, Facebook simply continued to ignore consumers’ Do Not Track signals.

Sensing rising consumer frustration, the private market responded with software that consumers could use to both stop surveillance and block targeted ads from loading on pages altogether.\footnote{191} Ad blockers prevented not only the visual display of advertising, but also third-party tracking. Generally, this worked by blocking the user’s device from making third-party initiated HTTP requests with advertising companies. In the Fall of 2014, after Facebook’s new tracking announcements, online searches for “how to block ads” spiked at an unprecedented rate.\footnote{192} Shortly after, Pew Research Center reported that 91% of Americans felt they had lost control over the way their personal data is collected and used.\footnote{193} A Forrester Research report showed that 19% of consumers had taken steps to activate the Do Not Track feature in their browsers—even though Do Not Track had no teeth.\footnote{194} The marketing materials of AdBlock, the #1 ad blocking software on the market, touted “Privacy is

\begin{footnotesize}
\begin{enumerate}
\item[188] \textit{Id.}
\item[191] Common ad blockers work by communications blocking, where the client’s request to an ad servers or ad company is prevented from occurring. They can also work by element hiding, where HTML elements are loaded onto the client’s page but hidden from the user (for example, hide elements with class = “Ad”). Disconnect and Privacy Badger are two products that include anti-trackers with their ad blockers, but Privacy Badger was the only company that could block tracking conducted by Facebook Like buttons.
\end{enumerate}
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Paramount.” However, publishers whose livelihoods depended on advertising started to panic at the prospect of mass consumer adoption of ad blockers. AdBlock, and another anti-tracking software company called Disconnect, joined hands with privacy advocacy group Electronic Frontier Foundation, in an attempt to broker an agreement with publishers—if publishers would only respect users’ activation of Do Not Track, they would drop their fences and stop blocking their ads.

The use of ad blocking software by consumers rose in tandem with the market’s ability to extract the rent of commercial surveillance. A 2015 joint study between Adobe and PageFair showed that there were 198 million people actively blocking ads, with a U.S. year-over-year growth rate of 48%. In August of 2015, Apple announced that its new mobile operating system, IOS 9, would permit developers to introduce apps that enabled content blocking into the app store. When IOS 9 released in September, the top app downloads were immediately for ad blockers. By 2016, reports showed that one in five smartphone users—or 420 million people worldwide—were blocking ads when browsing on the mobile web. By 2017, a report from the advertising research company eMarketer estimated that one-quarter of U.S. internet users were blocking ads one way or another. In tandem, independent studies conducted by the Pew Research Center, and the Annenberg Center, continued to show that Americans were overwhelmingly opposed to being shown ads targeted to them.

based on information derived from surveillance.201 Was this the largest boycott in human history?202

Facebook raced to engineer a way to circumvent users’ installation of ad blockers. Initially, Facebook prevented its public-facing pages from loading on user devices that had ad blockers installed. If consumers landed on forbes.com and Forbes prevented its page from loading, consumers could switch to a Forbes competitor to read news. With Facebook, consumers did not have any alternative product they could switch to. Then, in August of 2016, Facebook announced it had found a way to circumvent ad blockers entirely.203 Facebook “flipped a switch on its desktop website that essentially renders all ad blockers . . . useless.”204 This time, Rothenberg proclaimed, “Facebook should be applauded for its leadership on preserving a vibrant exchange with its users.”205 Here too, Facebook’s dominance played a role in its ability to devise a method to circumvent blockers.206 Before long, Wehner was sharing on earnings calls the ad revenue growth Facebook was able to sustain by evading ad blockers. For example, on Facebook’s Q3 2016 earnings call, Wehner pointed out that half of the 18% year-over-year revenue growth in desktop ads was “largely due to our efforts on reducing the impact of ad blocking.”207 From Q3 2016 to the end of Q2 2017, Facebook was able to make $709 million dollars circumventing ad blockers.208

With rapid consumer adoption of ad blockers and Facebook’s unique ability to force onto consumers the presence of behaviorally targeted ads, Facebook approached publishers with a proposition. Facebook offered publishers the

201. See Mary Madden & Lee Raine, Americans’ Attitudes About Privacy, Security and Surveillance, PEW RES. CTR. (May 2, 2015), http://www.pewinternet.org/2015/05/20/americans-attitudes-about-privacy-security-and-surveillance/ (study revealed that 93% of American adults believe that having control over who gets their information is important; 88% said it is important that they are not watched or eavesdropped on without their permission; 84% of respondents wanted control over what online marketers knew about them); Joseph Turow, Michael Hennessy & Nora Draper, The Tradeoff Fallacy, NEW ANNENBERG SURVEY RESULTS (2015), https://www.asc.upenn.edu/sites/default/files/TradeoffFallacy_1.pdf.


203. Facebook only had to block ads on desktop, because Facebook had already found way to serve ads in mobile apps that could not be touched by ad blockers.


205. See id.


ability to publish content not on their own websites, but inside the walls of the impenetrable Facebook, where Facebook could ensure the delivery of behaviorally targeted advertising that commanded higher rates in ad markets.\textsuperscript{209} Despite normally being competitors in the ad market, participating publishers like The New York Times worked in tandem with Facebook to sell the advertising. If a participating publisher sells the advertising, it keeps 100% of the ad revenue.\textsuperscript{210} If Facebook sells the advertising for The New York Times, Facebook retains a 30% cut. Facebook had the power to force invasive advertising on consumers through a capability that other publishers like The New York Times did not have.\textsuperscript{211} Facebook could successfully fight against users’ preference for privacy—users had to submit to the terms of trade imposed upon them by this century’s new communications network.

III. INDIRECT EVIDENCE CONFIRMS FACEBOOK’S MONOPOLY POWER

Facebook entered a competitive social media market and disintermediated competition by offering superior consumer privacy protections. Subsequently, Facebook tried to undermine privacy to initiate consumer surveillance for the purpose of delivering more targeted advertising, but the competitive market would not allow it. Only after other social networks like MySpace and Orkut exited the market, and Facebook amassed over a billion users, was Facebook able to reverse course, and initiate consumer surveillance. The fact-pattern demonstrates an inelasticity of demand for Facebook’s product, and in turn, constitutes a direct showing of monopoly power under Section 2 of the Sherman Act. Facebook’s ability today to extract surveillance in its exchange with consumers merely reflects an ability to extract monopoly rents from consumers that contradicts their own welfare. A review of indirect, or circumstantial, evidence of market power—to which I now turn—further explains Facebook’s exhibited monopoly power over product quality. Facebook controls over 80% of the social network market\textsuperscript{CITE?} and Facebook’s control is protected by strong entry barriers which dissuade new-entrants.

Evaluating a market’s structure by estimating a particular firm’s percentage share of a market can be a useful mechanism for predicting a firm’s market power, but should not be necessary to prove Facebook’s monopoly power.\textsuperscript{212}

\textsuperscript{209} This is Facebook’s Instant Articles program. See Instant Articles (July 2018), https://instantarticles.fb.com/.

\textsuperscript{210} Facebook does not receive zero consideration in return. Facebook can monitor and measure the behavior of readers of Instant Articles and monetize this data in various ways.

\textsuperscript{211} See Johnston, supra note 206.

\textsuperscript{212} See especially AREEDA & HOVENKAMP, §652, supra note 26 (articulating that Section 2 of the Sherman Act prohibits monopoly, which primarily refers to monopoly conduct, not monopoly shares, and going so far as to say, “Nothing in the language of the Sherman Act limits its conception of monopoly to large market share.”) Note that in \textit{Amex}, the Supreme Court did recently state that defining
The goal of antitrust law is to protect consumers from the harms associated with a lack of competition—namely, increased prices, decreased quality, lower output, and less innovation. Often, direct proof of a company’s ability to act like a monopolist is not available. In the absence thereof, circumstantial evidence of the market’s structure can indicate whether a particular firm has monopoly power. Under this market share-market definition approach to analyzing power, the exercise becomes one of calculating Facebook’s share of the relevant market. If one shows that Facebook controls a large percentage of a market that is protected by entry barriers, then this assertion serves as a proxy for direct proof of Facebook’s ability to set price or define quality at levels that deviate from the competitive norm. In Facebook’s case, direct evidence of monopoly power exists, and this fact should obviate the need for isolating Facebook’s share of a relevant market. Nonetheless, some scholars have argued that framing a defendant’s power in terms of market structure may still be necessary to satisfy Section 2 statutory requirements. In this respect, pleading a dominant share of a relevant market may serve a purpose outside the scope of proving power.

Under the market share-market definition framework, the first step is to isolate the relevant market from which firm’s market share is deduced. The relevant market is that in which “significant substitution in consumption” occurs, and should only include other products that consumers can turn to if one firm increases price or decreases quality. In Facebook’s case, the appropriate contours of the relevant market should only include other social networks that consumers use interchangeably. The purpose of defining the relevant market is to identify the swath of other products that can restrain a company’s ability to extract monopoly rents. Empirically, an earlier competitive social network market appeared to do just this. Competition from Murdoch’s MySpace or Google’s Orkut restrained how boldly Facebook (and others) could deteriorate quality given a constant price in a way that competition from instant messaging or email services today do not. In other words, Facebook’s ability to deteriorate quality below competitive levels only after the exit of other social networks lends credence to the position that the relevant market should be limited to social networks.


213. AREEDA & HOVENKAMP, §652, supra note 26.

214. See generally AREEDA & HOVENKAMP, §531, supra note 26 (also noting that identifying a market’s structure and defendant’s share may be useful to distinguish between monopoly rents extracted by a single monopolist versus coordinating oligopolists’).

215. See generally AREEDA & HOVENKAMP, §5.02 supra note 26; see also United States v. Grinnell Corp., 384 U. S. 563, 571 (a market is restricted to reasonably “interchangeable services”).

216. See generally Grinnell Corp., 384 U. S. at 571.

217. See generally infra Part II.
Furthermore, the relevant market should be constrained to social networks because social networking is a new, unique, form of communications, unrivaled in its ability to distribute and amplify a consumer’s communication. Whereas the telephone in the 20th century unleashed a watershed of one-to-one voice communications, the social network has opened the floodgates on one-to-many communications, distributed instantly from one person to others in a person’s “social graph.”

From the consumer’s perspective, Facebook is merely a tool for digital communications. The Facebook social media network enables instant one-to-many communication via text, audio, image, or video, exponentially decreasing the consumer’s transactional costs that are associated with such widely distributed communications. Initially, Facebook marketed its social media platform as “a social utility.” By simply hitting the singular “post” button, a mother might share wedding pictures with hundreds, if not thousands, of close and extended family members, long-lost college friends, and acquaintances worldwide.

In this nation’s earlier historic antitrust action against AT&T in the telephone market, the court defined the relevant market simply as “telecommunications,” because the public interest was so served since telecommunications had come to play a dominant role in “modern economic, social, and political life.” Social media has come to dominate the American way of life in much the same way that the telephone did for earlier generations. The fabric of American politics, the roll-out of new consumer products, and the dissemination of news all unfold on social media. The sitting U.S. President’s preferred way of communicating directly with the American people is through Twitter, one of the handful of social networks remaining today. Two-thirds of Americans now receive news via social networks, with the majority receiving news via Facebook. In some countries, the sheer amount of time

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218. The term “social graph”, initially popularized by Facebook itself and first referred to at the 2007 Facebook F8 conference, refers to a person’s web of connections, and is the underlying business asset that a social network uses to distribute one’s communication to one’s contacts. Facebook Unveils Platform for Developers of Social Applications, NEWSROOM.FACEBOOK.COM (May 24, 2007), https://newsroom.fb.com/news/2007/05/facebook-unveils-platform-for-developers-of-social-applications/.

219. On recent advertisements (as seen on nytimes.com medium rectangle ads on June 30, 2018), for example, Facebook marketed itself as a tool to “connect with friends and family.” Also consider generally the marketing language on Facebook’s website. Bringing the World Closer Together, FACEBOOK.COM (July 20, 2018), https://www.facebook.com/pg/facebook/about/?ref=page_internal.


citizens spends on social networks has become a matter of public health concern. Earlier this year, to address the time spent on social media, and the potentially addictive nature of such platforms, France passed legislation banning cell phones entirely from school grounds.\footnote{Sam Schechner, \textit{France Takes on Cellphone Addiction with Ban in Schools}, WALL STREET J. (Aug. 13, 2018), https://www.wsj.com/articles/france-takes-on-cellphone-addiction-with-a-ban-in-schools-1534152600.}

In the United States, and across the world, Facebook in particular dominates the social network market. In the U.S. alone, 210 million consumers have a Facebook account,\footnote{The Facebook ads interface claims to reach 210 million consumers in the U.S. ages 13 and over, \textit{Facebook Ads}, FACEBOOK.COM (July 20, 2018), https://www.facebook.com/business/products/ads.} with roughly three-fourths of those consumers using the platform at least once per day.\footnote{See \textit{Social Media Fact Sheet}, PEW RES. CTR. (Feb. 5, 2018), http://www.pewinternet.org/fact-sheet/social-media/.} To put this in perspective, it was not until some 100 years after the invention of the telephone that the telephone rivaled Facebook’s penetration into the lives of American households.\footnote{\textit{U.S. Census Bureau, Statistical Abstract of the United States: 1999} 885 (1999), www2.census.gov/library/publications/1999/compendia/statatab/119ed/tables/sec31.pdf.} But Facebook does not only cut wide, it also cuts deep. Americans currently spend over 40 minutes per day on just Facebook, and over an hour per day on Facebook owned-and-operated platforms, like Instagram.\footnote{EMARKETER.COM, supra note 71.} U.S. consumers spend approximately 150 million hours per day on Facebook\footnote{Id.} Facebook’s dominance also crosses international borders. Across the world, around one in every four humans has a Facebook account. This means that of the population that has access to the internet, nearly one in every two persons that could have a Facebook account does.\footnote{BROADBAND COMMISSION FOR SUSTAINABLE DEVELOPMENT, \textit{The State of Broadband 2017: Broadband Catalyzing Sustainable Development Report} (Sept. 2017), https://www.itu.int/dms_pub/itu-s/opb/pol/SPOL-BROADBAND.18-2017-PDF-E.pdf (estimating around 48% of global population had access to the internet at the end of 2017).}

Within the realm of social networks, only platforms that consumers use interchangeably, and that bear on Facebook’s demand elasticity, should be considered part of the relevant market for antitrust analysis. Here, particularly problematic for Facebook is the fact that of the U.S. adult population that uses any form of social media, nearly 99% use Facebook.\footnote{See PEW RES. CTR., supra note 226 (69% of U.S. adults use social media; 68% of U.S. adults use Facebook).} Subsets of consumers use Facebook in addition to one or more additional social networking platforms. This fact alone suggests that consumers do not find other social networking platforms to be adequate substitutes. Perhaps this is why when

\begin{enumerate}
\item[226.] See \textit{Social Media Fact Sheet}, PEW RES. CTR. (Feb. 5, 2018), http://www.pewinternet.org/fact-sheet/social-media/.
\item[228.] EMARKETER.COM, supra note 71.
\item[229.] Id.
\item[231.] See PEW RES. CTR., supra note 226 (69% of U.S. adults use social media; 68% of U.S. adults use Facebook).
\end{enumerate}
Senator Lindsey Graham (R-SC) asked Zuckerberg to name a product consumers could use instead of Facebook, Zuckerberg was unable to.\(^{232}\)

The fact that consumers find it indispensable to use Facebook simply reflects the fact that speech on Facebook is more powerful than other methods of personal speech. As the only social network with a user-base of over 2 billion, Facebook connects its users to the largest number of people, and can distribute their speech more broadly than users could otherwise. On a recent earnings call, Sheryl Sandberg, chief operating officer of Facebook, touted Facebook as the place to “reach everyone [in] almost every country in the world.”\(^ {233}\) One may not always want to speak loudly, but when one does, or one is selling a product, selling oneself for political office, or distributing news, Facebook distribution becomes a necessity.

Only Facebook has a user-base of over 2 billion. Competitive social networks with much smaller user-bases cannot directly compete with the built-in utility of Facebook’s product.\(^ {234}\) This explains why competitors instead narrowly focus on carving out a sub-niche in the social network market—short tweets, disappearing messages, a social network for professionals. For example, the second largest social network, Instagram, has 1 billion users globally, about 88 million in the U.S., and allows people to communicate almost entirely through visuals.\(^ {235}\) Facebook, however, owns Instagram. LinkedIn is in third place with about 500 million users, with 133 million in the U.S., but focuses specifically on being a “professional network,” enabling digital communication for “economic opportunity.”\(^ {236}\) Snapchat has 191 million daily active users worldwide, with approximately 72 million in the U.S., but distinguishes itself with short, disappearing pictures or videos.\(^ {237}\) Consider Twitter—with some


\(^{234}\) Since social networks today are closed communications protocols, each platform’s utility is a function of the number of users found on a particular platform.


\(^{236}\) About LinkedIn, LINKEDIN.COM (July 20, 2018), https://about.linkedin.com/.

\(^{237}\) See Snap Inc. Q1 2018 Quarterly Earnings Report, SNAP INVESTOR RELATIONS (May 2, 2018), https://otools.investis.com/clients/us/snap_inc/SEC/sec-show.aspx?Type=html&FilingId=12721842&Cik=0001564408 (reporting 191 monthly Daily Active Users (DAUs) and 81 million DAUs in North America). Snapchat does not provide a breakdown of U.S. only users. But Facebook’s U.S. reach is about 90% of Facebook’s North America reach (210
336 million monthly-active users, with 68 million in the U.S., which constrains user text communication to no more than 280 characters. For antitrust purposes, competing social networks—Instagram, LinkedIn, Snapchat, and Twitter—are not adequate substitutes because their user-bases are much smaller, and they serve a more narrow purpose.

With regards to instant messaging services such as WhatsApp and video sharing services such as YouTube, consumers use these services in inherently different ways than they use social media platforms. Thus, they too are not substitutes. Sandberg recently explained the difference between Facebook and instant messaging platforms Messenger and WhatsApp to investors: social networks such as Facebook are about one-to-many communications, Messenger and WhatsApp are mainly about one-to-one communications. Even so, Facebook also owns Messenger and WhatsApp. In response to an abuse of power investigation by Germany’s cartel office, Facebook complained that the office’s report “paints an inaccurate picture” of dominance because the report did not include Twitter, Snapchat and YouTube. But for the consumer, YouTube is more interchangeable with television or subscription-video on demand (Amazon, HBO, etc.) than it is with Facebook. In a reflection of this, YouTube markets itself to advertisers as a substitute for television network spend.

Facebook will not be successful in arguing that it is a two-sided platform and that the boundaries of the relevant market definition should account not only for Facebook’s share of the social network consumer market, but also its share of the digital advertising market. According to the Supreme Court’s opinion in Amex, defendant American Express, as a credit card company, operated a two-sided “transaction” platform, so plaintiffs needed to prove

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240. See Sandberg, supra note 233.
defendant’s conduct was cumulatively anticompetitive in both markets. The district court had erred in treating the credit-card market as two separate markets—one for merchants and one for cardholders—and then only evaluating the anticompetitive effects to the merchant side of the market. The Court in *Amex*, however, pigeonholed its holding to two-sided “transaction” platforms, where a company merely facilitates a simultaneous transaction between two parties. A transaction platform displays strong bi-lateral indirect network effects between the two distinct markets in which a defendant operates. With American Express, this appears true: more Amex cardholders always increases the value proposition for Amex merchants; and, more Amex merchants always increases the value proposition for Amex cardholders. Because of this, the relevant market has to include both sides. The Court pointed out a type of two-sided platform that might fail this rule—companies that deliver content to consumers, but advertising to marketers. Newspapers, it explained, fail the strong indirect networks effects test: more consumers are always good for advertisers, but more advertisers are not always good for consumers. Two-sided platforms that serve consumers on one side, but advertisers on the other, exhibit weak indirect network effects and should therefore be evaluated as one-sided markets for antitrust purposes. The Court’s earlier precedent in the antitrust case against the Times-Picayune newspaper in New Orleans supports this view. In *Times-Picayune*, the Court considered a challenge to a newspaper’s advertising policy and held that the relevant market includes only the newspaper’s market share in advertising, not its market share in consumer readership.

Under the second step of the market share—market definition analysis, market share should be derived from Facebook’s quantitative share of consumer time on social networks. Share of consumer time on social networks is the relevant measure of market share for two distinct reasons. First, Facebook does not charge users a fee, some competitors do, and a measure must be able to account for all competitors in the market. More importantly, consumer

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244. Id.
245. See Am. Express Co. at 2281-82 (“A market should be treated as one sided when the impacts of indirect network effects and relative pricing in that market are minor. . . . But in the newspaper-advertisement market, the indirect networks effects operate in only one direction; newspaper readers are largely indifferent to the amount of advertising that a newspaper contains. . . . Because of these weak indirect network effects, the market for newspaper advertising behaves much like a one-sided market and should be analyzed as such.”) (citing Lapo Filistrucchi, Damien Geradin, Eric van Damme, & Pauline Affeldt, *Market Definition in Two-Sided Markets: Theory and Practice* 1, 5 (Tilburg L. Sch. Legal St. Res. Paper Ser. No. 09/2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2240850 and Times-Picayune Publishing Co. v. United States, 345 U. S. 594, 610 (1953)).
247. While Instagram, SnapChat and Twitter do not charge users a price, competitor Vero Social, which surged to the #1 downloaded app on the Apple app store early 2017 following news of Facebook
time is the barometer which Facebook and other social networks use in the market—on the ground so to speak—to signal their relative dominance. On this point, the Supreme Court has indicated that one should calculate market share in the way that market participants think and talk about it. For example, in *Ohio v. American Express Co.*, the Supreme Court calculated the market share of credit card companies based on transaction volume, not transaction revenues—to reflect how market participants themselves signal their relative dominance.248 Social networks, including Facebook, Instagram, Twitter, and SnapChat speak of their relative strength in the social network market by referring specifically to the number of users and the number of minutes spent by users on their platform.249

However, even if one were to consider Instagram, Twitter, and SnapChat as part of the relevant market for antitrust analysis, Facebook still dominates market share. Including time spent on these other platforms, approximately 83% of the consumers’ time goes to Facebook and Instagram.250 Consumers spend about 66% of time across all just Facebook, 17.5% of time on Instagram, 16% on SnapChat, and 0.5% of time on Twitter. Anecdotally, Americans spend 19% of time spent across all mobile applications on just the Facebook mobile app.251

Facebook’s control of over 80% of consumer time reflects Facebook’s monopolistic power in the social network market. While there is no bright-line rule regarding market shares, courts have assumed monopoly power when market shares exceed over 70-plus percent.252 For example, before the dissolution of AT&T for monopoly power in the interexchange market,
AT&T’s share of interexchange revenue was about 77%. Standard Oil, found to have illegally monopolized the oil market, controlled about 90% of refinery output.

Notwithstanding Facebook’s dominant share of the relevant market, market share analysis also considers whether firms are protected by barriers to entry. Without entry barriers, new entrants have the opportunity to quickly disintermediate even the most dominant firms. The mere threat of entry can prevent monopolists from being able to profitably extract monopoly rents from consumers. But, there are entry barriers associated with Facebook’s *closed* communications protocol and over 2 billion users. When a communications network is closed, a user can only communicate with another user of the same network. This creates a powerful phenomenon known as direct network effects. Just as the utility of owning a phone in the late 19th century grew as phones became more accessible, so does the utility of a closed social network depend on how many other people use it. A new market entrant cannot easily get users to switch to a platform with less users. Additionally, the lack of perfect substitutes for Facebook has allowed the company to have proprietary control over one’s social graph. Facebook’s users are often connected exclusively through Facebook’s network, may lose cell phone numbers for older contacts, and Facebook becomes the primary method for users to remain in contact with one another. Because the communications protocol is closed, and Facebook controls one’s social graph, consumers face high switching costs and competitors face a significant barrier to entering the market.

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254. Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911).
256. A product has direct network effects if one’s use of a product increases the product’s utility for others. For example, in a market with only two competing social networks, assuming constant price and quality, the network with the larger user-base has greater value because it allows new users to communicate with more people. Other businesses with strong network effects include those of Uber, Wikipedia, and Airbnb. In such markets, the company that achieves early gains begins immediately to benefit from the superiority of one’s product due to network effects. The concept of network effects was first identified in the context of the long-distance telephony market in the 1970s. See Jeffrey Rohlfs, *A Theory of Interdependent Demand For A Communications Service*, THE BELL J. OF ECON. AND MANAGEMENT SCI. 16–37 (1974). Subsequent papers on this topic include W. BRIAN ARTHUR, *ON COMPETING TECHNOLOGIES AND HISTORICAL SMALL EVENTS: THE DYNAMICS OF CHOICE UNDER INCREASING RETURNS* (1983); Joseph Farrell & Garth Saloner, *Standardization, Compatibility, and Innovation*, THE RAND J. OF ECON. 70–83 (1985); Michael L Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 THE AM. ECO. REV. 424 (1985). During the first dot-com rush, venture capitalists and entrepreneurs in Silicon Valley were keenly in-tune and in-favor of investing in companies that benefited from direct network effects, or “first-mover advantage.” See generally Eric Ransdell, *Network Effects*, FASTCOMPANY.COM (Aug. 31, 1999), https://www.fastcompany.com/37621/network-effects.
IV. FACEBOOK’S PATTERN OF CONDUCT RAISES CONCERNS ABOUT ILLEGAL MONOPOLIZATION

A remaining question is whether Facebook’s pattern of behavior reaches the level of anticompetitive conduct with which antitrust law concerns itself. Parts I and II of this Paper traced the particular history of Facebook’s conduct with respect to the quality of its product. The qualitative aspects of its product, particularly the level of privacy, is not abstract—Facebook’s product is free, privacy was a critical form of competition in a functioning market, citizens favor no surveillance, and extracted surveillance is strongly tied to current Facebook revenues and profits. Part II argued that Facebook’s broad-scale surveillance of American consumers today reflects monopoly rents, a conclusion also supported by indirect evidence of Facebook’s monopoly power considered in Part III. Part IV now contends that Facebook’s conduct, taken collectively, raises serious issues of anticompetitive practices. Facebook’s conduct engendered trust in consumers, but the record suggests that Facebook’s commitment to user privacy was disingenuous. Facebook’s course of misleading conduct resulted in precisely the type of harm that antitrust law concerns itself with—the exit of rivals and the subsequent extraction of monopoly rents in contravention to consumer welfare.

A. Heightened Scrutiny in Markets with Direct Network Effects

Though Facebook may be a monopoly, antitrust law, and the Sherman Act specifically, only condemns monopolies that acquired their power by engaging in anticompetitive conduct.257 The classic definition of anticompetitive conduct is “the willful acquisition or maintenance of [monopoly] power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.”258 In other words, anticompetitive conduct falls outside the bounds of “competition on the merits.”259 It includes behavior that can be described as “predatory,” “exclusionary,” “unethical,” or “deceptive.”260

258. In United States v. Grinnell Corp., the Court articulated what remains the two-part test for a Section 2 violation: “(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.” 384 U. S. 563, 571.
259. Microsoft Corp., 253 F.3d (finding Microsoft conduct outside the scope of “competition on the merits” to be anticompetitive).
260. See Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 (1985); Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492, 500 (1988) (stating that “unethical and deceptive practices can constitute abuses of administrative or judicial processes that may result in antitrust violations”); Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 458 (1993) (defining anticompetitive conduct generally as “conduct which unfairly tends to destroy competition itself”). See also AREEDA & HOVENKAMP, supra note 26; ROBERT H. BORK, THE ANTITRUST PARADOX 138 (1978) (“If a firm has been ‘attempting to exclude rivals on some basis other than efficiency,’ it is fair to characterize its behavior as predatory.”). For an overview of how federal agencies and courts evaluate a
Though scholars debate when deception is actionable under antitrust laws, as opposed to merely under consumer protection statutes, even the leading antitrust treatise concedes that deception falls into the category of prohibited, anticompetitive, conduct, when deception has made “a durable contribution to the defendant’s market power.”

Courts have a broad mandate to capture and regulate a range of conduct that harms the competitive process and is likely to or does result in harm to consumers. The breadth and flexibility that courts have reflects the fact that “monopolization [conduct] has tended to be nonrepetitive and specific to industry.” Standard Oil’s strategies in the oil market differed from American Tobacco’s strategies in the tobacco market, AT&T’s approaches in the telephony market, or Microsoft’s tactics in the operating system market.

Moreover, anticompetitive conduct in the acquisition of monopoly power is of heightened concern in markets exhibiting direct network effects. In such markets, meaningful competition only exists at the early stages. At the beginning competition is fierce—each company vies to edge-out competitors to “tip” the market in its favor. If a company can achieve early adoption with consumers, it can thereafter benefit not only from its product’s price or quality, but also simply from its user-base—a feature that strongly influences consumer choice. Because of these market dynamics, the Court of Appeals for the D.C. Circuit in the monopolization case against Microsoft explained that competition in networked industries is often “for the field” rather than “within the field.”

Misleading, deceptive, or otherwise unethical conduct at the early stages can induce market participants to choose the firm that they think increases their monopolist’s deception, see Maurice E. Stucke, How Do (and Should Competition Authorities Treat a Dominant Firm’s Deception, 63 SMU L. Rev. 1069 (2010). For a conversation on deception specifically, see Kevin S. Marshall, Product Disparagement Under the Sherman Act, Its Nurturing and Injurious Effects to Competition, and the tension Between Jurisprudential Economics and Microeconomics, 46 SANTA CLARA L. Rev. 231, 244 (2006) (explaining that deception can “create entry barriers, lead to capricious market exit, create artificial market equilibrium, or even lead to oligopolies and monopolies.”).

Aareeda & Hovenkamp, §782, supra note 26 (additionally, scholars point out that in situations where deception by a monopolist is at issue, the concern should be deception of consumers).


Id. at 1037.

Theoretical economist W. Brian Arthur has published several papers discussing the unique nature of in markets characterized by network effects. His seminal paper is On Competing Technologies and Historical Small Events: The Dynamics of Choice Under Increasing Returns, supra note 256. See also Malcolm Gladwell, The Tipping Point: How Little Things Can Make a Big Difference (2006); William J. Kolasky, Jr. & William F. Adkinson, Jr., Single Firm Conduct: Who’s Big? What’s Bad? Presentation Before the A.B.A. Sec. of Antitrust L. 30 (Apr. 15, 1999) (on file with author) (stating that “if the ultimate market outcome is likely to be a monopoly of the surviving firm, with the opportunity to earn substantial rents, competition among firms to be the survivor will be intense.”).

welfare, but the very act of mistaken choice can lock in the market to their
detriment. Carl Shapiro, then deputy assistant attorney general for economics in
the Antitrust Division of the Department of Justice, addressed the need for
heightened concern: “Even more so than in other areas, antitrust policy in
network industries must pay careful attention to firms’ business strategies, the
motives behind these strategies, and their likely effects.”266 In that vein,
even Robert Bork, leader of Chicago-school antitrust jurisprudence, may have
agreed when he advised that one must pay attention to the “route by which
[monopoly] was gained.”267

Such was the focus of the Court’s analysis of Microsoft’s misleading
behavior in the operating system market.268 Microsoft had made false public
representations about its own products which induced developers to develop
applications compatible with Microsoft’s operating system. While Microsoft
represented that applications developers wrote would be cross-compatible with
Sun, developers ended up writing applications that were only compatible with
the Windows operating system. Microsoft’s false statements induced
developers to choose Microsoft to their detriment. Since the operating system
market exhibits direct network effects, misleading behavior to induce choice is
anticompetitive. This was anticompetitive conduct that supported the finding
that Microsoft had illegally monopolized the operating system market.

B. Pattern of False Statements, Misleading & Deceptive Conduct

A substantive issue is whether Facebook’s pattern of conduct was
anticompetitive and provides a basis for a claim of illegal acquisition of
monopoly power. To begin, Facebook entered the market with superior privacy
protections making promises to not violate user privacy which induced early
consumer reliance.269 For several years, in a hotly competitive market,
Facebook did not merely change its privacy representations, it continued to
perpetuate them. But while perpetuating the belief that Facebook did not track
consumers using third-party code, Facebook was caught doing precisely that on
multiple occasions.270 The investigative efforts of multiple independent
researchers unveiled that the claims Facebook was making to consumers via
Facebook’s own policies and the public comments of Facebook executives
were false.271 Facebook itself even conceded their falsity.272

266. Shapiro, supra note 26 (explaining that “the very nature of the ‘positive feedback’ cycle
means that monopolization may be accomplished swiftly. And, once achieved, the network effects
that helped create dominance may make it more difficult for new entrants to dislodge the market leader than
in other industries lacking network characteristics.”).
267. BORK, supra note 260 at 164.
268. Microsoft Corp., 253 F.3d at 76-77.
269. FACEBOOK PRIVACY POLICY (2004), supra note 42.
270. See infra Section I.B & I.C.
271. Id.
272. Id.

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Facebook then deflected consumer concern over the discovered hidden activity and false statements with words and actions that implied the sincerity of Facebook’s commitment to user privacy. For example, when Facebook’s hidden activity and false statements with Beacon were exposed, Facebook retreated and Zuckerberg called Beacon a “mistake.” Later, when Facebook’s hidden activity and false statements with social plugins were exposed, Facebook claimed that discovered tracking was due to inadvertent software “bugs” or that the tracking was innocuous because it was for users’ own “safety and protection.” At the time, the chief technology officer of Facebook assured, “[social plugins are] not intended for tracking,” rather user data collected was used “to protect the site from cyber-attacks by people who try to break in to users’ accounts.” An evidentiary question is whether this activity was in fact inadvertent and for users’ safety and protection or not. An investigation into the credibility of Facebook’s alleged reasoning by the German Data Protection Authorities in Schleswig-Holstein found it without merit. If Facebook’s reasoning was factually inaccurate, as the GDPA investigation suggested, then Facebook’s behavior was deceptive.

In addition to perpetuating factual inaccuracies, Facebook deceived users by omitting salient facts. Notably absent from public commentary was the fact that Facebook was thinking about, or planning on, using social plugins for surveillance. In 2011, Facebook had filed a patent for engaging in this type of behavior that was of public concern. The Federal Trade Commission’s case for illegal monopolization against Intel centered on Intel’s misleading behavior. For example, the FTC’s complaint alleged that Intel had engaged in deceptive acts by failing to disclose material information about the effects of its products. When Facebook’s surveillance conduct with plugins was discovered, Facebook provided affirmative, innocuous, and possibly false reasoning for its actions while omitting information related to Facebook’s

272. See Perez, supra note 90.
273. See Zuckerberg, supra note 109.
274. See infra Section I.B.
275. See Efrati, supra note 133.
278. See U.S. Patent, supra note 147.
internal dialogue about using plugins to conduct surveillance. Facebook likely deceived market participants.

In retrospect, Facebook’s widely-covered public announcement of a user referendum process for future privacy changes in the competitive market of 2009 may also raise issues of anticompetitive behavior. Facebook’s poor notice to consumers in 2011—when it proposed and passed an abolition of user voting—suggests that Facebook’s commitment to the user referendum was less than genuine. Consumers ultimately felt cheated that Facebook did not notify them of an opportunity to vote. Indeed, internal comments by employees suggest that Facebook made public representations about valuing privacy when in fact internally Facebook’s culture and practices were not concerned with user privacy. Facebook employees themselves sometimes parodied this disingenuous public-private disconnect.

C. Wider Pattern of False Statements and Misleading Conduct

Importantly, Facebook’s wider history may point to a larger pattern of misleading conduct within the company. In 2011, Facebook settled charges with the Federal Trade Commission alleging a range of false and misleading material statements made to consumers related to user privacy—all of which fell outside of the scope of Facebook’s conduct that is the focus of this Paper. For instance, the FTC complaint alleged that while Facebook’s privacy controls allowed users to restrict their information to “only friends,” Facebook was actually overriding user choice and sharing users’ information with third-parties. More recently, Facebook has come under congressional scrutiny for deceiving consumers by knowing but not disclosing to users that their data was misappropriated by political consulting firm Cambridge Analytica. When asked by Senator Kamala Harris (D-CA) if Facebook made an explicit decision to not inform users, Zuckerberg answered “yes,” and called it another “mistake.” The wider record of deceptive conduct with respect to user privacy may also be relevant to a larger case of unlawful acquisition (and even perpetuation) of monopoly power.

280. See supra notes 150-153 and accompanying text.
281. See Tsotsis, supra note 154; see Martinez, supra note 154.
Moreover, buyers of Facebook advertising would be keenly familiar with other “mistakes” and alleged “bugs” that Facebook claimed inadvertently caused a string of inflations in ad metrics, which financially benefited Facebook to the detriment of buyers. A full review of Facebook’s conduct (and pricing power) on the advertising side of the market is outside the scope of this Paper. However, I review here two incidents on the advertising side that suggest a larger pattern of willful disregard for truth. Aside from lending credence to a pattern and practice of false statements and misleading conduct, Facebook’s behavior generally reflects pricing power on the advertising side of the market.

For example, in September of 2017, media buyers became aware that Facebook materials claimed to reach more people in the U.S. than Census data shows even existed.\textsuperscript{284} The false representations are made in Facebook’s self-serve interface that businesses use to evaluate and purchase Facebook advertising and are the subject of a recently filed class action complaint.\textsuperscript{285}

To give another example, Facebook recently admitted to a succession of false statements related to ad metrics which induced marketers to purchase Facebook ads. For many years, Facebook did not allow ad buyers to audit and verify Facebook representations directly correlated to Facebook ad billing—despite audit rights being standard practice in the industry.\textsuperscript{286} Facebook advertising is subject to elevated risks of fraud. Unlike print advertising, digital advertising is shown only briefly to a user and poof disappears forever. In other words, without audit rights, digital media buyers suffer from the risk of sellers charging them for goods not delivered \textit{at all}. Facebook has long been a hold-out in permitting buyers to audit Facebook deliverables. The head of digital marketing at Wendy’s, who is currently the chief marketing officer of Papa John’s, once explained, “[w]hat frustrates us when we run a campaign on Facebook is that there’s almost no acknowledgement that the campaign even existed in the first place.”\textsuperscript{287}

\textsuperscript{284} The initial discrepancy was caught and pointed out in a note to investors by respected industry analyst Brian Wieser. See supra note 15; see also Allison Schiff, Facebook Data May Be at Odds with Census Data, But Advertisers Won’t Stop Spending, ADEXCHANGER.COM (Sept. 6, 2017), https://adexchanger.com/platforms/facebook-data-may-odds-census-data-advertisers-wont-stop-paying/


\textsuperscript{286} A refusal to submit to audits is a demonstration of pricing power on the advertising side of the market. Facebook’s conduct reminds us of Yellow Pages’ behavior in the print advertising market. Yellow Pages was also a hold-out, not allowing buyers to audit Yellow Pages’ distribution figures. Yellow Pages, of course, was also a monopoly. \textit{ASS’N OF NAT’L ADVERTISERS TELEPHONE DIRECTORY COMMITTEE AND AM. ASS’N OF ADVERTISING AGENCIES DIRECTORY ADVERTISING COMMITTEE, THE NEED FOR YELLOW PAGES THIRD-PARTY CIRCULATION AUDITING} (2005), available at http://www.ana.net/getfile/67.

\textsuperscript{287} Allison Schiff, Facebook: Counting Viewed Impressions is a ‘No Brainer’, ADEXCHANGER.COM (Feb. 18, 2015), https://adexchanger.com/online-advertising/facebook-counting-viewed-impressions-is-a-no-brainer/#comment-911780. See also Jessica Davies, ‘Facebook doesn’t
After mounting industry pressure and calls of fraud, Facebook capitulated and announced in the fall of 2015 that it would allow third-parties to audit select metrics. 288 With the impending release of the first audited metrics, Facebook came forward with disclosures of discovered “bugs” that had caused it to inadvertently inflate ad metrics for multiple years. 289 In September 2016, Facebook revealed that it had overestimated customers’ video ad view-times for the last two years. Facebook sent a letter to Publicis, one of the largest ad agencies in the world with a market cap of over $12 billion, estimating that it had overstated view times by 60-80%. Publicis had spent $77 million on Facebook ads the prior year. Publicis, in turn, sent a note out to clients: “This once again illuminates the absolute need to have . . . verification on Facebook’s platform. Two years of reporting inflated performance numbers is unacceptable.” 290

Between November and December of 2016, Facebook disclosed additional measurement misreporting. 291 Facebook had been inflating the number of visits to brand posts, over-reporting by 7-8% the average length of time people spent reading Instant Articles, over-stating video ad completion rates, over-reporting the number of clicks it had reported it sent to advertiser websites, over-reporting the number of Likes for live videos, and inflating the number of times people shared links of posts on Facebook. Advertisers used these metrics to ask and inform imperative questions: is this advertising campaign working? and should I spend more or less money in the future with Facebook?

The Association of National Advertisers (ANA) subsequently publicly called for an in-depth general audit, as they once did with the Yellow Pages—

operate with real-world metrics’: GroupM talks tough on Facebook, DIGIDAY.COM (Sept. 21, 2018), https://digiday.com/media/facebook-doesnt-operate-real-world-metrics-groupm-talks-tough-facebook/ (where an executive at WPP, Facebook’s largest single client, states: “We are still not able to verify delivery of our clients’ advertising via Facebook . . . They control the delivery of consumption data back to us. We also have major issues with the quality of the environment our ads are delivering in, especially when it comes to Facebook. Also, completion rates on Facebook are appallingly low.”).


which is still pending. P&G’s chief brand officer, Marc Pritchard, has warned that systemic fraud in ad markets may explain the U.S. economy’s anemic growth. Pritchard has publicly pressured Facebook to submit to transparency, and likened Facebook’s self-policing to letting a “fox guard the hen house.” Advertising agencies, the middlemen in ad buys, were and continue to be in an awkward position, having been entrusted to spend their brands’ money wisely. The chief operating officer of GroupM, the media buying arm of ad agency behemoth WPP, lamented at an industry conference that Facebook is one of the only ones that can measure themselves, and it is a result of “Facebook’s market dominance.”

D. Antitrust Harm: Monopoly Rents & Allocative Inefficiency

Ultimately, Facebook’s course of conduct misled consumers and resulted precisely in the type of harm with which antitrust law concern itself. Facebook today is a monopoly that has the power to extract monopoly rents from consumers, as detailed in Section II-C. Facebook’s collective conduct—specifically, false statements, misleading statements, and omissions—reviewed in Part I and Part II, contributed to this ultimate destination. The harm is not speculative, it is complete. This new age’s communications utility extracts the cost of widespread digital surveillance despite users’ preference to the contrary.

The tendency is to think that Facebook’s free service reflects consumer surplus, yet nearly every advertising market in the U.S. is in decline as American consumers indicate a preference for ad-free communications and media. In the world of television and video, consumers have flocked from ad-supported TV to ad-free, over-the-top competitors. In that world, Netflix, Amazon, and HBO, all paid, ad-free platforms, are bathing in a watershed

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295. Consumers have standing to sue for quality reductions. See [AREEDA & HOVENKAMP, ¶ 345, 502, supra note 26](https://www.amazon.com/Coconuts-Handbook-American-Competitive-Strategy/dp/156663084X/ref=sr_1_1?dchild=1&keywords=areeda+hovenkamp&qid=1562214152&sr=8-1), stating that “clearly a consumer has standing to sue a cartel that reduces quality of the product that the consumer purchased”). Facebook’s 2014 decisions to initiate consumer surveillance are also anticompetitive in the sense that they make it more difficult for new entrants like SnapChat to compete with Facebook on the advertising side of the market.
moment of creativity and high consumer satisfaction. With radio, terrestrial loses ground to digital alternatives that offer subscriptions to ad-free music streaming. While digital music platforms can be ad-supported or ad-free, the paid but ad-free models currently drive the largest share of growth in the industry. In the digital advertising market, most sellers of digital advertising struggle to obtain incremental, year-over-year revenue growth. In the midst of a booming economic cycle in 2017, The Guardian, Britain’s nearly 200-year-old daily newspaper, started to ask readers for donations after digital ad revenues fell. However, the market is growing. The U.S. internet advertising market grew 21.8% in 2016 and 21% in 2017. Facebook and Google accounted for over 99% and over 90% of that growth in 2016 and 2017, respectively. Consumer studies show that consumers today are averse to advertising. Against this backdrop, Facebook’s free but ad-supported communications service, built upon a massive commercial surveillance apparatus, may indeed reflect one great allocative inefficiency in markets.

CONCLUSION

“Monopoly in trade or in any line of business in this country is odious to our form of government False its tendency is repugnant to the instincts of a free people.”

—Chief Justice Sherwood of the Supreme Court of Michigan.

The fact that this century’s new communications utility is free but necessitates widespread surveillance of consumers is a paradox in a democracy. Facebook watches, monitors, and remembers what over 2 billion people do and say online. Contrary to what those in the advertising industry would regulators to think, American consumers value a state of no surveillance and have

296. The American Customer Satisfaction Index (ACSI), an annual survey of consumer attitudes to services including pay TV, video streaming, ISPs and fixed and wireless phone.


301. MILLWARD BROWN, AdReaction Gen X, Y and Z Executive Summary, http://www.millwardbrown.com/adreaction/genxyz/global/gen-x-y-and-z/how-media-habits-differ (consumer study finding that “gen Z” (16-19-year-olds) is “more averse to advertising in general”).

attempted to protect this aspect of their privacy since the beginning. The fact that the free market today offers no real alternative to this exchange is a reflection only of the failure of competition.

At least for this titan of tech, antitrust law provides a framework for appreciating and correcting for the foreclosure of consumer choice. Facebook is a monopoly that tipped the early market with promises of data privacy and then engaged in a long line of misleading conduct, which foreclosed competition. The historical record tells the story of Facebook’s monopoly power in the social media market. Facebook tried, but could not, degrade the quality of its product to impose commercial surveillance on users through Beacon in the competitive market of 2007. Thereafter, Facebook pivoted to licensing Like buttons, Logins, and other products to independent businesses, which Facebook could leverage for the same purpose. Yet competition between 2008 and 2014 continued to restrain Facebook’s ability to initiate tracking for the purpose of targeted advertising. Facebook had to retreat from alleged accidental tracking, assure consumers and other market participants that the underlying code for social plugins was not used for commercial surveillance, and then promise users an ability to vote on future privacy changes. Only after the exit of competitors, and the barrier to entry that comes with over a billion users on a closed communications protocol, was Facebook able to reverse course. The history of Facebook’s market entry and subsequent rise is the story of Facebook’s monopoly power. Facebook’s pervasive and intrusive commercial surveillance of citizens’ digital footprints is merely this titan’s form of monopoly rents.

Consumers today turn from Facebook to other websites and apps and face an identical degradation of quality across millions of sites and competitors on the advertising side of the market. For publishers like The New York Times and others, Facebook extracts commercial surveillance of their customers through publishers’ licenses of Facebook’s business products (e.g., Like buttons etc.). Facebook has commoditized these publishers’ own user data, once a prized proprietary possession, for its own benefit either to sell Facebook advertising or the advertising of a publisher’s competitors. This market structure has deteriorated the pricing power of market actors across the horizontal market and resulted in the duopoly of Facebook and Google—which account for just about the entirety of the growth in the digital advertising market against a backdrop of publishers such as BuzzFeed or The Guardian soliciting reader donations.

The historical record that elucidates Facebook’s monopoly power raises the question of whether Facebook’s decade-long course of conduct was anticompetitive—especially in the winner-take-all market of a closed communications platform. The record is replete with reliance-inducing future promises, false statements, disingenuous excuses, and convenient omissions.
which, collectively, likely deceived users. The adoption of a user referendum process for future privacy changes coupled with the failure to meaningfully notify users of an opportunity to vote further raises the specter of a pattern of anticompetitive conduct. Indeed, the wider record of misleading and deceptive conduct—whether that conduct was the subject of an FTC or congressional investigation or the complaints of advertisement buyers—may point to a more systemic problem which harms not only consumer welfare but also presents risk to market stability. Antitrust scholar Robert Steiner once warned that deception by a dominant firm could have a domino effect within an industry, leading smaller firms to engage in similar patterns of conduct and inefficiency in the industry.303 Indeed, today, the digital advertising industry is considered one of the most fraud-stricken in the world—the industry expects to absorb $19 billion of waste due to fraud in 2018.304

To correct for consumer harm and reduction of choice in the market, a remedy must induce competition and stop horizontal coordination. To induce viable opportunity for new entrants, consumers must be able to export their social graph,305 and Facebook should migrate from a closed to an open communications protocol. A user on Facebook should be able to send a message to, or receive a message from, a user of a competitive social network—in the same way that users of AT&T can call or text a user of Sprint, Verizon, or T-Mobile. The adoption of an open application programming interface for user messages, chats, posts, and other communications could aid this process. The social network LinkedIn permits communications to be distributed across users’ Twitter feeds for example. Additionally, it is paramount that a remedy put a stop to coordination amongst competitors. For this, we need to empower consumers with a singular Do Not Track switch that can counter the collusion in the horizontal market. Consumers must be able to


305. Others, including economist Luigi Zingales and Guy Rolnik, have also advised for social graph portability to increase competition. Luigi Zingales & Guy Rolnik, A Way to Own Your Social-Media Data, N.Y. TIMES (June 30, 2017), https://www.nytimes.com/2017/06/30/opinion/social-data-google-facebook-europe.html.
just say no to commercial surveillance—a broad interconnected apparatus that uniquely serves the digital duopoly. While politicians and regulators grapple with how to make sense of current market structures in and consumer frustrations with Big Tech, the principles of antitrust provide clarity for this era's dominant communications platform.
Pre-Dispute Mandatory Arbitration of Sexual Harassment Complaints: Bad for Business Too

Scott R. Thomas

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INTRODUCTION

Consider a recent twenty-one-year-old college graduate who, over a six-week period, survived three rounds of interviews with a large coveted corporation. The human resources director finally contacts the applicant to relay an offer of employment over the telephone but limits the details to the salary, vacation, and start date. The applicant, elated by the call, anxiously waits for the written offer to arrive. The offer arrives by mail with a package of paperwork for our applicant to sign before starting employment. As she sifts through the paperwork, she finds an employment agreement containing the following clauses:

**Arbitration.** If a dispute arises while you are employed by Coveted Corporation, you agree to submit any dispute arising out of your employment or the termination of your employment (including, but not limited to, claims of unlawful termination based on race, gender, age national origin, disability, or breach of contract) exclusively to binding arbitration under the Federal Arbitration Act, 9 U.S.C., Section 1. This arbitration shall be the exclusive means of resolving any dispute arising out of your employment or termination from employment by Coveted Corporation or you, and no other action can be brought in any court.

**Confidentiality.** The arbitration proceedings and arbitration award shall be maintained by you and Coveted Corporation required by court order or necessary to confirm, vacate or enforce the award and for disclosure in confidence to the parties’ respective attorneys and tax advisors.

The applicant reads these clauses and the remainder of the employment agreement, wondering what options she really has. As a recent college graduate with no experience, she decides not to explore the meaning of this language. After all, she does not want to jeopardize her employment opportunity and believes she will never have a dispute with her new employer. The applicant signs the agreement and begins her employment. Six months into her employment, she faces repeated unwanted sexual advances from her supervisor.

The employee consults the materials she received at the start of her employment. There, she finds the following statement from her employer in the employee handbook which quotes the Global Code of Conduct:
We do not tolerate harassment at Coveted Corporation. As employees, we are all expected to act in a professional manner and to avoid any action or behavior that, if unwelcome, may be considered harassment or sexual harassment.

“Harassment” includes any conduct that unreasonably interferes with an individual’s work performance or creates an intimidating, hostile, or otherwise offensive environment. Harassment can take many forms, including using slurs, epithets, inappropriate gestures, or making demeaning jokes. Regardless of the form it takes, behavior like this is not tolerated.

We report harassment. If you think you or someone else has been subjected to any form of harassment at Coveted Corporation (whether by an employee, customer, contractor, vendor, or supplier) we ask you to report it promptly to your immediate supervisor, another manager in your area, or your Human Resources contact. Remember, no matter which method you choose to use to report your concerns, we prohibit any form of retaliation or victimization against you for making a good-faith complaint. If you are a supervisor and hear an allegation of harassing behavior, you are expected to act promptly and to appropriately notify a Human Resources Manager.

In accordance with her employee handbook, the employee meets with human resources to discuss her hostile work environment and how to address the unwanted sexual advances from her supervisor. Unfortunately, the situation does not improve and she looks for help outside her employer. Her attorney tells her that the current state of the law likely limits her options. Having signed the “take-it-or-leave-it” employment agreement, the attorney tells her client that she may be bound to its terms, thereby preventing her from accessing the court system. Instead, the employee learns that she may need to rely on a system of arbitration for relief. Unfortunately, that system has numerous flaws. Her attorney closes the conversation with a warning not to discuss this matter with anyone else, as she would risk violating the Confidentiality Clause in her agreement.

The employee is not alone in her traumatic experiences at Coveted Corporation. According to a 2016 study by the Equal Employment Opportunity Commission (“the EEOC”), approximately sixty percent (60%) of female employees report that they have experienced at least one specific instance of sexually harassing behavior, such as unwanted sexual attention or sexual coercion. This EEOC report is consistent with the findings of the Pew Research Center which found that fifty-nine percent (59%) of women have personally received unwanted sexual advances or verbal or physical harassment.

of a sexual nature, whether in or outside of a work context. With over 27,000 harassment complaints in 2017, sexual harassment is the most common complaint made to the EEOC. Making this more troubling, approximately ninety percent (90%) of individuals who say they have experienced sexual harassment never formally report the incident or incidents.

Until recently, this fictional employee’s harassment and the troubling experiences of other victims rarely captured the hearts of those uninvolved with the case. However, the #MeToo movement and the Harvey Weinstein saga gave birth to a wave of reported cases and consideration by Congress. In response, Senator Kirsten Gillibrand introduced a bill entitled Ending Forced Arbitration of Sexual Harassment Act of 2017. That bill and its identical companion in the House of Representatives, introduced by Representative Cheryl Bustos, stated that “no pre-dispute arbitration agreement shall be valid or enforceable if it requires arbitration of a sex discrimination dispute.” In a press release issued on December 6, 2017, Senator Gillibrand made the following comments:

When a company has a forced arbitration policy, it means that if a worker is sexually harassed or sexually assaulted in the workplace, they are not allowed to go to court over it; instead, they have to go into a secret meeting with their employer and try to work out some kind of deal that really only protects the predator. They are forbidden from talking about what happened, and then they are expected to keep doing their job as if nothing happened to them. No worker should have to put up with such an unfair system.

Senator Gillibrand’s statement also describes the situation facing the fictional employee above. The courtroom is not open and she must remain

9. Id.
quiet. In the same press release, Representative Bustos made the following statements:

If we truly want to end sexual harassment in the workplace, we need to eliminate the institutionalized protections that have allowed this unacceptable behavior to continue for too long ... Whether it’s on factory floors, in office buildings or retail businesses, 60 million Americans have signed away their right to seek real justice and most don’t realize it until they try to get help. Our legislation is very straightforward and simple—if you have been subjected to sexual harassment or discrimination in the workplace, we think you—not the employer—should have the right to choose to go to court. While there are a lot of good companies that take sexual harassment seriously and work to prevent it, this legislation will help root out bad actors by preventing them from sweeping this problem under the rug.11

Representative Bustos focuses on the institutionalized protections provided to the perpetrators, but acknowledges the progress certain companies have made. Gretchen Carlson, a sexual harassment victim of Roger Ailes while at Fox News,12 stood with members of Congress at the introduction of S. 2203. There she made the following statement:

Forced arbitration is a harasser’s best friend. It keeps harassment complaints and settlements secret. It allows harassers to stay in their jobs, even as victims are pushed out or fired. It silences other victims who may have stepped forward if they’d known. It’s time we as a nation-together-in bipartisan fashion give a voice back to victims.13

In her statement, Carlson added her voice to the call to end the secrecy that provides the veil of protection for harassers. She also called for bipartisan legislation to lift that veil. Some legislators appear to have heard the call for bipartisan legislation. The Senate Bill has eighteen Cosponsors, fifteen Democrats and three Republicans.14 The identical House Bill has sixteen cosponsors, eight Republicans and eight Democrats.15 Despite its bipartisan support in the Senate and the House of Representatives, Skopos Labs16 has asserted that the bill has only a three percent chance of being enacted, and the bills have not moved past the committee stage in either the House of

11. *Id.*
14. Richard Blumenthal (D-CT), Chris Coons (D-DE), Richard Durbin (D-IL), Dianne Feinstein (D-CA), Lindsay Graham (R-SC), Kamala Harris (D-CA), Heidi Heitkamp (D-ND), John Kennedy (R-LA), Edward Markey (D-MA), Catherine Cortez Masto (D-NV), Lisa Murkowski (R-AK), Martin Heinrich (D-NM), Mazie Hirono (D-HI), Debbie Stabenow (D-MI), Margaret Hassan (D-NH), Jeanne Shaheen (D-NH), Jeff Merkley (D-OR), and Sheldon Whitehouse (D-RI).
15. Don Bacon (R-NE), Susan Brooks (R-IN), Barbara Comstock (R-VA), Debbie Dingell (D-MI), Brian Fitzpatrick (R-PA), Lois Frankel (D-FL), Jennifer Gonzalez-Colon (R-PR), Morgan Griffith (R-VA), Luis Gutierrez (D-IL), Pramila Jayapal (D-WA), Walter Jones (R-NC), Ann Kuster (D-NH), Zoe Lofgren (D-CA), Jacky Rosen (D-NV), and Elise Stefanik (R-NY).
Representatives or Senate. As discussed in Part II, this bill is not the first attempt to legislate the elimination of mandatory pre-dispute employment arbitration agreements, but is the most recent attempt.

The #MeToo movement and the Harvey Weinstein scandal focused our attention on the fairness or lack of fairness for victims of workplace sexual harassment and other discrimination. These victims, forced to pursue their claims in mandatory arbitration proceedings, need a better remedy than provided in their employment agreements. With the increase in the use of these agreements, the need for a solution has become more urgent. Past legislative failures do not generate confidence in a quick successful resolution. This Article, rather than suggesting a legislative solution as the best alternative, argues that our society should demand better corporate citizenship from employers. The recent social movements, fast-paced reaction spurred on by social media, and the attributes of today’s employees entering the workforce may indeed provide such an opportunity. This Article begins in Part I by discussing a history of the law, limitations on the law’s application, and employees’ efforts to avoid mandatory arbitration provisions. Part II describes the federal and state legislative, regulatory, and executive efforts to limit the reach of the FAA in the employment context. Part III explains the need for transparency and accountability in the handling of sexual harassment complaints. Part IV calls for better corporate citizenship rather than continuing the fruitless pursuit of legislation.

I. MANDATORY PRE-DISPUTE EMPLOYMENT ARBITRATION AGREEMENTS AND RECENT DEVELOPMENTS

Before beginning a discussion of the legal history, it is important to define the types of agreements in dispute. Like the fictional college graduate’s agreement, a mandatory pre-dispute employment arbitration agreement refers to a “prospective agreement between employer and employee to resolve future employment disputes by binding arbitration.” Employers can include these agreements in employment contracts and employee handbooks, or they may appear as standalone agreements. Sometimes these agreements are inserted into employment applications. In addition, some jurisdictions will go so far as to infer an employee’s agreement to arbitrate if the employee continues to

18. See infra Part III.
21. Id.
work for the company after receiving notice of the company’s policy requiring the arbitration of employment-related claims.\textsuperscript{22} In \textit{Howard v. Oakwood},\textsuperscript{23} a North Carolina appellate court found that an employee’s continued employment after receiving a notice of the employer’s required dispute resolution program reflected assent to arbitration. Like the fictional applicant described above, an applicant often has little or no bargaining power and cannot negotiate the terms of the agreement.\textsuperscript{24} This part discusses the history of the Federal Arbitration Act (“FAA”), the development of the expansive U.S. Supreme Court interpretations of the FAA providing pro-employer benefits, and whether an employee may avoid the application of mandatory arbitration agreements in the employment context.

\textbf{A. The FAA–Born from Hostility}

Hostility of U.S. courts toward arbitration has its roots in the English common law.\textsuperscript{25} That hostility appears in a Massachusetts Circuit Court opinion dating back to 1845, where Justice Story wrote that arbitrators “are not ordinarily well enough acquainted with the principles of law or equity, to administer either effectually, in complicated cases; and hence it has often been said, that the judgment of arbitrators is but \textit{rusticum judicium}.”\textsuperscript{26} That hostility remained through the 1800s.\textsuperscript{27} However, growing industrialization increased the number of commercial disputes and lessened some of the hostility.\textsuperscript{28} In 1924, the U.S. Supreme Court upheld The Arbitration Law of New York, enacted in 1920.\textsuperscript{29} The Arbitration Law of New York stated that a contract provision “shall be valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract.”\textsuperscript{30} Enactment of the FAA, followed shortly thereafter and adopted much of the New York statutory language.

Because of the hostility shown to arbitration matters, the House Committee made the following comments about the FAA’s purpose:

\begin{cite}
23. \textit{Id}.
25. See Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24 (1991) (“[The Federal Arbitration Act’s] purpose was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts[].”).
28. \textit{Id}.
\end{cite}
The need for the law arises from an anachronism of our American law. Some centuries ago, because of the jealousy of the English courts for their own jurisdiction, they refused to enforce specific agreements to arbitrate upon the ground that the courts were thereby ousted from their jurisdiction. This jealousy survived for so long a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts.  

In removing the bias described above, Congress gave arbitration agreements similar treatment to other contracts to promote their enforcement. In addition, Congress sought to effectuate several key dispute resolution policies: (1) promoting efficiency; (2) providing access to justice; (3) ensuring freedom of contract; and (4) diminishing the burden on the courts.

From this background, Congress wrote Section 2 of the FAA, which provides:

[a] written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

The language of the FAA left a number of areas open for interpretation by the courts. Court limitations, or the lack thereof, imposed on the FAA are described below.

B. Limitations on the FAA

Courts have wrestled with the FAA’s breadth since the Act’s enactment. Among other issues, the courts needed to determine whether the FAA’s application is limited to transactions occurring in interstate commerce, whether the FAA preempts state law, and whether the FAA applies to pre-dispute mandatory arbitration clauses in employment contracts.

32. See id. at 1 (noting that the FAA was designed to place arbitration agreements “upon the same footing as other contracts”). 
33. See id. at 2 (discussing Congress’s desire to promote efficiency).
34. See generally, Lawrence M. Friedman, Access to Justice: Some Historical Comments, 37 FORDHAM URB. L.J. 3, 5-6 (2009) (“Access to justice is not just a matter of courts in the basement of the house of justice. Many legal developments in the late twentieth century had a real impact on access to justice. Laws were passed that opened the way into the legal system for the underdogs, or the lawyers who represented them.”). 
35. See Mark Pettit, Jr., Freedom, Freedom of Contract, and the “Rise and Fall,” 79 B.U. L. REV. 263, 304 n.162 (1999) (noting that “[freedom of contract] was still strong in 1905 when Lochner v. New York was decided, and some view this period as the ‘zenith’ of contract in the United States”); Stephen A. Siegel, Understanding the Nineteenth Century Contract Clause: The Role of the Property-Privilege Distinction and “Takings” Clause Jurisprudence, 60 S. CAL. L. REV. 1, 8 (1986) (“By the nineteenth century, the sanctity of contracts entered into by individuals in the exercise of their common law rights had long been one of the central norms of Liberal social thought.”).
36. See Pettit, supra note 35, at 305 n. 162; Siegel, supra note 35, at 8.
1. Interstate Commerce Requirement

Section 2 of the FAA applies to a transaction “involving commerce.” After enactment, the courts split in their interpretation of Section 2. Some courts concluded that the FAA applies only to those contracts where the parties “contemplated” an interstate commerce connection. In *Burke County Public Schools Board of Education v. Shaver Partnership*, for example, a North Carolina court stated that where performance of the contract “necessarily involves, so that the parties to the agreement must have contemplated, substantial interstate activity the contract evidences a transaction involving commerce within the meaning of the Federal Arbitration Act.” Other courts held that the Section 2 phrase “involving commerce” reached to the outer limits of Congress’s power under the Commerce Clause. In 1995, the U.S. Supreme Court finally settled the split and adopted a broad interpretation of “involving commerce” in *Allied-Bruce Terminix Companies, Inc. v. Dobson*. The Court held that the phrase “involving commerce” meant the full exercise of Congress’s power under the Commerce Clause, and reasoned that the FAA’s legislative history “indicates an expansive congressional intent.” After concluding that the phrase “involving commerce” should be interpreted broadly, the Supreme Court further determined that the FAA applies to all contracts that involve commerce and does not require the contemplation of an interstate commerce connection by the parties.

2. Preemption of State Law

The Supremacy Clause of the U.S. Constitution mandates that state regulation must yield to the U.S. Constitution, as well as federal laws and regulations governing the same subject. The FAA does not contain an express preemption clause and many states had statutes governing the validity of arbitration agreements and awards before and after the enactment of the FAA.

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38. Id.
40. *Burke*, 279 S.E.2d at 822.
41. See, e.g., Foster v. Turley, 808 F.2d 38 (10th Cir. 1986); Snyder v. Smith, 736 F.2d 409 (7th Cir. 1984).
43. Id. at 274.
44. Id.
45. Id. at 278.
46. U.S. CONST. art. VI, cl. 2.
As a result, the courts eventually had to consider whether the FAA preempts state laws. The courts faced state legislation and court rulings that placed restrictions on the enforcement of mandatory arbitration clauses, particularly where the states found unequal bargaining power between the contracting parties. These restrictions included state requirements that mandated a judicial forum in certain matters and special conditions or procedural safeguards for use in the arbitration process. In its 1984 Southland Corp. v. Keating opinion, the U.S. Supreme Court held that the FAA applies in state court and overrides contrary state law.

Despite the Southland opinion, state legislatures and state courts continued to test the limits of preemption with their attempts to invalidate certain mandatory arbitration agreements. They did so by voiding agreements where they believed that arbitration would be unfair, contrary to public policy, or unfair to vulnerable individuals. In considering these preemption matters, the U.S. Supreme Court has held that the FAA supersedes state laws that “undermine the goals and policies of [the Act].” For example, the U.S. Supreme Court struck down a Montana law requiring a first-page notice to employees that the employment “contract is subject to arbitration” because a similar notice requirement did not apply to all contracts. A further example, outside of the employment context, involved the holding in AT&T Mobility LLC v. Concepcion, where the U.S. Supreme Court rejected California’s unconscionability standard as applied to class action waivers. After agreeing to a class action waiver when purchasing a cellular phone and service, Vincent and Liza Concepcion sought relief against AT&T in the California courts. The Concepcions relied on Discover Bank v. Superior Court, where the California Supreme Court held that class action waivers in consumer arbitration agreements are unconscionable if the agreement meets certain conditions. The waivers must be in an adhesion contract, involve disputes over small amounts of damages, and involve an alleged scheme to defraud. The U.S. Supreme Court did not agree with the Concepcions and held that the California Supreme Court’s Discover Bank decision was an obstacle to the
accomplishment and execution of the FAA and, therefore, the FAA preempted the decision.\textsuperscript{60}

3. Application to Employment Contracts

After the enactment of the FAA in 1925, uncertainty existed concerning the application of the FAA to employment contracts. Resolution came with the U.S. Supreme Court’s 1991 decision in \textit{Gilmer v. Interstate/Johnson Lane Corp.}\textsuperscript{61} In \textit{Gilmer}, the Court enforced a securities industry employee’s agreement to arbitrate a dispute arising from employment. This shocked employers who previously believed that the decision in \textit{Alexander v. Gardner-Denver Co.}\textsuperscript{62} would bar courts from enforcing pre-dispute mandatory arbitration claims in the employment context.\textsuperscript{63} This seemed to prompt businesses to compel arbitration to a greater degree and opened the floodgates for further agreements containing pre-dispute mandatory arbitration provisions.\textsuperscript{64} In its 2001 decision in \textit{Circuit City v. Adams}, the U.S. Supreme Court specifically ruled that the FAA applied to arbitration agreements written into employment contracts removing any doubt as to the application of the FAA to such matters.\textsuperscript{65}

C. Avoiding Application of the Agreement

However, despite its expansive application, the FAA left a “crack in the door” to dispute an arbitration clause via the “Savings Clause.”\textsuperscript{66} This phrase is contained in Section 2, stating: “upon such grounds as exist at law or in equity for the revocation of any contract.”\textsuperscript{67} The Savings Clause essentially permits arbitration challenges when an employee can prove that the contract should be revoked using ordinary contract law principles.

There are several ways in which employees can overcome mandatory arbitration agreements and bring their claims in court.\textsuperscript{68} One such challenge involves an assertion that the employment agreements were not written

\begin{flushright}
60. Concepcion, 563 U.S. 333. \\
62. Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974) (holding that an employee’s statutory right to trial \textit{de novo} under Title VII of the Civil Rights Act of 1964 is not foreclosed by prior submission of his claim to final arbitration under the nondiscrimination clause of a collective bargaining agreement). \\
64. See id. \\
67. Id. \\
68. See Sternlight, supra note 63, at 1644.
\end{flushright}
sufficiently broadly to cover the particular claim made by the employee. In reviewing this type of challenge, the Supreme Court has instructed that “[w]hen deciding whether the parties agreed to arbitrate a certain matter (including arbitrability), courts generally . . . should apply ordinary state-law principles that govern the formation of contracts.” Employees also challenge the validity of mandatory arbitration agreements with claims of unconscionability.

In reviewing an agreement for unconscionability, the U.S. Supreme Court strictly adheres to the principle that arbitration agreements are “placed on the same footing as other contracts.” Therefore, employees attempting to avoid arbitration agreements needed to look within the body of existing contract law for a solution. In doing so, many such employees relied on the doctrine of unconscionability. Section 208 of the Restatement (Second) of Contracts, with respect to contracts or terms, provides:

If a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result.

The U.S. Supreme Court has sanctioned unconscionability challenges to arbitration provisions, but has also made it clear that the doctrine of unconscionability may not be used to discriminate against arbitration agreements as compared to other contracts. In reviewing pre-dispute mandatory employment arbitration agreements the U.S. Supreme Court ruled that “[m]ere inequality in bargaining power . . . is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context.” The California courts have interpreted this language to mean that an agreement can withstand an unconscionability challenge unless there is a showing that both procedural and substantive unconscionability exist. Procedural

69. Id.
71. See Sternlight, supra note 63, at 1644.
72. See H.R. REP. No. 96, 68th Cong., 1st Sess., 1 (1924) (noting that the FAA was designed to place arbitration agreements “upon the same footing as other contracts”); DIRECTV, Inc. v. Imburgia, 136 S.Ct. 463, 468 (2015) (quoting Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 443 (2006)).
73. Perry v. Thomas, 482 U.S. 483, 492 n. 9 (1987) (“A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.”)
unconscionability refers to unfairness in the formation of the contract and substantive unconscionability refers to excessively disproportionate terms.\textsuperscript{76}

The Fourth Circuit, however, placed a limit on employer overreach and found against an employer based on substantive unconscionability alone in \textit{Hooters of America, Inc. v. Phillips}.\textsuperscript{77} There, the Fourth Circuit denied the employer’s motion to compel arbitration. The court described the agreement terms as “so one-sided that their only possible purpose is to undermine the neutrality of the proceeding.”\textsuperscript{78} The terms overwhelmingly favored the employer with respect to the filing of notices and the choice of arbitrators.\textsuperscript{79} The terms also limited employee claims to those in their notice, but allowed the employer to raise any matter in the arbitration.\textsuperscript{80} In addition, only the employer could move for summary judgment or seek to vacate the arbitration award.\textsuperscript{81} So, while the general rule requires a finding of both procedural and substantive unconscionability, dramatic overreaching by the employer in drafting the terms renders the agreement void without an additional finding of procedural unconscionability.\textsuperscript{82}

\section*{II. FEDERAL AND STATE LEGISLATIVE EFFORTS}

The states have taken legislative steps to provide protection for certain parties to arbitration agreements, but must stay within the limits of the FAA. Given these limits, employees have sought relief from Congress and the executive branch. These Congressional and executive branch efforts, presented in chronological order below,\textsuperscript{83} have produced no meaningful results in restricting the use of mandatory arbitration agreements. The following discussion begins with enacted and proposed state legislation and then addresses the mostly unsuccessful Congressional and executive branch efforts used to restrict pre-dispute mandatory arbitration agreements.

\subsection*{A. State Legislation}

States have expressed different levels of contempt for arbitration agreements. Alabama, an outlier among the states, specifically provides

\begin{footnotesize}
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  \item \textsuperscript{76} See Leff, \textit{Unconscionability and the Code-The Emperor’s New Clause}, 115 U. PA. L.REV. 485, 487 (1967).
  \item \textsuperscript{77} \textit{Hooters of America, Inc. v. Phillips}, 173 F.3d 933 (4th Cir. 1999).
  \item \textsuperscript{78} \textit{Id.} at 938.
  \item \textsuperscript{79} \textit{Id.} at 938-39.
  \item \textsuperscript{80} \textit{Id.}
  \item \textsuperscript{81} \textit{Id.} at 939.
  \item \textsuperscript{82} See also, Sanchez v. Valencia Holding Co., 353 P.3d 741, 748-49 (2015) (holding that provisions that “shock the conscience” can render an agreement or a portion of an agreement invalid in the absence of procedural unconscionability).
  \item \textsuperscript{83} Where Congress has attempted enactment of legislative on more than one occasion, the earliest occasion is used for ordering purposes here.
\end{itemize}
\end{footnotesize}
enforced arbitration agreements.\textsuperscript{84} Alabama has not repealed this statute despite the opinion of its own Alabama Supreme Court stating that the FAA preempts its application.\textsuperscript{85} Unlike Alabama, most states have arbitration acts that are similar to Section 2 of the FAA.\textsuperscript{86} Iowa and Missouri have similar rules to Section 2 of the FAA, but both states exclude “contracts of adhesion” and certain other matters from their rules.\textsuperscript{87} These exemptions create their own controversy, in that the FAA may preempt these exclusions.

Maryland and Washington have sought to bar the use of mandatory predispute arbitration agreements when the cause of action involves sexual harassment or sexual assault. Effective October 1, 2018, Maryland amended its Labor and Employment Law to void any “provision in an employment contract, policy, or agreement that waives any substantive or procedural right or remedy to a claim that accrues in the future of sexual harassment or retaliation for reporting or asserting a right or remedy based on sexual harassment.”\textsuperscript{88} Maryland also amended its Labor and Employment Law to prohibit employers from taking any adverse action against an employee who refuses to sign such an agreement\textsuperscript{89} and to require that employers pay the employee’s attorneys’ fees and costs.\textsuperscript{90}

Effective June 7, 2018, Washington prohibits employers from requiring an employee, as a condition of employment, to sign a nondisclosure agreement that prevents the employee from disclosing sexual harassment or sexual assault occurring in the workplace, at work-related events, between employees, or between an employer and an employee off the employment premises.\textsuperscript{91} Any nondisclosure agreement signed by an employee as a condition of employment that prevents the disclosure or discussion of sexual harassment or sexual assault is against public policy and is void and unenforceable.\textsuperscript{92} Consistent with the preemption discussion above, both the Maryland law and the Washington law will likely face employer challenges based on preemption by the FAA. Despite

86. E.g., ALASKA STAT. § 09.43.010 (2018); ARIZ. REV. STAT. § 12-1501 (2018); CONN. GEN.
STAT. § 52-408 (2018); DEL. CODE ANN. tit. 10, § 5701 (2018); FLA. STAT. § 682.02 (2018);
LA. STAT. ANN. § 9:4201 (2018); MASS. GEN. LAWS ch. 251, § 1 (2018); N.J. STAT. ANN. § 2A:24-1 (West 2018);
N.D. CENT. CODE § 32-29.3-06 (2018); OR. REV. STAT. § 36.620(1) (2018); 42 PA. CONS. STAT. § 7303
exception for real property disputes); TEX. CIV. PRAC. & REM. CODE ANN. § 171.001 (West 2018);
UTAH CODE ANN. § 78B-11-107 (West 2018); WYO. STAT. ANN. § 1-36-103 (2018).
88. MD. STAT. ANN. § 3-715(e) (2018).
89. MD. STAT. ANN. § 3-715(b) (2018).
90. MD. STAT. ANN. § 3-715(c) (2018).
91. WASH. ADMIN. CODE § 49.44.210(1) (2018).
92. WASH. ADMIN. CODE § 49.44.210(2) (2018).
the challenges they may face, additional states have similar legislation in process.93

B. Unsuccessful Federal Legislation and Revoked Executive Orders

1. 2007 to 2018—The Arbitration Fairness Act

In what could be described as “beating a dead horse,” the House of Representatives has introduced bills labeled The Arbitration Fairness Act on seven separate occasions. These introductions began in 2007 and have continued through 2018. In 2007 and 2009, the bills amended Section 2 of the FAA by providing that “No pre-dispute arbitration agreement shall be valid or enforceable if it requires arbitration of (1) an employment, consumer, or franchise dispute; or (2) a dispute arising under any statute intended to protect civil rights.”94 In 2011, the House slightly modified the bill to provide that “no pre-dispute arbitration agreement shall be valid or enforceable if it requires arbitration of an employment dispute, consumer dispute, or civil rights dispute.”95 In 2013, the House added antitrust disputes to the list of disputes covered in the proposal.96 The 2015, 2017, and 2018 versions of the bill contain language identical to that of the 2013 version with respect to the validity and enforceability of pre-dispute arbitration agreements.97 It appears that the seventh attempt, in keeping with the trend, still will not muster enough votes. Skopos Labs predicts that the Arbitration Fairness Act of 2018 has a three percent (3%) chance of success.98

2. Rape Victims Act of 2009

The Rape Victims Act of 2009 would have made any agreement between an employer and employee to arbitrate a dispute unenforceable with respect to any claim arising out of a rape allegation.99 Currently, claims arising out of rape allegations are arbitrable because existing arbitration agreements are enforceable in employment contracts unless Congress “has evinced an intention to preclude such agreements for the dispute at issue.”100 The purpose of the Rape Victims Act was to evince Congress’s intent that employees should not be

compelled by an employer to arbitrate any claim relating to a tort arising out of rape. ¹⁰¹ This bill did not make it out of committee.

3. 2014–Executive Order 13673

On July 31, 2014, President Obama issued Executive Order 13673, Fair Pay and Safe Workplaces. ¹⁰² Section 6(a) of the Executive Order provided that:

Agencies shall ensure that for all contracts where the estimated value of the supplies acquired and services required exceeds $1 million, provisions in solicitations and clauses in contracts shall provide that contractors agree that the decision to arbitrate claims arising under title VII of the Civil Rights Act of 1964 or any tort related to or arising out of sexual assault or harassment may only be made with the voluntary consent of employees or independent contractors after such disputes arise. Agencies shall also require that contractors incorporate this same requirement into subcontracts where the estimated value of the supplies acquired and services required exceeds $1 million. ¹⁰³

The Executive Order directed the Federal Acquisition Regulatory Council (“FAR Council”) to amend its regulations consistent with the Order’s requirements, and directed the Secretary of Labor (“Secretary”) to develop guidance to assist agencies in implementing the Order. ¹⁰⁴ The rule was amended again to reflect the findings of a preliminary injunction issued by the United States District Court for the Eastern District of Texas. ¹⁰⁵ On December 16, 2016, the Department of Defense, General Services Administration, and National Aeronautics and Space Administration, on behalf of the FAR Council, amended the FAR Council’s rule to conform to the district court’s injunction. ¹⁰⁶

On March 27, 2017, President Donald Trump signed a resolution of disapproval of the FAR Council’s rule ¹⁰⁷ under the Congressional Review Act, 5 U.S.C. 801 et seq. Under the Congressional Review Act, a rule shall not take effect or continue if a joint resolution of disapproval of the rule is enacted. ¹⁰⁸ Additionally, on March 27, 2017, President Trump issued Executive Order 13782, revoking Executive Order 13673, section 3 of Executive Order 13683, and Executive Order 13738, and directing all executive departments and agencies, “as appropriate and to the extent consistent with law, [to] consider promptly rescinding any orders, rules,

¹⁰¹. S. 2915, 111th Cong. § 2(b).
¹⁰³. Id.
regulations, guidance, guidelines, or policies implementing or enforcing the revoked Executive Orders and revoked provision."\(^{109}\) The benefits of Executive Order 13673 were short-lived.

3. Restoring Statutory Rights and Interests of the States Act

On February 4, 2016, Senator Leahy introduced into Congress the Restoring Statutory Rights and Interests of the States Act of 2016. The proposed bill provided the following exception to Section 2 of the FAA:

Subsection (a) shall not apply to a written provision that requires arbitration of a claim for damages or injunctive relief brought by an individual or small business concern (as defined in section 3 of the Small Business Act (15 U.S.C. 632)), in either an individual or representative capacity, arising from the alleged violation of a Federal or State statute, the Constitution of the United States, or a constitution of a State, unless the written agreement to arbitrate is entered into by both parties after the claim has arisen and pertains solely to an existing claim.\(^{110}\)

This bill varied slightly from the Arbitration Fairness Act of 2015, discussed above.\(^{111}\) On March 7, 2017, Senator Leahy reintroduced the bill, without any changes, as the Restoring Statutory Rights and Interests of the States Act of 2017.\(^{112}\) Both bills lacked bipartisan support and did not make it out of committee.\(^{113}\)

4. Mandatory Arbitration Transparency Act of 2017

This bill prohibits pre-dispute arbitration agreements from containing a confidentiality clause regarding an employment, consumer, or civil rights dispute that could be interpreted to prohibit a party from: (1) making a communication in a manner such that the prohibition would violate a whistle-blower statute; or (2) reporting or making a communication about tortious conduct, unlawful conduct, or issues of public policy or public concern.\(^{114}\) This bill provided an exception for situations when a party can demonstrate a confidentiality interest that significantly outweighs the private and public interest in disclosure. This bill differs from the Arbitration Fairness Act in that it addresses the confidential nature of the agreement rather than barring pre-dispute mandatory arbitration. The narrower scope here may not materially

\(^{110}\) S. 2506, 114th Cong. § 3(a)(2) (2016).
\(^{111}\) H.R. 2087, 114th Cong. § 3 (2015).
\(^{113}\) S. 647, 115th Cong. § 2(a) (2017).
increase its likelihood of passage as Skopos Labs has predicted only a three percent (3%) chance of enactment.\footnote{115}{S. 647: Mandatory Arbitration Transparency Act of 2017, GovTrack, \url{https://www.govtrack.us/congress/bills/115/s647} (compared to a three (3%) chance for the Arbitration Fairness Act of 2017).}

5. Tax Cuts and Jobs Act

Congress, unable to move comprehensive legislation out of committee, did successfully enact some mandatory arbitration reforms in tax legislation. Effective with amounts paid or incurred after December 22, 2017, and under the new section 162(q) of the Internal Revenue Code, Congress restricted the availability of business deductions for settlements or payments related to sexual harassment or sexual abuse when the payment is subject to a nondisclosure agreement. In this legislation, Congress did not ban the pre-dispute mandatory arbitration agreement or prohibit agreements with a nondisclosure clause.\footnote{116}{I.R.C. § 162(q) (2012).} However, by denying the deduction for certain expenses, Congress made the agreements more expensive for employers.

6. Ending Forced Arbitration of Sexual Harassment Act of 2017

As described in the Introduction, this bill would “prohibit a pre-dispute arbitration agreement from being valid or enforceable if it requires arbitration of a sex discrimination dispute.”\footnote{117}{H.R. 4570, 115th Cong. § 402(a) (2017).} This bill received a three percent (3%) chance of enactment from Skopos Labs.\footnote{118}{H.R. 4734: Ending Forced Arbitration of Sexual Harassment Act of 2017, GovTrack, \url{https://www.govtrack.us/congress/bills/115/hr4734}.} Given this bill’s prognosis and the prognosis of the other legislation discussed in this part, it appears that federal legislation targeting pre-dispute mandatory arbitration and associated nondisclosure agreements, other than tax legislation, remains unlikely.

III. An Urgent Need for Transparency and Accountability

American employers increasingly require their workers to sign pre-dispute mandatory arbitration agreements.\footnote{119}{See Colvin, supra note 1.} The Employee Rights Advocacy Institute for Law & Policy conducted research on the use of arbitration in the workforce.\footnote{120}{I.MRE S. SZALAI, THE WIDESPREAD USE OF WORKPLACE ARBITRATION AMONG AMERICA’S TOP 100 COMPANIES 3 (2018), \url{http://employeerightsadvocacy.org/wp-content/uploads/2018/03/NELA-Institute-Report-Widespread-Use-of-Workplace-Arbitration-March-2018.pdf}.} In turn, Professor Imre S. Szalai wrote the study entitled “The Widespread Use of Workplace Arbitration among America’s Top 100 Companies”.\footnote{121}{Id.} The study concluded that eighty (80) of the companies in the
Fortune 100, including subsidiaries or related affiliates, have used arbitration in connection with workplace-related disputes since 2010.\textsuperscript{122} Of those eighty (80) companies, thirty-nine (39) have used arbitration clauses containing class, collective, and joint action waivers.\textsuperscript{123}

The results for the Fortune 100 companies remain consistent with the findings of a similar study conducted by Alexander J.S. Colvin for the Economic Policy Institute in 2018.\textsuperscript{124} Colvin found that 50.4 percent (50.4\%) of employees faced requirements to sign mandatory arbitration agreements.\textsuperscript{125} Colvin determined that employers establish mandatory employment arbitration by having employees sign an arbitration agreement at the time of hiring. Colvin also noted some instances where businesses adopt arbitration procedures simply by announcing that these procedures have been incorporated into the organization’s employment policies.\textsuperscript{126} The likelihood of mandatory arbitration agreements increases with the size of the employer. Colvin’s research on companies with 1,000 or more employees showed that 65.1\% had mandatory arbitration.\textsuperscript{127}

The prevalence of these agreements and their increased use in recent years forces us to examine their role in our society. This part begins with a brief discussion as to why victims of sexual harassment should have and may need more protection than other plaintiffs. This part continues by describing these problems using fact patterns illustrating the extraordinary challenges facing employees and the perpetuation of the problem through the cover-ups created by confidentiality clauses.

\textit{A. Why Sexual Harassment is Different}

Social scientists have concluded that harassment leaves a detrimental impact on the physical and mental health of its victims that often lasts for years.\textsuperscript{128} Harassment has been associated with increased risk of anxiety, depression, and post-traumatic stress disorder.\textsuperscript{129} Research also reveals that sexual harassment contributes to financial difficulties, primarily by instigating a job change.\textsuperscript{130} Victims often leave their employment due to frustration with an employer’s inadequate response after reporting the harassment.\textsuperscript{131} Therefore,

\begin{itemize}
  \item 122. \textit{Id.} at 4.
  \item 123. \textit{Id.}
  \item 124. \textit{See Colvin, supra note 1.}
  \item 125. \textit{Id.} at 5.
  \item 126. \textit{Id.}
  \item 127. \textit{Id.} at 6.
  \item 128. \textit{See e.g.,} Heather McLaughlin et al., \textit{The Economic and Career Effects of Sexual Harassment on Working Women}, 31 GENDER & SOCIETY 333, 334 (2017).
  \item 129. \textit{Id.} at 334.
  \item 130. \textit{Id.} at 351.
  \item 131. \textit{Id.}
\end{itemize}
sexual harassment, like that experienced by the fictional applicant/employee, could have lasting economic effects. Research has shown that “harassment experienced in women’s twenties and early thirties knocks many off-course during this formative career stage.”

Silencing these victims’ voices through private arbitration and tolerating confidential pre-dispute mandatory arbitration agreements could perpetuate serious and demeaning conduct and shield those who perpetrate it. Consistent with this argument, Microsoft’s President and Chief Legal Officer nicely summarized the argument for why sexual harassment differs from other private arbitration:

We appreciate that many companies and business associations believe that the opportunity for private arbitration is sufficient. A great many responsible companies–Microsoft among them–have put in place a variety of internal processes so employees can escalate concerns. Arbitration alone has seemed reasonable to supplement these processes, and for most issues that seems appropriate. But as each new story about sexual harassment demonstrates, current approaches in this area have proven insufficient. Even as we look squarely at the sins of the past, we must take stronger steps to prevent these problems in the future. Because the silencing of voices has helped perpetuate sexual harassment, the country should guarantee that people can go to court to ensure these concerns can always be heard.

The National Association of Attorneys General agrees with Microsoft and provided the following similar statement:

While there may be benefits to arbitration provisions in other contexts, they do not extend to sexual harassment claims. Victims of such serious misconduct should not be constrained to pursue relief from decision makers who are not trained as judges, are not qualified to act as courts of law, and are not positioned to ensure that such victims are accorded both procedural and substantive due process.

The statements of Microsoft’s President and the National Association of Attorneys General acknowledge that arbitration provisions may be appropriate in certain situations, but victims of such serious employer misconduct need their voices to be heard to stem this tide of egregious behavior. But for Gretchen Carlson’s complaint against Roger Ailes at Fox News, decades of harassment could have gone unnoticed.

Because of the nature of an employer’s misconduct, a court’s opinion may also provide a certain level of dignity for the victim. It assures them that their views and arguments were heard and considered, and that the court respected

132. Id. at 352.
them as individuals. A court’s opinion would also show respect for the participants and their views by providing proof that they at least deserved an explanation for the decision.

B. Unequal Bargaining Power

Although it may appear on its face that both parties voluntarily entered into a pre-dispute mandatory arbitration agreement, such a conclusion would require a finding that the employee knew of the agreement and had a meaningful choice with respect to consent.

1. Unaware of existence of the clause

The FAA requires the existence of a valid contract under state law and incorporates state law in determining whether assent of the parties to a contract exists. Under state law, it is well-settled that mutual assent between parties is necessary for the formation of a contract. As discussed below, employees have challenged whether the manner in which employers provide mandatory arbitration agreements permitted or allowed for the assent of the employee. An agreement to arbitrate is clear when the employer presents an employee with an application or employment agreement with an arbitration clause, consideration is received by both parties, the employee signs the agreement, and the employee receives notice of the arbitration rules. However, employers have sought to compel arbitration in situations where the arbitration clause lies buried in a lengthy employment agreement or does not appear in the contract itself. Concerned with such situations, the National Association of Attorneys General has written a letter to congressional leadership complaining that “These arbitration requirements often are set forth in clauses found within the ‘fine print’ of lengthy employment contracts.” In Patterson v. Tenet Healthcare, Inc., the Eighth Circuit enforced an arbitration agreement where the arbitration agreement appeared on page thirty-one of the employee handbook signed by the employee. In some instances, simply acknowledging the receipt of an employee handbook can provide the requisite assent when the


137. See, e.g., Doctor’s Assocs. Inc. v. Casarotto, 517 U.S. 681, 685 (1996) (“state law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.”).


139. Letter from National Association of Attorneys General to Congressional Leadership, supra note 134.

employee also acknowledges the existence of the handbook. One jurisdiction has gone even further by inferring an employee’s agreement to arbitrate because the employee continued to work after receiving notice of the company’s policy that all claims are subject to arbitration.

Even when employers highlight the arbitration provisions, employees have difficulty with these agreements. Some employees sign employment agreements unaware that the agreements contain an arbitration clause or lacking the understanding of the clause’s importance. Indeed, research has found that employees are often unaware or fail to recall that they have signed arbitration agreements and may not understand the content and meaning of these documents. Unfortunately, this typically provides no legal protection for employees, since general contract law usually holds that parties assent to agreements regardless of whether or not they read and understand the contract’s terms. For example, in *Booker v. Robert Half Int’l., Inc.*, the court held that an employee assented to an arbitration agreement, notwithstanding the employee’s failure to read or understand it or the employer’s failure to explain it.

2. Employees lack leverage in negotiating the terms

Job applicants, such as the fictional applicant in the Introduction, may read their employment agreements and assume that they are non-negotiable adhesion contracts. This power imbalance in employment relationships results in contracts that are generally not bargained-for exchanges. As a result, employers are able to unilaterally decide to arbitrate disputes and plan arbitration procedures with no employee input or bargaining.


144. Id.


148. Id. at 125.
Hicks v. Mission Bay Management, LLC\textsuperscript{149} provides an example of such leverage in negotiating a pre-dispute mandatory arbitration agreement. Mission Bay Management LLC, doing business as Hilton San Diego Resort & Spa, offered Hicks a job as a spa director.\textsuperscript{150} Hicks was living in Minnesota when she received a letter outlining the offer that stated, “Your acceptance of this letter and the terms stated herein affirms that there are no other agreements, nor other information upon which you are relying in making your decision.”\textsuperscript{151} The letter did not mention arbitration.\textsuperscript{152} Hicks accepted the offer, canceled interviews she had scheduled for a position in Florida, sold her belongings, and moved to San Diego.\textsuperscript{153} On July 20, 2006, four days before she was to begin work, Hicks received a four-page employment application.\textsuperscript{154} The last paragraph of that application contained an arbitration clause.\textsuperscript{155} Approximately four years later, Hicks sued for pregnancy and sex discrimination, among other related counts.\textsuperscript{156} In response, Mission Bay Management, LLC sought to compel arbitration.\textsuperscript{157}

Reviewing the sequence of these events highlights the overwhelming leverage maintained by employers in these situations. Here, the employer hid the arbitration clause until the employee had canceled other interviews, sold her belongings, and moved to San Diego from Minnesota. Like the fictional applicant/employee in the Introduction, once Hicks had arrived in San Diego she had little remaining bargaining power. After reviewing the appeal, the California Appellate Court found procedural unconscionability due to the surprise and oppression in this matter, but compelled arbitration because both procedural and substantive unconscionability must be present before an arbitration clause is deemed unenforceable. In this case, Hicks had not met her burden with respect to substantive unconscionability.\textsuperscript{158} With the unconscionability standard set this high, the ordinary employee in situations similar to the fictional applicant/employee in the Introduction will have an extraordinarily difficult time fighting compelled arbitration.

\textsuperscript{150} Id.
\textsuperscript{151} Id. at *1-2.
\textsuperscript{152} Id. at *2.
\textsuperscript{153} Id.
\textsuperscript{154} Id.
\textsuperscript{155} Id. at *2-3.
\textsuperscript{156} Id. at *3.
\textsuperscript{157} Id. at *4.
\textsuperscript{158} Id. at *26.
C. Confidentiality

The U.S. Supreme Court has observed that “justice cannot survive behind walls of silence.”159 Although this statement appeared in an opinion discussing a trial, it should not be any less true when assessing arbitration. Even if a worker wins the case, confidentiality provisions can shield repeat offenders from exposure. Harvey Weinstein’s contracts with his employees illustrate this point. Employees working for Weinstein signed contracts stating they would not harm the company’s “business reputation” or “any employee’s personal reputation.”160 Weinstein also entered into settlement agreements with accusers that restricted their ability to discuss his misconduct.161 One such contract apparently provided for the destruction of evidence along with a signed statement by the victim that the conduct did not occur.162 Another contract apparently required one of Weinstein’s victims to say positive things about Weinstein if contacted by the media.163

Scholars began to criticize confidential settlements of discrimination claims long before the Weinstein scandal.164 Professor Theresa Beiner concluded that a confidential settlement “relieves employers of an obligation or incentive to examine their workplaces and consider that there may be organizational structural components that permit discrimination to flourish.”165 Fox News provides an excellent example of a failure of management to investigate its own culture. Some of the Fox News employees reported harassment for over a decade.166 Fox News settled numerous cases hiding the harassment with confidential settlements and arbitration.167 The cascading disclosures ultimately led to the departure of Ailes, O’Reilly, and Bill Shine.168 These dramatic

events all began with a lawsuit by Gretchen Carlson, a former anchor at the network.169 Due to the publicity following these events, Fox News had no choice but to investigate and confront years of harassment.

IV. PURSUING BETTER CORPORATE CITIZENSHIP BY DEMANDING TRANSPARENCY AND ACCOUNTABILITY

Justice Brandeis wrote, “Publicity is justly commended as a remedy for social and industrial diseases.”170 As discussed below, publicity may create advocates at the employee, customer, and shareholder level for better handling of sexual harassment claims. This part discusses how our fast-paced social media culture makes corporate sexual harassment cover-ups difficult to hide, thereby making it easier for today’s employees to discover and avoid offending employers. Armed with a better understanding of employee behavior and a responsibility to society, employees, corporations and their shareholders have changed the performance metrics in a manner that may lead us out of these troubled times. These businesses may be the best bet for taking steps to eliminate the mandatory pre-dispute employment arbitration agreements that have hidden the culture of sexual harassment and denied victims their day in court. To the contrary, companies that cover up sexual harassment could suffer in many ways including difficulties in attracting and retaining talented workers and attracting new investors for their businesses. This part also examines transparent business culture, the business benefits of a culture without pre-dispute mandatory arbitration agreements, and calls for better corporate citizenship. Three Fortune 100 companies were chosen to illustrate the points discussed in this part: Best Buy Co., Inc. (“Best Buy”), CVS Pharmacy, Inc. (“CVS”), and TJX Companies, Inc. (“TJX”).

A. Discovery is Inevitable in our “Glassdoor Culture”

Today, businesses operate in a transparent environment where behavior is difficult to hide.171 Employees may air their grievances in public forums, such as Glassdoor, often outside the control of their employers.172 The Glassdoor website allows the publication of anonymous reviews and experiences by employees and promises to be “the most trusted and transparent place for

172. Id.
today’s candidate to search for jobs and research companies.”  The anonymity provided users on the site may encourage additional feedback from the employees. Glassdoor’s Terms of Agreement states, in part, the following:

Defending Our Users. While we have no obligation to do so, we reserve the right, to the fullest extent permitted by applicable law, to take appropriate action to protect the anonymity of our users against the enforcement of subpoenas or other information requests that seek a user’s electronic address or identifying information. 174

Unfortunately, there are times when employers may have failed to monitor postings or correct the behavior reported on Glassdoor or any other website. For example, more than a year before Harvey Weinstein was first accused of sexual harassment, one employee of the Weinstein Company said that sexual harassment was “the norm” at the Weinstein Company in a Glassdoor review. 175

To illustrate the need for transparency and accountability, this part uses the three companies listed above to analyze the codes of conduct and arbitration agreements for consistency. With each of the three companies, the codes of conduct stand in stark contrast to the mandatory arbitration agreements. In other words, the companies demand exemplary behavior from their employees, but hide that behavior from public view through pre-dispute mandatory arbitration. After reviewing the codes of conduct and agreements, a keyword search for reviews of these businesses reveals that certain employees have concerns about sexual harassment and the mandatory arbitration agreements presented to them. These social media postings are meant to illustrate that businesses may have difficulty hiding pre-dispute mandatory arbitration agreements and sexual harassment. However, the accuracy and authenticity of the sexual harassment and discrimination claims cannot be confirmed or denied by social media postings. In addition, any one review may, in fact, be misleading or merely represent the rant of an unhinged employee.

1. Best Buy

In Section 2 of Best Buy’s Code of Business Ethics, titled Responsibility to Each Other, Best Buy implores its employees to “treat each other respectfully and ethically.” 176 Section 2 also demands a Harassment-Free Workplace using the following terms:

Best Buy prohibits any type of harassment in the workplace by an employee, supervisor, customer or visitor. This includes, but is not limited to, harassment on the basis of age, sex, race, color, ethnicity, citizenship, national origin, sexual orientation, gender identity, creed, religious preference or belief, disability, marital/family status or any other characteristic protected by law. Various national, state, local and provincial laws may include additional protected categories.

Despite the Code of Conduct’s demand for respectful and ethical behavior, Best Buy has a pre-dispute mandatory arbitration agreement with a class waiver that ensures that disputes alleging contrary acts remain confidential. The manner in which the arbitration agreement is communicated to new employees is described in Dugan v. Best Buy Co. Inc., an action by an employee to avoid compelled arbitration. Best Buy communicated its arbitration policy to employees through an eLearning module. The eLearning module consisted of four screens. The first screen, titled “Employee Solutions Process,” read:

Best Buy is committed to a welcoming, inclusive environment where employees come to work every day to do what they enjoy doing. From time to time you may encounter a concern that, if left unresolved, could negatively affect your employment experience. It is Best Buy’s goal to resolve all these issues and, in fact, has a clear well-established internal process to do just that.

The second screen, bearing the same title, outlined a progressive system for employees to address employment-related concerns, starting with discussions with the employee’s manager, next to human resources personnel, and then to the Employee Relations (ER) team. The text continued, “Under the Peer Review Program, eligible employees may have certain involuntary terminations reviewed, first by an ER manager and, if still not satisfied by the outcome, by a panel of managers and peers.” If those steps did not address the concern, employees could “choose to file a formal legal claim.” The screen text concluded, “Effective March 15, 2016, you will bring that claim in arbitration, rather than in court.”

A note at the bottom of both the first and second screens directed the employee to a link at a site at which “[a]dditional details” could be found. The heading of the third screen was: “Why is Best Buy Implementing an Arbitration policy?” The text that followed suggested that the arbitration process was more favorable than court proceedings.

179. Id. at *2.
180. Id.
181. Id.
182. Id. at *2-3.
183. Id. at *3.
The last screen read:
As with any other Best Buy policy, by remaining employed, you are considered to have agreed to the policy. The purpose of the eLearning is to ensure you read and understand the policy. Employees who do not take this eLearning are still subject to the policy.

I have read and understand the Best Buy Arbitration Policy that takes effect on March 15, 2016.

Just below that paragraph, the words, “I acknowledge,” appeared in a box that was intended to be mouse-clicked by the reader. A link at the bottom of the page allowed the reader the opportunity to “read and review” the policy and “FAQs” - frequently asked questions.

Reddit and Glassdoor reviewers commented on Best Buy’s mandatory arbitration policy. Reddit is a social news aggregation, web content rating and discussion website. As one can see from the Reddit posting below, Reddit user “AngryBlueShirt” was unhappy with the arbitration agreement.

Anyone else agree that the Arbitration Policy is the last straw?

Every year I feel less valued. The pay is stagnant, the environment is [sic] all the problems of a commission store, without the commission. The upwards mobility is now nonexistent. We are often treated not as employees, but as potential thieves. And now to top it off, they are forcing us into an arbitration agreement.

It is time that we stop allowing ourselves to be tossed around. Let’s find our local UFCW office, and sign up. At this point, what would unionizing take away from us that hasn’t already been lost?

We are on social media, so it isn’t like they can stop us organizing. And if every store signs on, they can’t shut us all down.

In this posting, AngryBlueShirt expressed displeasure with the mandatory arbitration agreement and further suggested unionization as a response to this “last straw.”

Best Buy can find similarly displeased employees on Glassdoor, where user “Geek Squad,” a Best Buy employee at the time of the posting, stated that the

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184. Id.
185. Id.
186. Id.
187. Id.
188. Id. at *3-4.
190. Angry Blue Shirt, Anyone Else Agree that the Arbitration Policy is the Last Straw?, REDDIT (Feb. 9, 2016), https://www.reddit.com/r/Bestbuy/comments/44xg76/anyone_else_agree_that_the_arbitration_policy_is/
191. Id.
company engaged in “rampant discrimination, and sexual harassment.”

Geek Squad also suggested that the company should “get rid of mandatory arbitration.”

2. CVS

CVS’s Code of Conduct titled “Respecting Colleagues” details harassment policies. In this section, CVS briefly discusses harassment, stating, “CVS Health is committed to maintaining a workplace environment free from discrimination, harassment and violence.” The Code of Conduct also provides harassment examples, asks employees not to disrupt the work environment through harassing behavior, and refers employees to the CVS Health Policy and Procedure Portal for further information.

In addition to the Code of Conduct, CVS provides a Health Colleague Handbook that greatly elaborates upon Workplace Sexual Harassment. CVS Health strictly prohibits and will not tolerate sexual harassment in the workplace. The company firmly believes that every colleague is entitled to a work environment free of offensive conduct of a sexual nature, regardless of its form or manner. The company recognizes that sexual harassment in the workplace seriously and negatively impacts colleague morale, trust, communication, teamwork and productivity, and creates legal liabilities for the company, its supervisors, and, in some cases, its colleagues. Sexual harassment consists of sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature either explicitly or implicitly when:

Submission to such conduct is made either explicitly or implicitly a term or condition of an individual’s employment; and
Submission to or rejection of such conduct by an individual is used as the basis for employment decisions affecting such individual; or
Such conduct has the purpose or effect of substantially interfering with an individual’s work performance or altering the terms and conditions of the individual’s employment by creating an intimidating, hostile or offensive working environment.

The CVS Health Colleague Handbook also lists examples of offensive conduct, discusses how employees should report offensive conduct, and describes the investigation procedures CVS employees should follow. The handbook stops short, neglecting to discuss relevant procedures for when CVS and an employee have a legal dispute. In other words, mandatory arbitration is not mentioned as the exclusive remedy.

193. Id.
196. Id. at 11-12.
Despite the Code of Conduct’s demand for respect among its colleagues, CVS’s pre-dispute mandatory arbitration agreement ensures that disputes alleging contrary acts remain confidential. CVS communicated this arbitration agreement to its employees through an online learning system, “Learnet.” The arbitration agreement requires employees to opt out if they want to decline the agreement. Hall v. CVS Health Corp. describes the manner in which CVS communicated the arbitration policy to employees.

On October 5, 2014, CVS invited its employees to participate in a training course, Arbitration of Workplace Legal Disputes. The course explained the employees’ rights as to arbitration, the manner in which they accept the policy’s terms, and how they may opt out of the policy. The policy provided that employees would accept the policy by continuing their employment with CVS Health after becoming aware of the policy, but allowed employees to opt out within 30 days of first viewing or receiving the policy. To opt out, the policy explained that an employee must mail a written, signed and dated letter stating clearly that he or she wishes to opt out of the CVS Health Arbitration of Workplace Legal disputes Policy. The letter must be mailed to [CVS’s P.O. Box in Rhode Island]. In order to be effective, the colleague’s opt out notice must be postmarked no later than 30 days after the colleague first views or receives the policy. Please Note, sending in a timely notice is the only way to opt out. A colleague cannot opt out by refusing to complete training or attend meetings about the policy.197

A reviewer on “SDN”—the social media website for a non-profit organization created to help students become doctors198—critically reviewed CVS’s policies, similar to that of Best Buy. The following posting appeared there.

To all CVS employees, have you acknowledged the arbitration training on Learnet (course 800305)? I know most employees probably didn’t even have time to read it while working and blindly acknowledged it. I hope most, if not all, of you opted out of this agreement. Since CVS is repeatedly sued for labor law violations, especially in California, they decide [sic] come up with this stupid agreement to avoid “class action” or “collective action” lawsuits. This ploy is to avoid them having to pay out all employees involved in similar circumstances. Arbitration also favors the employer [rather] than the employee. Please opt out soon and the only way to do so is by a written, signed and dated letter sent to them. This MUST be done within 30 days or you’re legally bound to use an arbitrator of their choosing to dispute legal claims, rather than having to deal with a judge and jury.199

Similar to Glassdoor and Reddit’s open platforms, Quora has provided insight into the impact of mandatory arbitration on employees. Quora is a website that defines itself as a place to share knowledge and better understand

198. STUDENT DOCTOR NETWORK, [https://www.studentdoctor.net/](https://www.studentdoctor.net/).
the world. Visitors to Quora’s website can ask questions and receive answers from other members. In a question and answer session on Quora, visitors discussed CVS’s mandatory arbitration agreements. In the paragraphs below, a bullet point response from a person identifying himself as “someone that went to law school” follows the mandatory arbitration agreement question.

Why did CVS Health Pharmacy ask its employees recently to embrace an arbitration clause limiting their rights to litigate employee issues?
- Mainly, to prevent class action lawsuits for systemic abuses.
- To avoid embarrassment from suits on public record.
- Because arbitration favors the employer more than courts do.

Like Best Buy, the social media comments reflect concerns about employer abuses and the lack of transparency resulting from the pre-dispute mandatory arbitration agreements.

3. TJX

Similar to CVS, TJX Companies, Inc. (“TJX”) supplies a Code of Conduct. TJX’s Code of Conduct provides, “We do not tolerate harassment at TJX. As TJX Associates, we are all expected to act in a professional manner and to avoid any action or behavior that, if unwelcome, may be considered harassment or sexual harassment.” However, TJX restricts its employees’ protections to those provided in the law through a clause asserting, “The Code is not intended to confer any special rights or privileges upon any of us or to provide greater or lesser rights than those provided by applicable law.” That same Code of Conduct also states, “The Code is not a contract. TJX retains the right to unilaterally modify the Code and Company policies at any time, without advance notice, to the extent permitted by applicable law.”

Despite the Code of Conduct’s demand for respect among its colleagues, TJX has a pre-dispute mandatory arbitration agreement with a class waiver that ensures disputes remain confidential. The eighth clause of the agreement provides employees with an opportunity to decline participation in the

201. Id.
203. Id.
205. Id.
206. Id.
agreement. However, an employee wishing to decline must comply with one of the two affirmative actions described below.

An Associate who does not want to participate in this Agreement may prepare a signed and dated letter stating that the Associate declines to participate in this Agreement. The letter should include the Associate’s Associate Identification Number (“AIN”) and the location where the Associate works. The Associate should mail his or her letter to The TJX Companies, Inc., PO Box 2410, Kyle, TX 78640, and should retain a copy of the letter for his or her records. Alternatively, the Associate may decline to participate in this Agreement by accessing the Agreement through myTJX.com and typing the Associate’s first and last name in the text field labeled “I decline to participate in this Agreement.”

Similar to Best Buy and CVS, TJX received social media criticism concerning its pre-dispute mandatory arbitration agreements. On February 10, 2014, a person identified as a “Sales Associate in Boston, MA” posted a lengthy Glassdoor review of TJX. In the “Cons” section, “Sales Associate in Boston, MA” articulated numerous complaints about the company. Among other thoughts, the employee stated the following:

Their newest tricks are two: first they are trying to get all employees to sign binding arbitration agreements waiving the employees [sic] rights to sue the company for their many abuses. You would no longer be able to sue for back wages, discrimination or poor working conditions. The company has been killed by successful suits in the past and they do not want to be forced to pay for their own misdeeds.

Because public disclosure is inevitable, businesses should revisit their reliance on private settlements and confidential arbitration as a way to conceal malfeasance.

B. Employees May Reward Employers for Transparency and Accountability

In a transparent environment, employees can better judge the performance of current and potential employers. Those judgments favorably impact the recruiting and retention of employees. Employers adopting policies favorable to employees and avoiding the inclination to conceal malfeasance may reap financial rewards due to more effective recruiting and increased retention rates.

I. Recruiting

Recruiting the right people generates substantial benefits for employers. In its calculation of a return on investment, The Boston Consulting Group has

208. Id. at 4.
209. Id.
211. Id.
212. Id.
called recruiting the most important human resources function. Given recruiting’s importance and the movement toward transparent employment, it follows that employment policies should reflect the desires of incoming employees.

Software Advice, a Gartner Company, provides research and user reviews on software and is considered a source of expertise for numerous business publications. Software Advice’s recent survey claims that nearly fifty percent (50%) of job seekers in the U.S. read Glassdoor reviews, suggesting reviews can influence recruiting efforts. Software Advice concluded that “Having a strong—and positive—presence on Glassdoor can improve your brand and help pique applicants’ interest in your company.” Therefore, doing business in the transparent environment created by Glassdoor and other social media websites may require improvements to corporate behavior in an effort to attract the most talented employees from today’s job seeker pool. As seen above, employees may discuss sexual harassment and mandatory arbitration in their employer reviews. Efforts to improve workplace culture and refraining from mandating arbitration could have a positive impact on the attraction of qualified employees.

2. Retention

Similar to its conclusions on recruiting, The Boston Consulting Group has concluded that companies that invest in people enjoy better economic performance. Compared to low-performing companies, high-performing companies are more likely to have policies that promote retention. To the contrary, employee turnover hurts companies. The Society of Human Resource Management’s research suggests that direct replacement costs can reach fifty to sixty percent (50% to 60%) of an employee’s annual salary, with total costs associated with turnover ranging from ninety to two hundred percent (90% to 200%) of an employee’s annual salary. As of 2016, the Society of Human Resource Management estimated the employee turnover rate at eighteen percent.


215. Id.

216. Strack, et. al., supra note 213.

percent (18%). When companies consider the turnover rate and turnover cost, they should conclude that turnover prevention is good for business.

With the substantial costs associated with turnover, many would expect companies to encourage retention and avoid policies and behaviors that lead to turnover. Unfortunately, because many employees quit their jobs rather than continue working in a harassing work environment, sexual harassment may have long-term consequences for careers. One study has shown that harassment at ages 29-30 can increase financial stress into the early thirties. Approximately thirty-five percent (35%) of the effect can be attributed to the victim’s job change, a common response to severe sexual harassment. Some quit to avoid harassers and others quit because of dissatisfaction or frustration with the employer’s response. Removing pre-dispute mandatory arbitration agreements should create the transparency necessary to curb the behavior. It should also remove some of the frustration experienced by those dissatisfied with the employer’s response to their complaints.

C. Investors Consider New Performance Metrics

Organizations are no longer assessed solely on traditional metrics such as financial performance, or even the quality of their products or services. Rather, investors increasingly judge businesses on the basis of their relationships with their workers, customers, communities, and impact on society at large—transforming them from business enterprises into social enterprises.

An organization’s financial performance appears to be linked to its citizenship record. Organizations have created hundreds of corporate social responsibility ("CSR") and "best places to work" indexes such as Fortune’s Most Admired Company list. A new meta-study found a direct correlation between CSR index ranking and profitability.

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220. Id. at 351.
221. Id.
222. Id.
Investors appear to have noticed the new metrics. A study of 22,000 investment professionals found that seventy-eight percent (78%) have increased their investments in CSR-focused firms. An organization’s track record of corporate citizenship can lift financial performance and brand value, while failure to engage can destroy reputation and alienate key audiences. Understanding that employment brand correlates directly with the quality of hiring and retention, some investors also evaluate organizations through online rating platforms such as Glassdoor. Investors reviewing these online rating platforms would likely find concern in the CVS, TJX, and Best Buy reviews described above.

D. Trust in Business May Pay Off

Across the globe, people trust business more than government. The 2018 Edelman Trust Barometer reported that people worldwide place fifty-two percent (52%) trust in business “to do what is right,” versus just forty-three percent (43%) in government. In the United States, in particular, trust in government has hit a four-year low, at just thirty-three percent (33%). Deloitte recently concluded the following with respect to trust in business:

Citizens are looking to business to fill the void on critical issues such as income inequality, health care, diversity, and cybersecurity to help make the world more equal and fair. This expectation is placing immense pressure on companies—consumers and employees alike are holding companies’ feet to the fire when it comes to how they treat their employees, communities, and society at large.

Several businesses have begun to fill the government’s void. These employers have adopted changes to their employment policies consistent with the government’s legislative efforts.

Microsoft Corporation, one of the world’s biggest software makers, said on December 19, 2017 that it had eliminated forced arbitration agreements with

229. See infra Part IV, A.
231. Id. at 11.
employees who make sexual harassment claims. “The silencing of people’s voices has clearly had an impact in perpetuating sexual harassment,” Brad Smith, Microsoft’s President and Chief Legal Officer, said in a phone interview. In a blog post, Brad Smith elaborated on Microsoft’s position and explained the company’s support for federal legislation:

That’s why today Microsoft becomes the first Fortune 100 company to endorse bipartisan legislation that will ensure that people’s concerns about sexual harassment can always be heard. We’re also taking a new step within Microsoft to ensure this will be the case, even while that legislation is pending. Senators Kirsten Gillibrand and Lindsey Graham recently introduced new legislation—S. 2203, the Ending Forced Arbitration of Sexual Harassment Act of 2017—which Microsoft supports. This bill would ensure that every person facing sexual harassment in the workplace can make their case in a public court, rather than solely behind closed doors in private arbitration.

Smith explained Microsoft’s actions with the following statement:

But as each new story about sexual harassment demonstrates, current approaches in this area have proven insufficient. Even as we look squarely at the sins of the past, we must take stronger steps to prevent these problems in the future. Because the silencing of voices has helped perpetuate sexual harassment, the country should guarantee that people can go to court to ensure these concerns can always be heard.

After returning from Washington to Seattle, we also reflected on a second aspect of the issue. We asked ourselves about our own practices and whether we should change any of them. At Microsoft we’ve never enforced an arbitration provision relating to sexual harassment, and we pride ourselves on having an open-door policy that encourages employees to raise any such concerns internally so they can be investigated thoroughly and addressed appropriately. But we also reviewed and found that we have contractual clauses requiring pre-dispute arbitration for harassment claims in employment agreements for a small segment of our employee population. We concluded that if we were to advocate for legislation ending arbitration requirements for sexual harassment, we should not have a contractual requirement for our own employees that would obligate them to arbitrate sexual harassment claims. And we should act immediately and not wait for a new law to be passed. For this reason, effective immediately, we are waiving the contractual requirement for arbitration of sexual harassment claims in our own arbitration agreements for the limited number of employees who have this requirement.

Ride-hailing companies Uber Technologies Inc. and Lyft Inc. scrapped mandatory arbitration to settle sexual harassment or assault claims, giving

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234. Id.
235. Smith, supra note 133.
 victims several options to pursue their claims including public lawsuits.\footnote{236} Uber’s victims were previously required to enter into confidentiality agreements as part of arbitration to settle claims, which prevented them from speaking publicly about the facts surrounding any sexual assault or harassment. Uber announced in a blog post that its employees can now settle claims through either mediation or arbitration, where they have the option of confidentiality, or court. “We commit to publishing a safety transparency report that will include data on sexual assaults and other incidents that occur on the Uber platform,” Uber’s Chief Legal Officer, Tony West, wrote. Lyft also removed the confidentiality requirement for sexual assault victims and ended mandatory arbitration for individuals. “This policy extends to passengers, drivers and Lyft employees,” it said.\footnote{237}

Orrick Herrington & Sutcliffe, an international law firm founded in San Francisco, California serving technology, energy, infrastructure and finance clients, has 940 attorneys and gross revenues approaching $1 billion.\footnote{238} Recently, the firm announced that it would no longer require any of its employees, including associates, to sign mandatory arbitration agreements.\footnote{239} “Orrick has decided that it’s time for us to make a change,” the firm said in a statement given to Above the Law. Mitchell Zuklie, Orrick’s chairman, said, “We listened to the conversation on this issue and realized it was time for us to make a change. We’re very focused on being a best place to work for the best talent, and that means taking a fresh, forward-thinking look at everything we do.”

Top law schools seem to have joined the fight to create transparency and accountability by requiring disclosure of mandatory arbitration agreements and nondisclosure provisions for those firms participating in campus recruiting for summer associates.\footnote{240} Fourteen of the country’s top law schools have asked that firms participating in campus recruiting disclose such policies in a new survey.\footnote{241}

\begin{thebibliography}{99}


\bibitem{237} Id.\footnote{237}

\bibitem{238} Orrick, \textsc{Law.com}, \url{https://www.law.com/law-firm-profile/?id=227&name=Orrick-Herrington-Sutcliffe}.


\bibitem{241} Id.

\end{thebibliography}
V. CONCLUSION

This paper takes no issue with arbitration as a general means of settling disputes with employees. Attorneys zealously representing employers may and should seek arbitration and confidentiality as a means of protecting their clients’ interests. In addition, certain victims may need or prefer the confidentiality provided by arbitration and nondisclosure agreements.

Instead, this paper focuses on pre-dispute mandatory arbitration agreements and their associated nondisclosure provisions by describing their detrimental impact on employees. This impact extends to the physical and mental health of its victims, contributes to their financial difficulties, and knocks many victims off-course during the formative years of their careers. Silencing these victims’ voices through private arbitration and tolerating confidential pre-dispute mandatory arbitration agreements could perpetuate serious and demeaning conduct, while shielding perpetrators.

Various federal legislative efforts have failed and state legislative efforts are likely preempted by the FAA. Despite the lack of an effective governmental response, employers should not sit silently and miss an opportunity to improve relations with employees and reduce the prevalence of sexual harassment. Today, in a world with increased transparency, employers cannot hide from sexual harassment behind mandatory arbitration agreements or nondisclosure provisions. Given this backdrop, we should direct our efforts to convince employers that the fight for transparency and accountability will yield results in recruiting and retaining the best and brightest employees, ultimately generating financial and other rewards for investors and employers.
PIERCING THE CORPORATE VEIL: HISTORICAL, THEORETICAL AND COMPARATIVE PERSPECTIVES

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INTRODUCTION

The concept of a company as a separate entity from its shareholders is well known and recognized in many common law and civil law countries. Generally, this is a fundamental aspect of corporate law and courts hesitate to depart from it. Nevertheless, the principle of separate personality is not absolute. In both, common law and civil law countries, the courts have the power to depart from it. Where the courts do not give effect to separate personality, it is often said that the courts “pierce” or “lift” the corporate veil. This will usually, but not
inevitably, lead to liability being imposed on another person, perhaps in addition to the corporate vehicle.\textsuperscript{1}

This paper aims to compare and critically examine the circumstances under which veil piercing takes place against the objectives of incorporation. Both common law jurisdictions, including England, Singapore, and the United States, and civil law countries, including China and Germany, are discussed in this paper. The main purpose of this comparison is to offer a reasonably comprehensive and thorough examination of how courts in these jurisdictions apply the principle of veil piercing, which has been formally adopted either through case law or legislation. This paper employs the functional method in comparative law, but we also consider other aspects, including the law in context method and the historical method. The countries being compared, whether they use common law or civil law systems, share many parallels in part because the historical circumstances leading to the rise of corporate personality were very similar, and also because the corporate laws in Asian countries referred to in this paper are legal transplants. The paper argues that in almost all the jurisdictions examined, some cases of veil piercing ought not to have been decided as such because such decisions give rise to sub-optimal outcomes. Instead, other legal tools should have been used, particularly those in the law of torts. We believe this paper fills a gap in the literature of comparative corporate law, as the doctrine of veil piercing has been frequently misapplied and there is a paucity of academic commentary in this area.\textsuperscript{2}

This paper proceeds as follows. In the next part, we will outline the historical context that led to the rise of the modern corporation. After this, the paper sets out the conceptual framework behind separate personality and veil piercing. Thereafter, it will discuss the approaches to veil piercing in the jurisdictions mentioned earlier and critically evaluate these approaches in light of the rationale behind separate personality and other relevant objectives in corporate law.

\textbf{HISTORICAL CONTEXT}

Certain business arrangements, including forms approximating to the modern partnership, can be traced back to ancient Rome and perhaps even before. Today, we are familiar with the limited partnership as well as the general partnership, both of which have roots in Roman times. The Roman \textit{societas} (partnership) allowed the \textit{socius} (partner) to contribute capital or labor towards any enterprise,

\footnotesize\textsuperscript{1} It does not mean that the corporate entity ceases to exist but simply that corporate personality is not given its full effect.

\footnotesize\textsuperscript{2} In writing this paper, we have borne in mind the excellent advice to approaching comparative corporate law given by David C. Donald, \textit{Approaching Comparative Corporate Law}, 14 FORDHAM J. CORP. \& FIN. L. 83 (2008), in particular to be aware (as much as we can) of the natural distorting tendencies of one’s own perspective.
commercial or otherwise, unless the enterprise was illegal. The relationship between the partners was contractual. Typically, the partners were responsible for the societas’ debts and had rights to the societas’ claims. However, it was possible to also structure the societas in a manner where a partner could be exempt from all losses. Therefore, the agreement between the partners resembles a current general or limited partnership. The essential difference was that in relation to third parties, a partner could not act for the societas or for other partners so as to bind them to such third parties. Any contract entered into by a particular socius on behalf of the societas was the responsibility of that socius only vis-à-vis the other contracting party. The contract between the socii determined the extent to which a socius could ask other socii to bear losses arising out of business transactions (as well as how gains were to be shared).

The societas proved to be a convenient and flexible basis for business associations and influenced the development of business forms throughout Europe, although over time some of its more individualistic characteristics were abandoned to facilitate management. For example, one important development was the idea of agency, which brought the societas closer to the modern conception of partnership. Agency allowed a socius to act in a manner that was binding on other socii if he acted for the societas and not in his own name. This made the other socii directly liable to creditors. Over time, this development and other concepts that formed part of the written, common laws of medieval Europe (the ius commune) helped give partnership law more of the characteristics that modern lawyers can identify with. This brief foray into Roman law illustrates that from early times there was a need for business forms that facilitated associations of persons wishing to engage in transactions with a view to profit.

The main disadvantage of the societas (and the modern partnership) was the absence of limited liability. The societas (and, subject to the terms of the partnership agreement, the general form of partnership) also did not have perpetual succession and would be terminated upon the withdrawal or death of one of the partners. Notwithstanding this, the Romans understood the benefits of the modern company. The societas publicanorum was a variation of the societas used by private entrepreneurs who entered into public contracts with the state. The societas publicanorum resembled the modern shareholder company with its ability to issue traded, limited liability shares, and the departure of socii did not affect its existence. A single person could contractually bind the firm and

6. Id. at 469.
7. Id. at 455–56; Ulrike Malmendier, Law and Finance “at the Origin” 47 J. Econ. Literature 1076, 1088 (2009).
assume rights in the name of the firm. Some sources even describe it as equivalent to a legal person. The private entrepreneurs constituting the societas publicanorum were known as “government leaseholders” or publicans.

Therefore, unsurprisingly, from the 16th century in England there were attempts to create business organizations that had the same characteristics as the societas publicanorum. In England, the early forms of corporateness were the ecclesiastical and the lay. Of the latter, there were municipal corporations during the time of William the Conqueror. These corporations had the right to use a common seal, make by-laws, plead in the courts of law and hold property in succession. Boroughs, whether they had or did not have a royal charter, also apparently held these privileges. However, the rights that were not held through a charter were not safe until the Crown recognized them. The authority of the Crown supplemented natural prescriptive right.

The gilda mercatoria, which was an incorporated society of merchants having exclusive rights of trading within a borough, was another early form of corporateness. As they were associated with boroughs there is some controversy about whether the grant of gilda mercatoria to the merchants of a borough was a grant of corporateness to the borough as well. The intimate connection between them makes it difficult to separate the two as distinct organizations. Nevertheless, the fact that, occasionally the status of liber burgus (free borough) and gilda mercatoria were granted separately suggests they were distinct.

Subsequently, the grant of royal charters extended to commercial enterprises beyond those linked to a borough. A few of the most famous commercial enterprises included the East India Company, Standard Chartered Bank and Royal Bank of Scotland. Aside from royal charters, the corporate form could also be attained through an Act of Parliament. These were not frequently granted and likely required either political connections, wealth or a combination of both. Accordingly, a substitute developed. By the end of the seventeenth century, some idea had been gleaned of one of the primary functions of the corporate concept, namely the possibility of combining the capitalist with the entrepreneur.

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8. Malmendier, supra note 7, at 1084–89.
9. Id. at 1085.
11. Id. at 138.
12. COLIN ARTHUR COOKE, CORPORATION, TRUST AND COMPANY: AN ESSAY IN LEGAL HISTORY 21 (1950).
13. Id. at 177–78.
14. The grant of royal charters also extended to other bodies, such as universities and professional organizations. Further, see STEPHEN BAINBRIDGE & TODD HENDERSON, LIMITED LIABILITY: A LEGAL AND ECONOMIC ANALYSIS 27–31 (2016).
was effected through the formation of large quasi-partnerships known as joint stock companies.  

The term ‘company’ in this context was of course a misnomer by modern standards as it simply meant association. Joint stock companies were unincorporated associations, many of which were originally formed as partnerships by agreement under seal, providing for the division of the undertaking into shares which were transferable by the original partners. In England they emerged in the 16th century because of the demands of foreign trade which required capital in large amounts to be tied up for lengthy periods. In essence, such ‘companies’ continued to be partnerships. They differed from a typical partnership because they generally consisted of many members, and this meant that the articles of agreement between the parties were usually very different. This structure was not without its problems as partnership law was not well suited for a large association. For example: (1) each of the investors was liable for the joint stock company’s debts; (2) each investor had power to bind the others to a contract with outsiders; and (3) if the joint stock company wanted to sue a debtor all investors had to be joined as plaintiffs. The converse was also true if the joint stock company was to be sued; all investors had to be joined as defendants.

As a result of the transferability of shares, speculative activity took place. The British Parliament intervened to curb the gambling mania by enacting the ‘Bubble Act’ of 1720. The purpose of the Act was to prevent persons from acting as if they were corporate bodies, or to have transferable shares without any authority from the British Parliament. Throughout the eighteenth century and beyond the shadow of 1720 retarded the development of incorporated companies.

21. AUSTIN ET AL., supra note 17, at ¶ 2.110.
23. Royal Exchange and London Assurance Corporation Act, 1719, 6 Geo. 1, c. 18 (Eng.).
25. DAVIES, supra note 15, at 28; see also WILLIAM ROBERT SCOTT, THE CONSTITUTION AND FINANCE OF ENGLISH, SCOTTISH AND IRISH JOINT-STOCK COMPANIES TO 1720, at 438 (1912).
Notwithstanding the Bubble Act, unincorporated joint stock companies continued to exist. An important provision of the Act was in section 25, that exempted ‘trade in partnership’ that ‘may be lawfully done.’ Given that joint stock companies were in essence partnerships, there was considerable scope to work around the Bubble Act. This manifested itself in the ‘deed of settlement company’ which was linked to the two equitable forms of group association, the partnership and the trust.26 Many such ‘companies’ were established during the period the Bubble Act was in force.27 In this incarnation, the ‘company’ would be formed under a deed of settlement (something approximating to a cross between a modern corporate constitution and a trust deed for debentures or unit trusts), whereby the subscribers would agree to be associated in an enterprise with a prescribed joint stock divided into a specified number of shares; the provisions of the deed could be varied with the consent of a specified majority of the proprietors; management would be delegated to a committee of directors; and the company’s property would be vested in a separate body of trustees, some of whom would also be directors.28 The deed of settlement would also provide that the trustees could sue or be sued on behalf of the company to get around the difficulty of claims by or against an unincorporated body with a potentially large membership.29

In addition, the deed would provide that each shareholder was to be liable only to the extent of his share in the capital stock. Although such a provision could only apply to the shareholders inter se and not be binding on third parties dealing with the company,30 limited liability could be achieved if contracts between the company and third parties stipulated that the other party to the contract could only look to the common stock of the company and not the assets of individual shareholders.31 A number of English cases in the insurance context held that policyholders were bound by the terms of the deed of settlement of the insurance company if such terms were incorporated into the insurance contract.32

Holdsworth, writing about the joint stock company of the seventeenth century, said that this and other advantages which followed from the corporate form meant that the promoters were able to secure the supreme advantage of attracting capital more easily to finance their undertakings.33 It gave capitalists an opportunity for investment and made available trade capital that would not
otherwise have been employed in trade. Nevertheless, there was ambivalence towards the corporate form. Adam Smith, for example, had reservations about joint stock companies on the basis that directors of such companies, being the managers of money from others, could not be expected to watch over it with the same vigilance as partners would watch over their own. Negligence and profusion must therefore “always prevail, more or less, in the management of the affairs of such a company.” Joint stock companies were less efficient than private individuals and could usually succeed only with monopoly rights. Despite such ambivalence, the Joint Stock Companies Act was passed in 1844 and marked the beginning of modern company law in England. The Act of 1844 came about because of the continued importance of joint stock companies. In addition, concerns over dishonest promoters gave rise to a view that such entities had to be regulated.

Nonetheless, limited liability was not a feature of the Act of 1844 and it did not arrive easily. It had not been included in the 1844 Act because there continued to be strong reservations against any extension of limited liability. For instance, according to the 1854 report of the Royal Commission on Mercantile Laws appointed in 1853, a majority opposed extending limited liability to joint stock companies. The commercial community also expressed dissenting views. For example, the Manchester Chamber of Commerce thought that limited liability was subversive of the high moral responsibility that was the hallmark of the law of partnership. A Manchester manufacturer said limited liability “would become the refuge of the trading skulk; and, as a mask cover the degradation and moral guilt of having recklessly gambled with the interests of traders; and then the stain which now attaches to bankruptcy would cease to exist.” In this, we find the familiar concern over unscrupulous promoters using corporate vehicles as an instrument of fraud or other sharp practice, and the lessening of incentive for personal responsibility and vigilance. Yet one wonders if some of the concern might not have been motivated by self-interest on the part of the promoters.

34. See id. at 213.
35. An early observation of what is today known as the ‘agency’ problem.
36. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 326 (1869).
37. Id.
38. The Act provided inter alia for incorporation by registration thereby paving the way for incorporation to be available widely, and disclosure of key information relating to the company which continues to be seen as an important safeguard to third parties dealing with corporate vehicles.
40. Harris, supra note 39, at 282.
41. Davies, supra note 15, at 42.
42. Cooke, supra note 12, at 156–57.
43. Quoted in Hunt, supra note 39, at 117–18.
of those who did not welcome the democratisation of a business vehicle that could lead to more competition.  

Evidently, these concerns did not prevail.  

One reason was capital flight as money flowed overseas, particularly into joint stock companies that offered limited liability. Allowing limited liability would potentially raise the investment opportunities available domestically. This is an early illustration of how, in some areas, the power of the marketplace can bring about greater legal convergence. Another was “social amelioration”. Limited liability would allow the middle and working classes not to be excluded from fair competition through the fear of personal bankruptcy. It would open up more opportunities for them. It was also thought that the ability to involve a wider segment of people in business might unleash creative energies and revitalise English industry that was in danger of losing its edge and being overtaken by overseas capitalists. Accordingly, the Limited Liability Act of 1855 was passed. It was soon repealed but substantially re-enacted in the Joint Stock Companies Act 1856.

The incorporated form, and limited liability, came about in England because of the utility of a business organization that could effectively accumulate capital for more productive use. There is an economic purpose, but more broadly the corporation and limited liability are regarded as beneficial to society as a whole. Their purposes are as much social and political as they are economic. Ultimately, corporations, like other institutions, must continue to justify their existence by demonstrating that whatever their faults, they bring utility to society that is not easily substitutable. It follows (or at least is implied) that in principle incorporators, owners and managers of companies ought not to expect the full benefits of incorporation if their conduct undermines faith in the institution, and therefore its utility to society. The next part of this paper will discuss this further.

The experience of England is mirrored in other jurisdictions that over time adopted liberal corporate laws to facilitate development. In the United States, as in England, a number of alternatives to the corporate form were used from time to time. These included the limited partnership, the business trust, and the joint stock company and it was by no means certain that a corporation was the best way to raise and manage money for enterprise. After the American Revolution,

44. See McQueen, supra note 27, at 81–86.
45. Mahoney, supra note 22.
46. McQueen, supra note 27 at 99–100.
47. Hunt, supra note 39, at 120.
48. See McQueen, supra note 27, at 125.
49. This is not to suggest that other alternative business forms would not have been able to achieve such goals: see Harris, supra note 39, at 291.
50. For example, it has been said that limited liability “clearly encouraged the flow of capital into new enterprise”: see Herbert Hovenkamp, ENTERPRISE AND AMERICAN LAW: 1836-1937, at 54 (1991).
a strong and growing prejudice in favour of equality opposed the English tradition that corporate powers be granted only in rare instances. This led almost immediately to the enactment of general incorporation acts for ecclesiastical, educational, and literary corporations. It was also easier to obtain corporate charters from the new state legislatures than it was in England, leading to a considerable extension of corporate enterprise in the field of business before the end of the eighteenth century.53 The United States was 30 years ahead of English practice, as charters were granted fairly frequently between 1800 and 1830, albeit with conditions and restraints placed on the corporate bodies.54 Special chartering, however, smacked of privilege and set off a reform movement that sought to bring about equal access to corporate chartering. States also began to compete for corporate charters in order to increase taxes paid by corporations.55

In 1811, the State of New York became the first to pass a general incorporation statute for businesses, although it originally only applied to companies seeking to manufacture particular items, such as anchors and linen goods.56 Soon, the types of businesses eligible to incorporate included all forms of transportation and nearly all forms of manufacturing and financial services as well. Other states followed the New York approach. The combined result of a more liberal approach to charters and general incorporation statutes caused the corporation to become crucial to the American economy by the last third of the nineteenth century.57 It provided an efficient and trouble free device to aggregate capital and manage it in business, with limited liability and transferable shares.58 The adoption of limited liability was an important development. It arose because of the pressure on the growing corporations (of the first half of the nineteenth century) to raise the capital required to take advantage of the emerging technology of the times. It was also a matter of protracted political struggle.59

Taking two examples in Continental Europe, in 1848, Sweden issued a governmental decree that recognised the legal position of the joint stock company. The coming of the railroad with its necessity for a large accumulation of capital was the initial catalyst.60 In a number of German states, the pressure to

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53. JOSEPH STANCLIFFE DAVIS, ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 7–8 (1917).
54. COOKE, supra note 12, at 134. See also JOHN STEELE GORDON, AN EMPIRE OF WEALTH – THE EPIC HISTORY OF AMERICAN ECONOMIC POWER 229 (2004) (observing that between 1800 and 1860, the state of Pennsylvania alone incorporated more than 2000 companies).
56. FRIEDMAN, supra note 52, at 172; BAINBRIDGE & HENDERSON, supra note 14 at 37–38.
57. GORDON, supra note 54, at 228–29; FRIEDMAN, supra note 52, at 177 (suggesting that the triumph of the corporation as a business form over other business forms was due to almost random factors).
58. FRIEDMAN, supra note 52, at 178 (quotations omitted).
60. CHARLES P. KINDLEBERGER, A FINANCIAL HISTORY OF WESTERN EUROPE 204 (2006).
move towards a system of free incorporation became progressively irresistible in the 19th century as the country faced the question of how to raise and regulate large capital sums needed for major industrial and infrastructure projects. As with many other countries, the coming of the railways was an important spur for this.  

Moving to Asia, the first company law in China was enacted by the Qing Dynasty in 1904. It established four types of companies, one of which was the company limited by shares. To qualify as juridical persons with limited liability, all companies had to register with the Ministry of Commerce with registration fees assessed as a percentage of capitalization. Prior to 1904, there was little formal law associated with business enterprises. In part this was because engaging in commerce did not attract high social prestige. Farmers and artisans enjoyed higher social prestige, the former reflecting the importance of agricultural pursuits for much of Chinese history. Business, on the other hand, was regarded as parasitic without creating anything of value. Given the lack of formal law, many Chinese businesses were family affairs, and people often entered transactions based on trust. Private ordering rather than law played a more important role. The objectives of the 1904 law were to promote China’s industrial development; to attain perceived Western standards of law so as to justify demands for the abolition of the system of extraterritoriality that had been imposed on China since the 1840s; and the strengthening of the power of the central government. These broad aims informed revisions of Chinese Company Law over the next eight decades.

After the People’s Republic of China was established in 1949, company law was abolished. A process of collectivisation and nationalisation took place that only began to be reversed after the death of Mao Zedong and the era of Deng Xiaoping. This eventually led to the promulgation of the 1993 Company Law, which took effect on July 1, 1994. Article 1 of that Act stated that it was intended to meet inter alia the needs of establishing a modern enterprise system, to maintain the socio-economic order, and to promote the development of the socialist market economy. These stated objects illustrate the instrumentalist nature of corporate law in China.

65. Kirby, supra note 62, at 43–44.
In fact, the process in Asia of creating a commercial law comparable to that found in Western countries began earlier in Japan. The impetus was similar to China’s. Japan wanted to end the legal extraterritoriality granted to foreign residents that had been imposed by the “unequal treaties” that forced the opening of the country to foreign trade. In addition, the Meiji government felt that a modern commercial and corporate law system was necessary for the evolution of modern corporations which were regarded as indispensable for nursing strong economic growth. In turn, this would allow the country to create a strong military to assure her safety and independence.  

It will be clear from the foregoing that the development of corporate law in China (and Japan) was driven significantly by socio-political objectives. As both countries adopted the German civil law model, their corporate laws were at one time heavily modelled after German corporate law, although American law has since become increasingly influential. In many other parts of Asia that were colonized such as Singapore, colonial governments introduced Western corporate law and naturally mirrored the law in the colonizing country.

VEIL PIERCING – A THEORETICAL ANALYSIS

The brief historical analysis outlined above reminds us that even though we currently take separate personality and limited liability for granted, neither came about naturally or easily. They were accepted ultimately because of a hard-nosed assessment that their benefits outweighed the risks, the latter of which was clear to most. Corporate legislation implicitly tolerates these risks for the greater good.

Statements such as the following have been made in numerous US cases and is true for many other jurisdictions as well:

The doctrine that a corporation is a legal entity existing separate and apart from the persons composing it is a legal theory introduced for purposes of convenience and to subserve the ends of justice... It is clear that a corporation is in fact a collection of individuals, and that the idea of a corporation as a legal entity or person apart from its members is a mere fiction of the law introduced for convenience in conducting the business in this privileged way.

This is the norm today; however, corporate legislation will often contain express exceptions to separate personality or limited liability, and it is not

68. For example, Singapore’s Companies Ordinance, 1940 (Act No. 49/1940) (Sing.) was based on England’s Companies Act, 1929, 19 & 20 Geo. 5, c.23 (Eng.).
70. See e.g., Companies Act (Cap. 50, Rev. Ed. 2006) (Sing.), § 340(1) (imposing personal liability on a person who was knowingly a party to a company carrying on business with the intent to defraud creditors of the company, or of any other person, or for any fraudulent purpose).
unusual for other legislation to express exceptions as well in specific circumstances.\textsuperscript{71} Such exceptions arise because of a policy choice that the benefits of incorporation ought not to be fully available in such instances.

Given the existence of specific legislative carve outs, and the apparently unqualified nature of limited liability in most jurisdictions,\textsuperscript{72} it is conceivable that any limits to corporate personality or limited liability should be determined within such limited parameters. This has not been the case. The courts have gone beyond exceptions found in legislation to ignore corporate personality and extend liability to shareholders or directors of companies. When corporate personality is ignored or liability is extended, it is often said that the courts are piercing or lifting the corporate veil, thereby allowing the courts to take legal notice of the persons behind the company, usually the shareholders, to whom personal liability may then be attached for obligations that prima facie ought to be attributed only to the company.

What justifies such judicial intervention? In common law countries, statutory interpretation allows a court to determine the scope of a legislative provision, not only from the express language used, but also from what may be fairly implied from the express terms of the legislation and its purpose. As an English judge, Willes J, put it, the legal meaning to be ascribed to a legislative provision is “whatever the language used necessarily or even naturally implies.”\textsuperscript{73}

In the well-known case, \emph{Salomon v. A. Salomon & Co. Ltd.}, it was established, beyond doubt in England, that the company was to be treated as a person separate and distinct from its shareholders, including the principal shareholder and director. Lord Watson observed:\textsuperscript{74}

\begin{quote}
In a Court of Law or Equity, what the Legislature intended to be done or not to be done can only be legitimately ascertained from that which it has chosen to enact, either in express words or by reasonable and necessary implication.
\end{quote}

Accordingly, separate personality cannot be extended to a point beyond its reason and policy, and will be disregarded when this occurs.\textsuperscript{75} Separate corporate identity is conferred “to further important underlying policies, such as the promotion of commerce and industrial growth” and as such “may not be asserted

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\item \textsuperscript{71} See e.g., Residential Property Act (Cap. 249, Rev. Ed. 2009) (Sing.), § 2, defining a “Singapore company” as generally one which is incorporated in Singapore, and additionally all its directors and members must be Singapore citizens. Thus for the purpose of this legislation, the nationalities of non-Singaporean directors and members are attributed to the company. This in turn determines whether the company falls within or outside the legislative prohibitions.
\item \textsuperscript{72} China, which has a more general and open legislative exception which is found in Article 20 of the PRC Company Law promulgated by the National People’s Congress, is an outlier, as we discuss in the part on the People’s Republic of China infra.
\item \textsuperscript{73} \textit{Chorlton v. Lings} (1868) L.R. 4 C.P. 374 (Ct. Common Pleas) 387. \textit{See also Russian and English Bank v. Baring Brothers}, [1936] 1 A.C. 405 (H.L.) 427 (the House of Lords held that it was a necessary implication of the relevant winding up provisions in the Companies Act that the dissolved foreign company was to be wound up as if it had not been dissolved but had continued in existence).
\item \textsuperscript{74} \textit{Salomon v. A. Salomon & Co. Ltd.}, [1897] A.C. 22 (H.L.) 38.
\item \textsuperscript{75} \textit{Sanders} 159 S.E.2d at 784; \textit{TLIG Maintenance Services}, 218 So. 3d at 1271.
\end{itemize}
for a purpose which does not further these objectives in order to override other significant public interests which the state seeks to protect through legislation or regulation.”76 In other words, at common law the courts, in construing corporate legislation as giving rise to entities with separate personality and shareholders with limited liability, have concluded that there are implicit limits to this separateness.77 These limits are ascertained by reference to what the court construes as the legislative intent behind such legislation, namely to bring about positive social and economic outcomes through an organizational framework that facilitates business transactions.78

Using Germany as a civil law comparator, Germany shares similarities with the English common law approach insofar as courts are showing growing reluctance to pierce the corporate veil. In Germany, when limited liability is disregarded, it is referred to as “Durchgriffshaftung” and relates to situations not governed “expressly by statutory or other legal rules in which an entity’s existence is disregarded and the owner is held individually liable for the obligations of the company.”79 Under the modern approach, courts limit veil piercing to the scenario of commingled assets and otherwise rely on the law of torts to deal with instances in which shareholders intentionally lead companies into insolvency.

Given the importance of legislative policy to determine when piercing the corporate veil takes place, it is unsurprising that generally, in the jurisdictions discussed above, the courts disregard the corporate personality very sparingly and there are few real instances of piercing taking place.80 This is consistent with the fact that limited liability was eventually settled upon by legislatures after decades of debate that fleshed out its advantages and disadvantages. The separation of power between judiciaries and legislatures necessitates that due respect be given to the policy choice made. In addition, the advantages of limited liability are regarded as crucial to the development of mature market economies. These advantages have been discussed widely elsewhere and will not be repeated here.81 Also, courts tend to be sensitive to the need for certainty in matters of

80. See e.g., Prest v. Petrodel Resources Ltd [2013] UKSC 34; [2013] 3 WLR 1 (Eng.) (hereinafter “Prest”); Alting, supra note 79, at 191. Although US courts affirm the exceptional nature of veil piercing, the courts there appear more willing to pierce the corporate veil, and courts in China appear even more willing to do so. This is discussed in the part on the People’s Republic of China infra.
business. The importance attributed to certainty is part of the explanation as to why courts do not generally draw a distinction between voluntary creditors who choose to contract with a company and involuntary creditors such as tort victims.

Considering that veil piercing occurs only in exceptional circumstances where the use of the corporate vehicle is inconsistent with the legislative purpose behind corporate personality and limited liability, the courts in the jurisdictions surveyed above express a remarkably similar rationale underlying veil piercing. In the United Kingdom (UK), Lord Sumption, who delivered the leading judgment in _Prest v. Petrodel Resources Ltd._, opined that “recognition of a limited power to pierce the corporate veil in carefully defined circumstances is necessary if the law is not to be disarmed in the face of abuse.” According to his Lordship, the considerations found in the English cases reflect the broader principle that the corporate veil may be pierced only to prevent the abuse of corporate legal personality. Arguably, this approach by the UK Supreme Court is to be welcomed as it: (1) moves the focus away from metaphors such as “sham” and “façade” to justify veil piercing and which provide virtually no guidance to future courts, and (2) provides an approach that is based on policy.

A court in Singapore, another common law jurisdiction, has framed the approach in similar terms:

Courts will, in exceptional cases, be willing to pierce the corporate veil to impose personal liability on the company’s controllers. While there is as yet no single test to determine whether the corporate veil should be pierced in any particular case, there are, in general, two justifications for doing so at common law — first, where the evidence shows that the company is not in fact a separate entity; and second, where the corporate form has been abused to further an improper purpose.

Courts in the US have also invoked abuse as the underlying principle justifying disregard of the corporate personality. Under _Glazer v. Commission on Ethics for Public Employees_, a court may, “pierce the corporate veil when the established norm of corporateness has been so abused in conducting a business

82. _Prest_ [2013] 3 WLR 1 [27].

83. _Id._ at [34]. See also _VTB Capital Plc v Nutrieck International Corp_ [2012] EWCA (Civ) 808, [2012] 2 C.L.C. 431, 460 (where the Court of Appeal of England and Wales stated that the “relevant wrongdoing [for veil piercing purposes] must be in the nature of an independent wrong that involves the fraudulent or dishonest misuse of the corporate personality of the company for the purpose of concealing the true facts”); _Faiza Ben Hashem v. Abdulhadi Ali Shayif_ [2008] EWHC 2380 (Fam), [2009] 1 F.L.R. 115 [163] (“it is necessary to show both control of the company by the wrongdoer(s) and impropriety, that is, (mis)use of the company by them as a device or façade to conceal their wrongdoing.”).

84. Tan, _supra_ note 77, at 20–21. See also Tan Cheng-Han, _Piercing the Separate Personality of the Company: A Matter of Policy?_, 1999 SING. J. LEG. STUD. 531, 537–43 (1999) (foreshadowing _Prest v Petrodel_). Admittedly, Lord Sumption saw the application of the doctrine in very narrow terms but in this regard he was not in the majority. While all the Justices on the panel agreed that veil piercing was exceptional, they were not prepared to foreclose possible situations where veil piercing may take place beyond the category of “evasion” cases that Lord Sumption felt was the only true category where the corporate veil is lifted.


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that the venture’s status as a separate entity has not been preserved.” Corporate personality will be respected unless the “legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime,” acts that speak to abusive conduct. Although under the Federal system in the US courts are not bound by a uniform position on veil piercing, generally there must be an element of wrongdoing to justify disregarding corporate personality.

The importance of wrongdoing towards establishing abuse of the corporate form is another reason piercing is an exceptional remedy. Controllers of companies who in such capacity engage in wrongdoing will often find themselves incurring liability to their companies. While such liability may be academic where the entities are operating under the control of such persons, the issue of veil piercing often arises where the companies are insolvent and incapable of meeting their obligations or liabilities to third parties. In such instances, insolvency regimes usually impose a collective framework within which creditors of companies have their claims adjudicated. Insolvency laws typically frown on creditors who obtain preferential treatment when the corporation is already insolvent. This is economically efficient as it facilitates an orderly and fair distribution of an insolvent entity’s assets to all creditors. When piercing takes place, there is a danger that it may undermine the collective insolvency process and place the claimant in a superior position compared to other creditors of the insolvent corporation. Any successful claim against a corporate controller will diminish the controller’s assets and increase the probability that the company will not be able to obtain the full measure of any loss caused to it by the controller’s wrongful act. This in turn diminishes the pool of assets available for distribution to creditors as a whole and places those creditors who are able to act more quickly, usually those that are more sophisticated and with greater financial resources, in a superior position. The more liberal the approach to veil piercing, the greater the risk of undermining the insolvency process.

Another perspective favoring a narrow approach to veil piercing is its potential overlap with other legal doctrines. In Prest v. Petrodel, Lord Sumption opined that the veil piercing “principle is a limited one because in almost every case where the test is satisfied, the facts will in practice disclose a legal relationship between the company and its controller which will make it

86. Glazer, 431 So.2d at 757 (citations omitted).
88. This is discussed below.
89. See generally, ROY GOODE, PRINCIPLES OF CORPORATE INSOLVENCY 235-237 (4th Ed. 2011); Secured creditors are a significant exception to this as security arrangements are generally regarded as falling outside the general insolvency process. In common law jurisdictions such as England and Singapore, this is because a secured creditor is regarded as having a proprietary interest in property taken as security, allowing such secured creditor the right vis-à-vis such security to stand outside the liquidation process. See IAN FLETCHER, THE LAW OF INSOLVENCY 747- 749 (5th Ed. 2017).
unnecessary to pierce the veil.” Where this was not necessary, it would not be appropriate to do so because there would be no public policy imperative to justify such a course.\textsuperscript{90} Another member of the panel, Lord Neuberger, expressed the view that a number of cases that involved veil piercing could and should have been decided on other grounds.\textsuperscript{91} Such a view of veil piercing confines the doctrine to a residual category. Nevertheless, this is consistent with the doctrine operating in exceptional circumstances. While a set of facts can raise overlapping legal rules, the exceptional nature of veil piercing justifies its application to situations of abuse that do not potentially fall within other areas of the law. Thus, where the situation overlaps with another area of law, the underlying policies and principles of that area, rather than veil piercing, should set the boundaries for personal liability. Veil piercing in such circumstances gives rise to a risk that corporate law may overreach. The difficulty lies in determining whether individual cases fall into gaps that corporate law should fill or if the lack of any other more obvious remedy reflects the inherent inappropriateness of the claim.

An example of potential overreach may be found in cases where directors (or senior management) were found liable for a tort committed by, for instance, an employee of the company on the basis that the tortious act had been procured, facilitated or directed by the said directors. In many common law countries, this raises a difficult question of policy. On the one hand, directors do not act personally in the discharge of their directorial responsibilities. There are good reasons for this, including the need for the benefits of corporate personality to extend to corporate officers lest it gives rise to disincentives to manage companies. Yet, this view conflicts with the principle that a person should answer for their own tortious acts.\textsuperscript{92} In Australia, judicial statements have been made that this “is a complex and burgeoning field of law”\textsuperscript{93} and has led to “a confusing picture on an issue that has persistently vexed the common law.”\textsuperscript{94}

In Canada and Singapore, there is authority to support the proposition that corporate personality is disregarded where a director is found liable for procuring a tortious act by another person. Canadian courts have made it clear that a particular mental state is required before authorization, direction or procurement sufficient for secondary tortious liability is made out. In \textit{Mentmore Manufacturing Co v. National Merchandise Manufacturing Co}, Le Dain J expressed the view:

\begin{quotation}
But in my opinion there must be circumstances from which it is reasonable to conclude that the purpose of the director or officer was not the direction of the
\end{quotation}

\begin{itemize}
\item \textsuperscript{90} Prest [2013] 3 WLR 1 [35].
\item \textsuperscript{91} Prest [2013] 3 WLR 1 [64].
\item \textsuperscript{92} \textit{Mentmore Manufacturing Co v. National Merchandise Manufacturing Co} (1978) 89 DLR (3d) 195 para. 23 (hereinafter “Mentmore Manufacturing”).
\item \textsuperscript{93} \textit{G M (North Melbourne) Holdings Pty Ltd v. Young Kelly Pty Ltd} [1986] FCA 164 para. 58 (Austl.).
\item \textsuperscript{94} \textit{Root Quality Pty Ltd v. Root Control Pty Ltd} [2000] FCA 980 para. 115 (Austl.).
\end{itemize}
manufacturing and selling activity of the company in the ordinary course of his relationship to it but the deliberate, wilful and knowing pursuit of a course of conduct that was likely to constitute infringement or reflected an indifference to the risk of it.\footnote{This approach has been accepted in a number of other Canadian decisions.\footnotemark[95]}

This approach has been accepted in a number of other Canadian decisions.\footnote{In \textit{Halford v. Seed Hawk Inc.},\footnotemark[96] Pelletier J said the principle underlying the approach in \textit{Mentmore Manufacturing} was that the courts would not allow a corporation to be used as an instrument of fraud. Personal liability attaches to a director where such behavior is tortious, or when the corporation is used as a cloak for the personal activities of the director.\footnotemark[98] This is the language of veil piercing.}

Under Canadian law, the courts will disregard the separate legal personality of a company where it is dominated and controlled, and being used as a shield for fraudulent or improper conduct. Thus, the conduct in question must be akin to fraud to warrant veil piercing.\footnote{Indeed, the similarity between secondary liability for procuring a tort and veil piercing under Canadian law can be seen from the following statement:\footnotemark[100] The question of whether the appellant, as an officer and director of ACPI and ACL, could be found to be personally responsible for the tort committed by the corporations — had this question been raised on the pleadings — would require evidence to support a finding that the appellant exercised clear domination and control over the corporations in directing the wrongful things to be done, and that the conduct he engaged in was akin to fraud, deceit, dishonesty or want of authority and constituted a tort in itself.}

The above statement was made in the context of piercing the corporate veil but the reference to “directing” wrongful acts is similar to the imposition of secondary liability as a joint tortfeasor.

In Singapore, the link between veil piercing and secondary liability in tort has been more explicit. In \textit{TV Media Pte Ltd v. De Cruz Andrea Heidi},\footnotemark[101] Singapore’s apex court, the Court of Appeal, held that where a statement of claim alleged that the defendant had authorized, directed and/or procured acts that amounted to corporate negligence, this was essentially a submission to lift the

\begin{footnotes}
\end{footnotes}
The court also agreed with the trial judge that the veil should be pierced as the defendant director had authorized, directed or procured acts of negligence. In particular, the court said:

After all, a court can only find a director personally liable for authorizing, directing or procuring the company’s tort if it has first lifted the company’s corporate veil which otherwise protects a director from being found liable.

While such an approach seems to provide a basis to impose personal liability, the issue may be better resolved within the framework of tort law, so that it can consider the relevant policies that should underpin the imposition of secondary tortious liability, an issue that goes beyond corporate entities. In English tort law, where a person “authorizes, procures or instigates the commission of a tort” by another, the former becomes a joint tortfeasor who is equally liable with the primary tortfeasor. This is not to suggest that the understanding of what amounts to authorization or procurement in the corporate and non-corporate context should necessarily be the same. Rather tort law, which constantly must balance and assess the appropriate measures to regulate civil wrongdoings, may be more suited to determining this issue than corporate law. The contours of liability for civil wrongs are the essence of tort law. Accordingly, the law of torts, not the doctrine of veil piercing, may provide a superior framework to determine the circumstances under which a corporate officer should be responsible for the tortious act of a subordinate.

Similarly, where a director has caused a company to commit a tort and this leads to the insolvency of the corporation and therefore inadequate compensation for the tort victims who are involuntary creditors, there should not be recourse to veil piercing. The real question is whether the circumstances justify imposing a duty on the director to the tort victims, or if the director has breached a duty of care to the company that entitles the liquidator to bring a claim on behalf of the corporation against the director. These are policy issues at the heart of tort law, while corporate law lacks the analytical tools to address them. Engaging in veil piercing creates a messy and uncertain shortcut.

VEIL PIERCING – A COMPARATIVE ANALYSIS

Having outlined the conceptual framework behind veil piercing, we now analyze from a comparative perspective the judicial reasoning in veil piercing cases and the specific factors that courts take into consideration when such issue arises. The jurisdictions considered are England, Singapore, the United States, Germany and China.


103. *TV Media* 3 Sing. L. Rep. at [119].

104. DAVID HOWARTH ET AL., HEPPEL AND MATTHEWS’ TORT LAW 1121 (7th ed. 2015).
England and Singapore

Both England and Singapore have broadly similar approaches. Their courts have increasingly recognized that the main issue in dispute in these corporate liability cases revolves around whether corporate officers have abused or misused the corporate form. Accordingly, England and Singapore have begun to move away from the use of metaphors such as sham and façade as the basis to disregard corporate personality.

One significant uncertainty in England relates to the scope of the veil piercing doctrine. While it is an exceptional doctrine, Lord Sumption would limit it only to a category of “evasion” cases, namely those where a company has been interposed to frustrate the enforcement of an independent legal right that exists against the controller of the company. The majority of the judges in Prest v. Petrodel left the matter open, and it is suggested that in principle it is difficult to see why other instances of veil piercing should be foreclosed if the underlying basis is abuse of the corporate form. Human ingenuity suggests that we should be wary of bright-line rules.

Although Lord Sumption also spoke of a second category of “concealment” cases, he did not consider this to involve veil piercing. This was because the interposition of a company to conceal the identity of the real actors will not stop a court from identifying who the real parties to the transaction or act are if identification is relevant. Here, there is no lifting of the corporate veil, as the court is merely looking behind the corporate structure to see what it is concealing. This is a well-known principle that goes beyond veil piercing. According to Diplock LJ in Snook v. London and West Riding Investments Ltd, parties carry out sham transactions when they execute documents or perform other acts that are intended to give the appearance of legal rights and obligations being created that are different from what they intend. A company may be used to create the appearance that it is a party to a transaction so as to mask who the real parties are. Although this may not involve true veil piercing, the effect is very similar and it is also unclear to what extent the other judges agreed with this view. Traditionally, it has been considered an aspect of veil piercing and

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105. Prest [2013] 3 WLR 1 [28], [33].
107. Tan, supra note 77, at 31–32.
108. Prest [2013] 3 WLR 1 [28].
110. As in Adams v. Cape Industries Plc [1990] 2 WLR 657 (HL) in relation to AMC which the court held was a mere corporate name and had no real role in the transactions.
there are jurisdictions that treat it as such.\textsuperscript{111} Concealment cases will therefore be discussed in this paper.

Although the Singapore courts have generally endorsed the approach in \textit{Prest v. Petrodel}, that abuse of corporate personality is what underlies veil piercing,\textsuperscript{112} the Singapore Court of Appeal had previously also accepted an “alter ego” ground as a distinct basis to lift the corporate veil. This ground is premised on the company carrying on the business of its controller.\textsuperscript{113} This may arise because the company was the agent or nominee of the controller.\textsuperscript{114} The former basis is clearly incorrect. If a company is an agent for another person, such other person will generally be personally liable because of the law of agency and not because of any disregard of corporate personality. Indeed, for an agent to bind its principal, the agent must be a distinct person in the agent’s own right.

Leaving aside cases where there is an agency relationship, in the case of \textit{Alwie Handoyo v. Tjong Very Sumito},\textsuperscript{115} the Court of Appeal accepted that the appellant, Alwie, was the alter ego of a company known as OAFL. Accordingly, the court reasoned that OAFL’s corporate veil should be pierced. Alwie beneficially received payments from OAFL’s bank account and Alwie admitted that he used the account as his personal bank account, which is an example of commingling. In Alwie’s view, he was authorized and entitled to receive money paid to this bank account.\textsuperscript{116} In addition, Alwie also actively procured a payment due to OAFL into his personal bank account.\textsuperscript{117}

Given the facts, Lord Sumption would have regarded this as a concealment case. The real actor was Alwie and OAFL was merely a convenient vehicle for him to structure a transaction to which he was the true protagonist. Other cases provide additional examples. In \textit{Re FG Films Ltd},\textsuperscript{118} the court found that the film in question, which was the subject of an application to receive a British film classification, could not be classified as such for the purposes of the Cinematograph Films Act 1938. The applicant company had a share capital of only £100 and it could not be said that this “insignificant company” undertook the making of the film in any real sense, which had cost at least £80,000. On this basis, the court held that the applicant company was merely the nominee or agent of the American company that had financed the making of the film. Although the

\textsuperscript{111} For example, see the discussion below of cases involving commingling.
\textsuperscript{114} \textit{NEC Asia Pte Ltd} [2011] 2 Sing L. Rep. 565 [31].
\textsuperscript{115} \textit{Alwie} [2013] 4 Sing. L. Rep. 308 [96] – [100].
\textsuperscript{116} \textit{Tjong} [2012] SGHC 125 [70]; \textit{Alwie} [2013] 4 Sing. L. Rep. 308 [98].
\textsuperscript{117} \textit{Alwie} [2013] 4 Sing. L. Rep. 308 [99].
\textsuperscript{118} \textit{Re FG Films Ltd} [1953] 1 WLR 483 (Eng. Ch. Div.).
decision was based on agency, it could also have been justified on the concealment principle as the learned judge considered that the applicant company’s involvement was “purely colourable.”

Another example is *Gencor ACP v. Dalby*, where a company had no sales force, technical team, or other employees capable of carrying on any business. Its only function was to make and receive payments. On this basis, the court found that the controller of the company was the alter ego of that company.

**United States**

Generally, in the United States, a plaintiff seeking to pierce the corporate veil must establish “(a) the ‘unity’ of the shareholder and the corporation and (b) an unjust or inequitable outcome if the shareholder is not held liable.”

In establishing the unity part of the test, courts will look at factors such as “a failure to observe corporate formalities, a commingling of individual and corporate assets, the absence of separate offices, and treatment of the corporation as a mere shell without employees or assets.” The unjust outcome aspect is more difficult to specify but one common example would be a shareholder stripping essential assets from the corporation by dividends, or excessive salaries or other payments for services. A more uncertain basis involves companies that were undercapitalized at the outset so that it could not pay its foreseeable debts.

Although corporate law in the US is based primarily on state law, virtually all state jurisdictions in the US subscribe to one of the two traditional formulations of veil piercing jurisprudence. These are the three factor “instrumentality doctrine” and the “alter ego” doctrine.

The instrumentality doctrine was outlined in *Lowendahl v. Baltimore & O. R. Co.* First, it requires more than control of the corporate entity. Liability must depend on “complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own.”

Second, the defendant must have used such control “to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of the plaintiff’s legal rights.”

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119. *Id.* at 486.
121. KLEIN ET AL., supra note 55, at 148.
122. *Id.* (quotation omitted).
123. Blumberg, supra note 59, at 304, n. 17; see also BAINBRIDGE & HENDERSON, supra note 14, at 86–102.
125. *Id.*
the control and breach of duty must have caused the injury or loss complained of.

In *RRX Indus, Inc. v. Lab-Con, Inc.*, the court stated that the alter ego doctrine applies where “[1] such a unity of interest and ownership exists that the personalities of the corporation and individual are no longer separate, and [2] an inequitable result will follow if the acts are treated as those of the corporation alone.” Although these appear to be separate tests, it is difficult to see any real difference between them. At their essence, they both require some form of wrongdoing as a result of the control of another person or persons, the extent of which meant that the corporation was unable to function as an entity in its own right. The domination was used to support a corporate fiction and the entity was organized for fraudulent or illegal purposes.

Indeed, in *Wm. Passalacqua Builders, Inc v. Resnick Developers South, Inc.*, the court was of the view that the instrumentality and alter ego doctrines are “indistinguishable, do not lead to different results, and should be treated as interchangeable.”

As mentioned earlier, of the jurisdictions considered in this paper the US (apart from perhaps China) seems to have a more liberal approach in practice to veil piercing. Although courts often say that the corporate form will be disregarded reluctantly or exceptionally, the cases in the United States appear to take into consideration a wider range of matters than other common law courts in England, Singapore, Australia, Hong Kong or New Zealand.

One reason for this may be that the approach in the United States is more explicitly policy-based. Thus, in *Wm. Passalacqua Builders, Inc v. Resnick Developers South, Inc.*, the court remarked that ultimately it had to be decided whether “the policy behind the presumption of corporate independence and limited shareholder liability—encouragement of business development—is outweighed by the policy justifying disregarding the corporate form—the need to protect those who deal with the corporation.” US courts appear to place more emphasis on the need for persons dealing with corporations to be protected while the emphasis on *caveat emptor* in many other common law jurisdictions seems to be stronger.

A second reason may be the importance of domination and control in the American jurisprudence. While many cases say that it is insufficient in itself, it is a central element of veil piercing in US cases, but has relatively little weight

126. *RRX Indus, Inc. v. Lab-Con, Inc.*, 772 F.2d 543, 545 (9th Cir. 1985).
129. Id. at 139.
130. In *Craig v. Lake Asbestos of Quebec, Ltd.*, 843 F.2d 145, 150 (3d Cir. 1988) the court opined that only after there has been a finding of dominance does one reach the fraud or injustice issue. In *Morris
in the other common law jurisdictions mentioned previously. Considering the two elements of wrongdoing and control/dominance, one could take the view that the presence of wrongdoing is significantly more important from a practical standpoint; where a corporation has been used to achieve a purpose that is regarded as abusive, it is hard to see a court finding that this has not been brought about in circumstances where the corporation has been so dominated as to justify veil piercing. In jurisdictions such as England and Singapore, the issue of wrongdoing (and therefore what constitutes sufficient wrongdoing) is the focus. Where the relevant abuse has been established, the inquiry then turns to the person or persons responsible for bringing about the abusive conduct in order to determine the liable party. The American approach, on the other hand, places significant weight on formalistic requirements as indicators of control and dominance.

In accordance with control and dominance occupying a central place in the United States to determine whether it is appropriate to ignore corporate personality, the courts have set out a list of factors that would tend to show that the defendant was a dominated corporation, such as:

1. the absence of the formalities and paraphernalia that are part and parcel of the corporate existence, i.e., issuance of stock, election of directors, keeping of corporate records and the like,
2. inadequate capitalization,
3. whether funds are put in and taken out of the corporation for personal rather than corporate purposes,
4. overlap in ownership, officers, directors, and personnel,
5. common office space, address and telephone numbers of corporate entities,
6. the amount of business discretion displayed by the allegedly dominated corporation,
7. whether the related corporations deal with the dominated corporation at arms length,
8. whether the corporations are treated as independent profit centers,
9. the payment or guarantee of debts of the dominated corporation by other corporations in the group, and
10. whether the corporation in question had proper property that was used by other of the corporations as if it were its own.  

The centrality of dominance and control inclines courts in the United States to see these as being undesirable in themselves and, it is suggested, predisposes them to have a more expansive view of wrongdoing compared to courts from other common law jurisdictions. There almost seems some inevitability in imposing liability when the initial conclusion is that a shareholder/parent has utterly dominated the subsidiary. This is demonstrated by the “identity” doctrine which is discussed in the next paragraph. Taken as a whole, there is a danger of

v. New York State Department of Taxation and Finance, 623 N.E.2d 1157, 1161 (N.Y. 1993), it was said that “complete domination of the corporation is the key to piercing the corporate veil” though establishing a wrongful or unjust act towards the plaintiff was also necessary. See also BAINBRIDGE & HENDERSON, supra note 14, at 91–93.


132. See also KAREN VANDEKERCKHOVE, PIERCING THE CORPORATE VEIL: A TRANSNATIONAL APPROACH 81 (2007) (finding that some courts “have been quite liberal in defining the ‘wrong’ required” for the instrumentality doctrine).
the doctrine being over and under inclusive. In relation to the latter, as the elements for veil piercing are conjunctive, scrupulous adherence to formality will go a long way towards reducing the risk of veil piercing. Conversely, relatively unsophisticated shareholders or businesses that have not been properly advised are at greater risk of being subject to the doctrine.

Third, aside from the “instrumentality” and “alter ego” doctrines, reference is also sometimes made to “agency,” or to a person using “control of the corporation to further his own rather than the corporation’s business,” with the consequence that the corporation was only a “dummy” or “shell.” Where piercing takes place in these circumstances, the existence of wrongdoing does not appear to be crucial as this category seems to be distinct from the two earlier doctrines, even if at times it is conflated with them. It is perhaps best described as the “identity” doctrine which has been criticized as being “such a diffuse and relatively useless approach that it does not deserve extended discussion.” Certainly agency, properly speaking, ought to be distinct from veil piercing.

Where the law finds that an agency relationship has arisen, it means that the agent is a distinct person from the principal. Although the principal is bound by the agent’s acts, this is because the principal has authorized the agent to act in a certain manner and the agent has done so in accordance with the principal’s instructions. Aside from agency, where a corporation is merely a “dummy” or “shell,” this could include situations similar to the concealment principle that has been recognized in England where the real party to a transaction is not the corporation but some other person. The understanding in the United States

133. At least in theory. As a practical matter, where a court is of the view that the corporate vehicle has been used in an abusive manner, it would in all likelihood strive to find the necessary dominance and control, which begs the question of whether control and dominance should occupy such a central place in the judicial reasoning. Certainly the conjunctive nature of the elements is unusual by the standards of the other jurisdictions discussed in this paper as it suggests that control or wrongdoing simpliciter cannot as a matter of principle ever give rise to piercing.


135. Id. at 8. The concept of agency has also been invoked in this context, see e.g., Berkey v. Third Ave Ry. Co., 155 N.E. 58, 61 (N.Y. 1926); Port Chester Elec. Constr. Corp. v. Atlas, 40 N.Y.2d 652, 657 (1976).

136. Wm. Passalacqua Builders Case, 933 F.2d at 138.

137. See e.g., Wm. Passalacqua Builders Case, 933 F.2d 131, 138; Fletcher v. Atez, Inc, 68 F.3d 1451, 1458 (2d Cir. 1995).

138. BLMBERG, supra note 131, at 122.

139. See e.g., Lowendahl, 287 N.Y.S. at 74–75, which also noted that “agency” in this context was not being used in its technical legal sense.

140. RESTATEMENT OF THE LAW (THIRD) OF AGENCY §1.01 (AM. LAW INST. 2006).

141. Given the vague nature of this doctrine, some cases have regarded it as interchangeable with the other veil piercing theories. See e.g., Wm. Passalacqua Builders Case, 933 F.2d 131, 138 (the corporate veil may be pierced “either when there is fraud or when the corporation has been used as an alter ego”); Fletcher, 68 F.3d 1451 (finding that fraud was not necessary under the “alter ego” doctrine though there must be an overall element of injustice or unfairness which are somewhat vague concepts; contra Walton Construction Co, LLC v. Corus Bank, N.D.Fla., July 21, 2011, at *3 (stating that “fraud, or a similar injustice or wrongdoing” must be demonstrated); Wausau Business Insurance Co. v. Turner Construction Co., 141 F.Supp.2d 412 (S.D.N.Y. 2001) (adopting the approach from Wm. Passalacqua Builders Case,
goes beyond this, as some courts simply ask if the company is merely a conduit for the shareholder/parent, or exists simply as a mere tool, front or personal instrumentality.  

Fourth, some cases of veil piercing have arrived at the right conclusion in terms of liability, but the reasoning may have been better justified on some basis other than veil piercing. Where, for example, an appropriate officer of the parent company has made representations assuring the plaintiff that the parent company will be the responsible party, and the plaintiff reasonably placed reliance on this, either an estoppel against the parent would arise, or a contract may have come into existence between the parent and the plaintiff on the objective theory of contract formation. In such cases, there is no need to resort to veil piercing.  

As mentioned earlier in a different context, engaging in veil piercing risks creating a messy and uncertain shortcut. Indeed, McFerren v. Universal Coatings, Inc utilized an alternative approach.  

Where proof of wrongdoing is unnecessary for veil piercing (wrongly, it is submitted), or where an expansive notion of wrongdoing is applied because the level of control or identification is regarded as excessive, it is difficult to resist the notion that the doctrines are a proxy for what is really taking place, namely that the real basis for veil piercing in such cases is what courts regard as extremely poor corporate governance. The courts have pierced the corporate veil because of the failure to sufficiently distinguish the company’s activities from its parent/owner. Some examples will illustrate this. In Gorill v. Icelandair/Flugleider, the corporate veil was pierced on the “instrumentality” theory. The court was of the view that the element of domination and control was made out. In addition, the subsidiary’s wrongful termination of employment was a sufficient “wrong” for the doctrine to be made out. With respect, this seems to go too far. Wrongful termination of employment is a breach of contract. Unless there is something special about employment contracts, to find that a breach of contract is a sufficient wrong that can lead to veil piercing suggests that a wide

933 F.2d 131); In re MBM Entertainment, LLC, 531 B.R. 363 (S.D.N.Y. Br. 2015) (also following Wm. Passalacqua Builders Case, 933 F.2d 131). Although some cases that apply the “instrumentality” and “alter ego” doctrines do so in the absence of proof of inequitable conduct, many cases do not, see BLUMBERG, supra note 131, at 117–24. It is suggested that proof of wrongdoing should be a critical element. In countries such as England and Singapore where small companies predominate, even what is referred to as “one-man” companies, over-reliance on concepts of dominance and control will likely lead to corporate personality being potentially ignored in a very large number of companies. English and Singapore courts have therefore reiterated that control and dominance are in themselves unimportant, see e.g., Adams [1990] 2 WLR 657; Public Prosecutor v. Lew Syn Pau [2006] SGHC 146, [2006] 4 Sing. L. Rep. (R) 210.


146. Id. at 853.
variety of legal wrongs are in themselves sufficient for such purpose. Given that a successful claim against a corporate defendant is a pre-requisite for veil piercing, it is difficult to see when this element will not be satisfied. On such a liberal view of “wrong,” any real limit on veil piercing will amount to little more than the element of domination/control.

*Carte Blanche (Singapore) Pte Ltd v. Diners Club International, Inc.*147 provides another example of a liberal approach to the understanding of wrongdoing in veil piercing. A subsidiary entered into a franchise agreement with the plaintiff company. As a result of a corporate reorganization, the subsidiary transferred its operations to its parent such that by the end of 1983, it had no separate offices, officers, books, or bank accounts. The plaintiff’s franchise was serviced solely by employees of the parent company. Subsequently, a dispute arose over certain provisions of the franchise agreement and the chairman of the subsidiary, who was also chairman of the parent, gave notice of default to the plaintiff. The notice indicated the chairman’s title as chairman of the parent company and not the subsidiary. The parties proceeded to arbitration and it was found that the subsidiary was in breach of the franchise agreement when it withheld services from the plaintiff. As the plaintiff was unable to collect damages from the subsidiary, it attempted to do so from the parent.

The court held that this was an appropriate case for the corporate veil to be pierced. The court accepted that the subsidiary acted as a separate corporation from its organization from 1972 until mid-1981. The question was whether it did so in 1984 when the franchise agreement was breached. This depended on whether its parent dominated or controlled its actions. It was noted that at the time of the breach in 1984: (1) the subsidiary had observed no corporate formalities for at least two years; (2) it kept no corporate records or minutes and had no officers or directors elected in accordance with its by-laws; (3) it had no assets, and its initial capitalization of $10,000 was insignificant when compared to the more than $7,000,000 in loans that it received from group companies to finance its business activity; (4) it had no separate offices or letterhead; (5) it had no paid employees or a functioning board of directors; (6) all of its revenues were put directly into the parent’s bank account, which paid all of its bills; (7) services provided to the plaintiff from 1983 came from full-time employees of the parent; (8) its revenues and marketing reports were not recorded independently, but were treated as part of the parent’s revenues and statistics; and (9) the chairman was the only person who functioned on behalf of the subsidiary and he was also chairman of the parent’s board. He was paid no salary by the subsidiary and occasionally acted not in the name of the subsidiary but in the name of the parent.

While the preceding facts indicate a failure to properly segregate the activities of group companies, it is difficult to see any wrongdoing aside from the breach of the franchise agreement.\textsuperscript{148} The risk of breaches of contract are inherent in any contractual relationship and should be the subject of a specific bargain if a contracting party wishes to extract greater security from a parent company or other shareholder. In addition, as American law recognizes the tort of inducing a breach of contract, it might seem more appropriate for such wrongs to be determined within this framework, which is shaped by policies relevant to such liability. From a policy perspective, the decision is also difficult to justify as providing an optimal measure of protection for those who deal with corporations. It would seem from the judgment that if the breach had taken place before mid-1981, no veil piercing should take place. Was the plaintiff in any way materially prejudiced after such date?\textsuperscript{149} It is difficult to see how it was. The subsidiary’s financial position did not appear to be any worse after this date. While its capitalization was low, there is nothing wrong with financing a business from loans, and a substantial sum was advanced to it for its business. Prima facie, it would appear that such loan was unrecoverable with the consequence that the parent company also made a substantial loss. The other factors listed by the court are failures relating to proper formalities reflecting poor governance but are of marginal relevance upon closer scrutiny.\textsuperscript{150} The business of the subsidiary was almost moribund given the existence of only one remaining franchisee, the plaintiff. For the subsidiary to have continued operations on this basis might have led to a greater drain on its remaining financial resources (if any). This could have led to its winding up and consequently brought the franchise agreement to an end. \textit{Carte Blanche} is a good example of the potentially distorting effects when the element of control/dominance sits at the heart of the test for veil piercing.

\textsuperscript{148} It is possible that because the court expressed the test for veil piercing using the disjunctive “or” for the elements of control and wrongdoing, rather than the conjunctive “and” which New York courts have since endorsed (see \textit{Cary Oil Co. Inc. v. MG Refining & Marketing, Inc.}, 230 F.Supp.2d 439, 488 (2002)), the court in \textit{Carte Blanche} may have arrived at its decision purely on the basis of control.

\textsuperscript{149} In \textit{Abraham v. Lake Forest, Inc}, 377 So.2d 465, 469 (La. Ct. App. 1980) the subsidiary was undercapitalized, there was commingling of funds, and almost all the business of the subsidiary was accomplished by unanimous consent of the shareholders. Nevertheless, no piercing took place as the plaintiff was a sophisticated real estate entrepreneur who exercised business judgment when contracting with the subsidiary and was not relying on the credit of the parent corporation.

\textsuperscript{150} It would have been possible to structure the relationship between the parent and subsidiary more formally to minimize the danger of veil piercing. For example, there could have been an agreement between both companies under which employees of the parent would provide services to the subsidiary in consideration for which the parent would be allowed to collect the subsidiary’s revenues and apply them towards such costs with any excess held for the benefit of the subsidiary. This would have addressed some of the criticisms of the parent’s conduct. Once again, this illustrates the sub-optimal nature of rules that may trip up small and relatively unsophisticated businesspeople or entities even though in this case the parent was not such a person. A similar point is made by BAINBRIDGE & HENDERSON, supra note 14, at 108–09.
piercing. It gives rise to the danger that it can be applied in a formulaic manner without regard to the proper context of the case.\footnote{151}{On the other hand, in Penick v. Frank E. Basil, Inc., 579 F. Supp. 160, 166 (D.C. Cir. 1984), no piercing took place because the plaintiff failed to establish “that the employees of either failed to observe proper corporate formalities.” In any event, the claim was for breach of a contract of employment with the subsidiary which should generally not be a sufficient act of wrongdoing to justify piercing. In Amsted Industries, Inc v. Pollak Industries, Inc, 382 N.E.2d 393 (Ill. App. Ct. 1978), the court held that while there may have been some failures to adhere to formalities within the corporations, the veil would not be pierced as against the individual shareholder as there were other indicators that the separation between the corporations existed. The companies had separate employees that were paid by the company which employed them; the companies had separate meetings of directors and kept separate minute books; they had separate bank accounts; they never advertised together; and they never circulated a joint financial statement. In other words, there was at least a threshold observance of corporate formalities.}

Nevertheless, the outcome itself may have been correct as the subsidiary’s operations and assets had been absorbed into the parent company.\footnote{152}{Carte Blanche Case, 2 F.3d at 28.} This meant that when the parent’s employees and its chairman dealt with the plaintiff, they did so on behalf of the parent which had stepped into the shoes of the subsidiary. In other words, the conduct of the parties brought about a novation of the contract from the subsidiary to the parent. Veil piercing would not be necessary in these circumstances. The parent was liable to the plaintiff under the contract that the parent and plaintiff became parties to.

Similarly, in Sabine Towing & Transp. Co., Inc. v. Merit Venture, Inc.,\footnote{153}{Sabine Towing & Transportation Co., 575 F.Supp. at 1448.} the court apparently relied on a breach of contract as one aspect of wrongdoing. However, given that the wrongdoing included acts that were designed to keep creditors from reaching the subsidiary’s remaining assets, one wonders if reliance on laws designed to prevent fraudulent conveyances would have been more appropriate and sufficient.\footnote{154}{See Lowell Staats Mining Co, Inc v. Pioneer Uravan, Inc., 878 F.2d 1259 (10th Cir. 1989).} And in Viitch v. Furr, the court opined that insolvency or undercapitalization is often an important factor evidencing injustice.\footnote{155}{Vuitch v. Furr, 482 A.2d at 819 (D.C. 1984).} No elaboration was given and it is suggested that in and of themselves such situations should not be equated with injustice.

Parker v. Bell Asbestos Mines, Ltd provides a further example illustrating a broader understanding of wrongdoing in the United States.\footnote{156}{Parker v. Bell Asbestos Mines, Ltd, 607 F. Supp. 1397 (E.D. Pa. 1985).} The issue related to the extent to which a parent could be insulated by its subsidiary from tort liability for asbestos related harm. In England, where there was similar litigation, the issue was resolved in favour of the parent with the court taking the view that the purpose of incorporation was to allow a person to limit potential future liabilities.\footnote{157}{Adams [1990] 2 WLR 657. Such an approach is also the position in Singapore, see Singgood [2016] 1 Sing. L. Rep. 1129 [195].} In Parker v Bell Asbestos Mines, Ltd, the court came to the opposite conclusion from that in England by drawing a distinction between:\footnote{158}{Bell Asbestos Mines, Ltd., 607 F. Supp. at 1403.}
(1) carrying out the everyday affairs of corporate business (e.g., the mining and sale of asbestos)—the sort of activity which traditionally merits the privilege of limitation of liability bestowed by the protective corporate form; and (2) carrying out legal maneuvers aimed at maximizing the limitation of liability to a point of near invulnerability to responsibility for injury to the public. In our view, the latter, which may well be the situation here, constitutes an abuse of privilege, which in an equitable analysis of competing public policy considerations must surely fail.

On the face of it such a distinction is difficult to justify. Business activities inevitably give rise to the possibility of tortious acts, and it is hard to see why a corporate structure that is intended to maximize the limitation of liability for such acts is an abuse of privilege. It may be if the activity in question will inevitably give rise to a tort, and in such an instance the directors of the company may also be personally liable for procuring the company to engage in a tortious act. As a general and unqualified statement of the law, however, *Parker* with respect probably goes too far. ¹⁵⁹

In England, the effect of separate personality in the context of the tort of negligence can be limited by finding that a parent company has assumed responsibility towards the employees of a subsidiary so as to give rise to a duty of care towards such employees. Arguably, this is the real issue, namely what are the circumstances where a parent ought to incur tortious liability to employees of a subsidiary. For this to arise in England, it is not necessary that the parent should have absolute control over the subsidiary. Tortious liability was found where “(1) the businesses of the parent and subsidiary are in a relevant respect the same; (2) the parent has, or ought to have, superior knowledge on some relevant aspect of health and safety in the particular industry; (3) the subsidiary’s system of work is unsafe as the parent company knew, or ought to have known; and (4) the parent knew or ought to have foreseen that the subsidiary or its employees would rely on its using that superior knowledge for the employees’ protection…. A court may find that element (4) is established where the evidence shows that the parent has a practice of intervening in the trading operations of the subsidiary, for example production and funding issues.” ¹⁶⁰

It is worth pausing at this stage to make a broader point. It is arguable that in a tort or contract case, where negotiation is not plausible (for example where contracts are in a standard form), if a corporation has an amount of capital that is unreasonably low given the nature of its business and the risks it faces, from an *ex ante* perspective, veil piercing may be justifiable. On the other hand, veil piercing should not take place where creditors can protect themselves *ex ante*. ¹⁶¹ Having a company operate in a way that puts third parties at risk of uncompensated harm where such risks would reasonably be expected to occur, or that similarly puts the other contracting party at risk of contract breach because

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¹⁵⁹. See also *Lake Asbestos of Quebec, Ltd.*, 843 F.2d at 145.
it is clear that the other contracting party has to deliver the goods or products ordered to another person, would be unjust and an abuse of corporate personality as required by veil piercing doctrine. Limited liability in such circumstances provides incentives to invest recklessly.\textsuperscript{162}

As powerful as this view may be, veil piercing may not be the best solution. Should veil piercing in such situations take place, the courts are really holding the shareholders and/or directors of such a corporation accountable for the loss suffered by the tort victim or unfortunate counterparty to the contract. The broader (and real) policy issue therefore is whether the circumstances are such as to impose a direct duty of care on the said shareholders or directors to such persons. Again, tort law may provide a superior framework for analysis and, depending on the facts, other areas of tort may be applicable.

It is worth noting that many of the US cases discussed above involved parent-subsidiary relationships.\textsuperscript{163} It may be that a more liberal approach to veil piercing in the US is explicable on this basis. It has been argued that, in the context of a corporate group, the theoretical analysis behind limited liability largely becomes irrelevant. For instance, any veil lifting within a corporate group does not affect the ultimate investors of the enterprise as the piercing is generally not extended beyond the corporate parent.\textsuperscript{164} Such an approach reflects the perceived reason and policy behind limited liability and hence its limits. An alternative approach that is more accommodative of group enterprises may reflect a view that, given the right circumstances, large firm size can bring about efficiencies (e.g. through risk spreading, economies of scale and scope, access to capital markets, more favourable borrowing terms) which as a whole benefit society. A mix of large and small firms may also provide the most optimal environment for innovation to take place.\textsuperscript{165} Part of the reason for this is because some innovation takes place in start-up companies founded by former employees of large enterprises.\textsuperscript{166} This also applies to large firms that decide to spin off divisions or lines of businesses into subsidiaries. It is therefore optimal to treat corporate shareholders no differently from individual investors. This will avoid disincentivizing enterprises from growing without endangering the entire enterprise given the greater

\begin{footnotes}
\item \textsuperscript{163} For example, see Walkowsky \textit{v.} Carlton, supra note 134; and see also Mangan \textit{v.} Terminal Transportation System, Inc., 247 A.D. 853 (1936).
\item \textsuperscript{164} BLUMBERG, supra note 131, at 93–97; see also BAINBRIDGE \& HENDERSON, supra note 14, at 293–301 which argues that veil piercing should be abolished with respect to individual shareholders.
\end{footnotes}
complexity and therefore risk inherent in larger enterprises. Such a viewpoint probably underpins the approach in England and Singapore where arguments relating to group enterprise liability have not been met with much success.\textsuperscript{167}

On the whole, the body of cases relating to veil piercing in the US is somewhat confused. It is difficult to disagree with the following comment:\textsuperscript{168}

In light of the diversity of judicial approaches, the use of expansive rhetoric, and the sheer volume of legal opinions, veil-piercing jurisprudence in the US lacks the degree of certainty and predictability that the modern business requires. The veil-piercing common law of torts and contracts remains highly discretionary and problematic for the business planner.\textsuperscript{169}

\textit{Germany}

Veil piercing by courts is rare in Germany.\textsuperscript{170} The courts restrict direct claims of harmed creditors against shareholders to situations in which assets have been commingled. In all other instances, the principles established and applied by German courts have recently changed.\textsuperscript{171} Shareholders that strip a company of its assets to the disadvantage of creditors may be liable, but for tort and not on the basis of veil piercing. Courts avoid veil-piercing because the liability of the shareholders is to the company, not to its creditors since the latter’s losses are of a reflective nature.

Shareholders are also never personally liable in situations of undercapitalization or for abuse of the corporate form, and a dominant influence exercised on a company is by itself no basis for such liability either. Earlier judgments that applied the principles relating to corporate groups\textsuperscript{172} to instances where shareholders exercised a dominant influence over a company in the group

\begin{itemize}
\item \textsuperscript{167} See e.g., Adams [1990] 2 WLR 657; Win Line (UK) Ltd v. Masterpart (Singapore) Pte Ltd [1999] 2 SLR(R) 24; Manuchar Steel [2014] SGHC 181.
\item \textsuperscript{169} It has been suggested, however, that although many aspects of veil piercing doctrine from judicial decisions make little sense, if the actual outcomes of cases are analyzed, piercing cases can be explained as judicial efforts to remedy one of three problems, namely to ensure behavior that conforms to a statutory scheme, to preserve the objectives of insolvency law, and to remedy what appears to be fraudulent conduct, see Jonathan Macey & Joshua Mitts, \textit{Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil}, 100 CORNELL L. REV. 99 (2014). There is no difficulty with the first two categories but in the third it is clear that fraudulent conduct is construed broadly so the difficulty of construing what conduct crosses the line remains.
\item \textsuperscript{170} For a similar conclusion, see \textit{COMPARATIVE COMPANY LAW – A CASE-BASED APPROACH} 219 (Mathias Siems & David Cabrelli eds. 2nd ed. 2018).
\item \textsuperscript{171} As such, observations such as those made in \textit{Am. Lecithin Co. v. Rebmann}, 12-CV-929 (VSB) (S.D.N.Y. Sept. 20, 2017) as to the similarity between the German law on veil piercing and New Jersey or Delaware law are no longer correct.
\item \textsuperscript{172} Aktiengesetz [AktG] [Stock Corporations Act], Sept. 6. 1965, BGBl. I at 1089, last amended by Gesetz [G], July 17, 2017 BGBl. I at 2446, art. 9 (Ger.), available at https://www.gesetze-im-internet.de/aktg/AktG.pdf, §§ 291-318.
\end{itemize}
to its financial detriment are obsolete. They have been absorbed by newly established principles that apply when the existence of the company is threatened by shareholders. The term used in the relevant German rulings ("existenzvernichtender Eingriff") translates literally into “existence annihilating interference.” We have chosen to refer to it as “annihilating interference.”

For a better understanding of the policy reasons underpinning the German position, the discussion of the principles of veil piercing is preceded by some introductory remarks about relevant aspects of German company law.

**Veil-piercing in the context of the smaller German company type, the GmbH**

Whereas English law, and the jurisdictions that have derived their corporate laws from it, typically subject the private limited company to essentially the same rules and requirements as the public limited company, German law has created two substantially different forms of corporations. One form is the Gesellschaft mit beschränkter Haftung ("GmbH"), which is the company of choice of small-and medium-sized businesses and therefore frequently closely held. Its typical structure explains why veil-piercing or a functional equivalent is a relevant issue for the GmbH. In closely-held companies, shareholders can exercise a dominant influence and attempt to enrich themselves to the disadvantage of the company and its creditors. German law also grants the shareholder meeting a dominant influence over the GmbH. In contrast to other jurisdictions where directors may generally manage companies independently of directions from shareholders, the German GmbH requires directors to adhere to shareholder resolutions decided in meetings.

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174. Even the UK follows this rule although its public limited company is subject to EU legislation and therefore while there are some differences between the two corporate forms, the overall conceptual approaches are similar and accordingly substantially different from the German concept. Some US states offer a separate regime for closely-held corporations, particularly Delaware, that shareholders can opt into. In other states, the courts apply special principles to closely held corporations that serve the interests of minority shareholders. However, the deviations from the general rules are rather insignificant compared to the existence of fundamentally different regimes for different types of companies in jurisdictions that follow the German and French approaches.

175. For these elementary principles of German company law, see generally Gregor Bachmann, Introductory Editorial: Renovating the German Private Limited Company - Special Issue on the Reform of the GmbH, 9 German L.J. 1064 (2008).

176. As Götz Hueck & Christine Windischler, Gesellschaftsrecht § 24 Rdn 27 (21st ed. 2008) correctly emphasize, the issues of limited liability and veil piercing are not limited to the GmbH, but factually-speaking of little relevance for the stock corporation. It could be added that this is so because the particular liability-triggering scenarios are very rare for larger, widely-held corporations with a strict structure of corporate governance that reduces the influence of shareholders to a minimum.

177. An example is in Singapore, where this principle is firmly expressed in §157A of the Singapore Companies Act, subject to any provisions in the Act itself or the corporate constitution.

178. This principle is derived from section 37(1) GmbHG that provides that the powers of the directors are limited by the resolutions of the shareholders in meeting.
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The GmbH is not simply a smaller version of the stock corporation (Aktiengesellschaft or “AG”), which relies on a detailed regime underpinned by largely mandatory statutory law. The corporate governance structure of the AG vests the decision-making powers in its two-tier board and not in the shareholders.179 It is therefore generally considered a company form that is, conceptually speaking, entirely different from the GmbH.180

German legislation created the GmbH in 1892,181 and the GmbH Act (GmbHG)182 became the model law for similar forms of limited liability companies in civil law jurisdictions throughout the world. This seems, in particular, interesting and relevant from an Asian perspective. In the late 19th and early 20th centuries, German law had a significant influence over East Asian jurisdictions.183 Although German company law remains important in the region, a wave of legal transplantation of US corporate law has dramatically reduced the impact it once had. This decline in influence is most obvious in Japan where the legislature in its 2006 company law reform abolished its GmbH-equivalent, the yūgen kaisha, and reduced Japanese company law to one type of corporation, the kabushiki kaisha with no minimum capital requirement, and adopted a US-style LLC called the gōdō kaisha.184

**Cases of undercapitalization and liability for “annihilating interference”**

Whether undercapitalization of the GmbH may justify a piercing of the corporate veil was controversially discussed in German literature until the Federal High Court firmly decided against it in a 2007 ruling.185 This discussion about a potential liability for undercapitalized companies is best understood with

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181. See Roth & Kindler, supra note 173, at 16.


183. For Japan, see e.g., KONRAD ZWEIGERT & HEIN KÖTZ, AN INTRODUCTION TO COMPARATIVE LAW 298 (Tony Weir trans., 3d ed. 1998); MATHIAS SIEMS, COMPARATIVE LAW 211–12 (2014); CARL F. GOODMAN, THE RULE OF LAW IN JAPAN: A COMPARATIVE ANALYSIS 20 (4th ed. 2017).

184. See Beurskens & Noack, supra note 180, at 1071.

185. On the discussion of the literature prior to the ruling, see Rüdiger Veil, Gesellschaftsverhältnis wegen existenzvernichtenden Eingriffen und materieller Unterkapitalisierung [Liability of Members under Annihilating Interference and Substantial Undercapitalization], 2008 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 3264, 3265.
some insight in the basics of German principles of minimum capitalization and capital maintenance.  

Principles of German law of capital maintenance

The minimum initial legal capital of the stock corporation (AG) must amount to EUR 50,000. This is double the amount required by the EU second directive that pursues a minimum harmonization approach and applies in all EU member states. It permits the member states to implement higher, but excludes lower, minimum capital requirements. The United Kingdom is another prominent member state of the EU that goes well beyond the minimum required by EU legislation and sets the minimum capitalization of its public companies at GBP 50,000.

The registration of the GmbH requires a minimum legal capital of EUR 25,000. German law therefore requires a substantial amount of initial capital for the incorporation of any company because even the so-called ‘Entrepreneurial Company’ (Unternehmergesellschaft), created by a 2008 reform of the GmbHG and sometimes referred to as “GmbH-lite,” is ultimately a GmbH with a minimum capital of EUR 25,000. Although it can be established without any legal capital, it remains an imperfect company with inconvenient restrictions until capital up to the amount of EUR 25,000 has been contributed, at which time it converts into a GmbH.

In this respect, Germany contrasts with the UK. The minimum capital requirements stemming from EU legislation only apply to the public limited and its civil-law equivalents (i.e., the German stock corporation AG), rendering the decision whether to require a minimum capital for smaller company forms a national matter. While the United Kingdom has exercised its legislative discretion in a way typical of common law-countries and abstained from minimum capital requirements for its private limited companies, Germany still...

186. For more detail on the principles of capital maintenance in German company law, see ROTH & KINDLER, supra note 173, at 54–66.
189. Companies Act 2006 (c. 46) (UK), § 763(1). For further examples of EU countries going beyond the required minimum, see ROTH & KINDLER, supra note 173, at 33.
190. Section 5(1) GmbHG. For a comparative look at different European jurisdictions, see ROTH & KINDLER, supra note 173, at 33.
191. On the reform, see Bachmann, supra note 175, at 1063–68; Beurskens & Noack, supra note 180, at 1069–1073.
192. See GmbHG, § 5a, especially paragraph 5 for the transformation into a “proper” GmbH and paragraph 4 for the restrictions until its legal capital reaches EUR 25,000, especially the requirement that one-fourth of its annual profit must be allocated to its legal capital. On this aspect, see Beurskens & Noack, supra note 180, at 1084.
193. Art 45(1) Codification Directive, supra note 188.
pursues what was once the typical fashion of civil law jurisdictions and requires
a substantial legal capital as a precondition for the incorporation of a GmbH.\textsuperscript{194}

In addition, principles of capital maintenance are strict in German company
law. The traditional German approach to capital and its maintenance for purposes
of creditor protection strongly influenced the rules of EU law, which have forced
the United Kingdom to deviate from general common law principles that apply
to the distribution of profits to shareholders in the case of public companies.\textsuperscript{195}

Profits, and more generally assets necessary to maintain the legal capital are not
to be distributed to shareholders,\textsuperscript{196} and shareholders who receive payments
contrary to this principle must make repayment. If such repayment falls short of
the amount owed, all other shareholders are jointly and severally liable for the
remaining sum.\textsuperscript{197} In addition, a solvency test applies and holds the directors of
the GmbH liable for any asset transfers to shareholders (including those in
fulfilment of contractual obligations such as repayment of loans to a shareholder
or payment for goods purchased from a shareholder) if such transfers have led to
the illiquidity or balance-sheet insolvency of the company.\textsuperscript{198}

We emphasize these principles of German law here because we believe that
they help to explain the decisions of the German courts that will be discussed
below, especially the Federal High Court’s reluctance to pierce the corporate veil
in instances where undercapitalization of a GmbH is suggested, i.e., where its
legal capital looks inadequate in light of its business purpose and/or obligations.
When requirements for initial capitalization and maintenance of capital are strict,
calls for penalties for undercapitalization in a material sense are less appealing.

As emphasized in the German legal literature, minimum capital requirements
bear no indication of the correct or appropriate amounts of capitalization for
companies. The minimal capital requirements aim to establish integrity of the
business that the founding members commit to, and they seek to prevent
insolvencies at an early stage of a company’s life. The underlying theory

\textsuperscript{194} Many other civil-law jurisdictions have abolished such minimum capital requirements. On the
French s.-s.r.l., see CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L223-2 (Fr.). On Japan, see
Beurskens & Noack, supra note 180, at 1071, and see also the discussion on the People’s Republic of
China at infra .

\textsuperscript{195} Section 830 of the UK Companies Act 2006 represents the general company law approach to
the distribution of profits to shareholders and applies to the private limited company. In contrast, section
831, in relation to public companies, implements the principles of capital maintenance stemming from the
Codification Directive, supra note 188, and correspond to the stricter principles that have traditionally
been pursued in Germany. For an analysis of the drastic change in common law principles that took place
in the early 20\textsuperscript{th} century, see Basil S. Yamey, Aspects of the Law Relating to Company Dividends, 4 MOD.
L. REV. 273 (1941). On Germany’s influence on the directive Stefan Grundmann, European Company
Law (Intersentia 2012) 205.

\textsuperscript{196} GmbHG, §30(1). See CARSTEN JUNGMANN & DAVID SANTORO, German GmbH Law – Das

\textsuperscript{197} GmbHG, §§31(1) and (3). For exemptions from this rule, see JUNGMANN & SANTORO, supra
note 196, at 42.

\textsuperscript{198} GmbHG, § 64. See also JUNGMANN AND SANTORO, supra note 196, at 44.
provides that shareholders, and often shareholder-directors in small companies, whose own equity is at stake are prudent decision-makers, rely on sounder business plans and try to stay clear of exorbitant risk. By contrast, minimum capital requirements do not seek to provide a guarantee as to whether the amount of legal capital to which the shareholders commit in the corporate constitution is adequate for the pursuit of the planned business endeavours. Neither the registration authorities that incorporate a company, nor the shareholders that commit to the corporate constitution, provide any implicit statement of this kind. Similar to all the jurisdictions discussed in this paper, creditors need to be aware that German company law expects them to exercise their own due diligence and business judgment.\footnote{199}
insolvency. However, the court made the requirements for such liability more onerous. It explicitly reversed its previous holdings that had created a subgroup of veil-piercing based not on torts, but on abuse of the corporate form as an exception to the principle of limited liability. This had resulted in shareholders being held directly liable vis-à-vis the company’s creditors in situations where recourse under the statutory provisions protecting the maintenance of the GmbH’s capital was insufficient to fully compensate them. Liability was imposed on shareholders where they openly or secretly depleted the company of assets that were needed to satisfy creditors.

Based on the civil law understanding that courts do not establish but simply apply the law, German courts are not held to the principle of stare decisis and are therefore not bound by their previous rulings or those of other courts. However, in the interests of legal certainty, it is understood that courts should not arbitrarily change past decisions and ought to explain their reasons when they do so. The cases regarding veil-piercing form no exception to this rule. The BGH explained that it considered its former rulings questionable from a doctrinal perspective because they had resulted in shareholders being held directly liable to creditors although no duties owed to creditors were breached. The duties that were breached were owed to the company and only resulted in losses to the company. The BGH considered it flawed to assume that any loss of corporate assets immediately affected the creditors. Instead, the losses were of a purely reflective nature, and reflective losses generally did not give creditors any remedies. The previous decisions created contradictory outcomes because “annihilating interference” (a concept explained immediately below) resulted in direct external liability of shareholders, whereas the statutory provisions for the

203. Id. ¶ 16.
205. BGH Trihotel, 2007 NJW 2689 ¶ 17.
207. BGH Trihotel, 2007 NJW 2689 ¶ 18.
208. Id. ¶ 21.
209. For an introduction to basic differences between court rulings in common and civil law countries, see Joseph Dainow, The Civil Law and the Common Law: Some Points of Comparison, 15 AM. J. COMP. L. 419, 426–27 (1967); Ewould Hondius, Precedent in East and West, 23 PENN ST. INT’L L. REV. 521, 525 (2005) (with references to the Kingdom of Prussia, one of the legal predecessors of today’s Germany). The situation has since changed as courts discuss their and other court’s former rulings, but they are still not legally bound by them.
211. Id. ¶ 26.
maintenance of capital (§§30 and 31 GmbHG) only led to shareholders’ internal liability.\textsuperscript{212}

The Court emphasized that veil-piercing had to be applied cautiously because it could undermine the principle of limited liability. It was evidently worried that supporting widely-worded categories of veil piercing would create a mechanism that courts could use too lightly. It emphasized that the loss of the privilege of limited liability would threaten the very existence of the GmbH as a popular and useful type of business entity and thereby go against the intentions of the legislature. Thus, the court concluded that shareholders could not be liable for “abuse of the corporate form” as set out in its previous decisions.\textsuperscript{213}

However, shareholders continued to be personally liable in cases of “annihilating interference,” but no longer based on the considerations previously applied.\textsuperscript{214} The Court held that “annihilating interference” was henceforth to be understood as tortious liability for improperly and self-servingly tampering with corporate assets. These corporate assets are subject to strict rules of capital maintenance in the interest of creditors. Tampering with these assets results in tortious liability when it causes or aggravates corporate insolvencies.\textsuperscript{215} Damages are owed to the company alone and not to its creditors because their losses are of a purely reflective nature.\textsuperscript{216} In practice, this means that administrators in insolvency proceedings enforce these claims on behalf of the company.\textsuperscript{217} Outside of insolvency, creditors must obtain an enforceable title against the company and then request to be assigned the company’s claims against its shareholders.\textsuperscript{218}

To be held liable for “annihilating interference” under tort law, the shareholders’ conduct must conform to the strict requirements of section 826 of the German Civil Code (“BGB”) which provides: “A person who, in a manner contrary to public policy, intentionally inflicts damage on another person is liable for the damage.\textsuperscript{219} In addition, the Court stated at paragraph 20 that the previous principles had proved difficult to apply for practitioners and lower courts alike.

\textsuperscript{212} Id. ¶ 32. In addition, the Court stated at paragraph 20 that the previous principles had proved difficult to apply for practitioners and lower courts alike.

\textsuperscript{213} Id. ¶ 27.

\textsuperscript{214} As explained above, “annihilating interference” is the loose translation chosen here for the German expression existenzvernichtender Eingriff. Other authors speak of “endangering the existence of the company,” see ROTH & KINDLER, supra note 173, at 68, but the wording chosen here reflects the drastic language used by the courts in German.

\textsuperscript{215} BGH Trihotel, 2007 NJW 2689 ¶ 28.

\textsuperscript{216} Id. ¶ 17. The Court held at paragraphs 19 and 24 that liability for “annihilating interference” was still needed because a lacuna of legal consequences was left by the statutory provisions in cases where shareholders drain companies of their assets without crossing the line set out in sections 30 and 31 GmbHG, i.e. without touching the subscribed capital of the company. As the Court said at paragraph 25, corporate assets require protection even beyond the lines drawn by the capital requirements if this is necessary to meet the obligations owed to creditors. On this need for principles protecting the assets of the company below the threshold of subscribed capital, see also ROTH & KINDLER, supra note 173, at 68.

\textsuperscript{217} BGH Trihotel, 2007 NJW 2689 ¶ 34.

\textsuperscript{218} Id. ¶ 34 and confirming BGH II ZR 129/04, Oct. 24, 2005, 2006 NZG 64.
to the other person to make compensation for the damage.” \footnote{\citet[§ 826, \textit{translation at} \url{https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p3497} (Ger.).}} This requires a shareholder to harm the company intentionally and in bad faith. \footnote{\citet{Roth&Kindler:note173:173:68}.} The provision’s premise is that the shareholder is aware that his behaviour is detrimental to the corporation’s finances and equally aware of all facts that render the act contrary to public policy, but not necessarily that he understands that the law holds his acts to be contrary to public policy, nor that he intends to harm the creditors. It suffices to know and accept that the company’s ability to pay its obligations is permanently impaired as a result of his actions, a state of mind referred to as \textit{dolus eventualis}. \footnote{\citet{BGH:Trihotel:2007:2689:30:BGH:II:ZR:292:07,Feb.:9,2009:Sanitary:545:547}.} As a result, a shareholder can, factually speaking, only be held liable when the risk of insolvency is very real and obvious to the shareholder. \footnote{\citet{BGH:Trihotel:2007:2689:44:referring to BGH:Autovertragshändler:2005:NZG:177}.} Importantly, not only the shareholders of the disadvantaged company, but also the shareholders of a second company that itself holds shares in the company can be liable. The BGH has confirmed this rule where such shareholders in effect dominate the disadvantaged company. The supporting argument is that no shareholder should be allowed to hide behind formalities, i.e., the fact that he is not a shareholder himself is of no defense when effectively the harm done is the same as if he were. \footnote{\citet[§ 13 Rdn 51 (Adolf Baumbach & Alfred Hueck eds., 21st ed. 2017).}{BGH:II:ZR:264:06, Apr.:28, 2008:GAMMA:2008:NJW:2437:13; Lorenz Fastrich, GMBHG § 13 Rdn 51 (Adolf Baumbach & Alfred Hueck eds., 21st ed. 2017).}}

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\textit{The GAMMA judgment of the BGH}
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The BGH confirmed these new principles shortly afterwards in its \textit{GAMMA} ruling. This ruling of the BGH was preceded by the judgment of a state court of appeal that held the shareholders of a GmbH personally liable for using the company as a so-called “Cinderella company”. The term is commonly used in German cases and legal writing for companies in which shareholders exercise their influence in ways that ultimately prove detrimental to creditors. \footnote{\citet{Lutter&Bayer:note201:201:Rdn 40}.} These shareholders had burdened the company that subsequently became insolvent with obligations originally owed by other companies in the same group although
it had been clear, as the court put it, that the subsequently insolvent company was inadequately capitalized in view of the obligations transferred to it. They also convinced a number of workers employed by other companies in the group to move to this subsequently insolvent company, a further fact that became relevant for the BGH’s decision.

The BGH overruled the appellate court’s judgment and reaffirmed its former ruling in *Trihotel* that shareholders whose actions endanger the company’s existence cannot be held directly liable to creditors.225 It went on to clarify further points. It emphasized that instances of mere undercapitalization in a material sense, i.e., instances that do not involve a breach of the principles of capital maintenance, do not meet the requirements of an “annihilating interference.”226 The BGH emphasized that such undercapitalization alone could not lead to shareholder liability and explicitly rejected academic writing to the contrary.227 It emphasized that shareholders are responsible for providing the required legal capital of the GmbH, but are under no obligation to furnish it with the financial means necessary to meet all its legal obligations; such a duty would be incompatible with the company’s nature as an entity of limited liability.228 Shareholders are under no obligation to assess and provide adequate financing to the company. They are only required to abstain from depriving the company of its assets in any manner incompatible with the rules of capital maintenance.229 Such acts can take place when they channel corporate assets to a sister company, themselves or other shareholders or parties related to shareholders.230

In the case at hand, the court held that an annihilating interference of the shareholders could not be based on their failure to adequately finance the company to enable it to pay off its debt. The company was formally fully capitalized as required by the law and the shareholders did nothing to deprive the creditors of their right of legal access to all of the company’s assets when it was a going concern.231 However, in an interesting twist, the court ultimately held the shareholders liable for compensation payable to the company’s employees because they had failed to disclose the precarious financial situation when these employees agreed to move from their former employer to this company. The BGH based this liability also on section 826 of the BGB. As a result, the employees had a direct claim against the shareholders because of a tortious act committed against them, not against the company.

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227. *Id.* ¶ 16–22.

228. *Id.* ¶ 23. The principle of limited liability follows from section 13(2) GmbHG.


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A direct claim against shareholders may therefore exist, but only when a tortious wrong was directly committed to the creditors of the company. This ruling in GAMMA is therefore in line with Trihotel because it does not contradict the latter’s holding that purely reflective wrongs and losses cannot be claimed by creditors. Further judgments have since confirmed the holdings of Trihotel and GAMMA. In one of them, the BGH ruled that it could amount to “annihilating interference” and hence shareholder liability (under section 826 of the BGB) to the company when a shareholder prevented the company from pursuing its legitimate claims against him. Here again, the court confirmed that shareholders might be personally liable for their actions, but generally not to creditors of the company, but to the company itself.

Veil-piercing for commingling of corporate and private assets

Legal writing almost uniformly supports veil-piercing in cases where shareholders commingle the company’s assets with their own. By doing so, shareholders disregard the company’s separate legal identity in financial matters. In terms of the exact requirements that justify such an exception to the principle of limited liability, however, academic commentators have not been able to reach an agreement.

The BGH has repeatedly supported this category of corporate veil-piercing and helped to shape its contours. In a 2005 ruling, the BGH defined the requirements for personal liability resulting from commingling of corporate and personal assets in disregard of principles of capital maintenance. It held that payment transactions among the company, its shareholder(s) and third parties must lack transparency to the extent that it becomes impossible to attribute them to the company and that, consequently, the corporate assets become indistinguishable from the shareholder’s personal assets. It thereby confirmed previous judgments that had arrived at the same conclusions. Any personal liability resulting from such conduct may only affect the shareholder(s) responsible for the situation, and no other shareholders who simply happen to be members of the company during the time when such commingling occurs. This type of veil piercing therefore most commonly applies to sole or majority shareholders.

As a result, German courts pierced the veil in cases in which shareholders commingled corporate and private assets. Commingling presently represents the

234. BGH II ZR 178/03, Nov. 14, 2005, 2006 NZG 350 ¶ 15. On these judgments, see also ROTH & KINDLER, supra note 173, at 67.
only situation in which German courts still rely on the principles of veil-piercing to hold shareholders directly liable to the creditors of a company. Notwithstanding the principle that civil law judges do not make law, veil-piercing in these commingling cases is a judge-made legal rule that fills a gap left by statutory law. Its doctrinal basis is abuse of the corporate form\(^\text{237}\) that results in the loss of the privilege of limited liability and instead leads to the application of section 128 of the Commercial Code (Handelsgesetzbuch) that holds all general partners of commercial partnerships personally liable.\(^\text{238}\) It is strictly separate from all other scenarios in which shareholders’ actions result in losses for the company. These other cases are at present resolved by application of general principles of law, be it the statutory provisions of liability for tortious acts (as discussed above) or principles of contract law (as explained below). As emphasized repeatedly, such application of general principles of the law may result in shareholders’ internal liability, i.e., damages owed to the company, not in any direct liability owed to the company’s creditors.

To distinguish these two scenarios, i.e., veil piercing with consequential personal liability to the company’s creditors on the one hand and breaches of the law resulting in shareholders’ liability vis-à-vis the company on the other, the BGH emphasized that improper accounting is not a sufficient basis for veil-piercing. While it certainly amounts to a breach of the law which may therefore give rise to damages by the company against the directors, this does not justify an exception to the principle of limited liability.\(^\text{239}\)

It should be added that embezzlement of corporate assets results in shareholder liability under sections 30 and 31 of the GmbHG, and may also amount to “annihilating interference” but is not a basis for veil-piercing under the commingling exemption.\(^\text{240}\) As explained above, shareholders are liable for repayment to the company under sections 30 and 31 of the GmbHG when they receive payments when the company’s legal capital is not intact. A transfer of assets outside a formalized distribution process such as distribution of dividends, capital reduction or share buybacks is subject to an arm’s length test. If a diligent director would not have agreed to the conditions granted to the shareholder in a transaction with an unaffiliated third party, then the transaction with the shareholder is deemed a “hidden allotment of corporate assets” (verdeckte Vermögenszuwendungen) and constitutes a breach of the duty of good faith generally owed by shareholders to the company under German law. Such a

\(^\text{237}\). Called Objektiver Rechtsmissbrauch, see Hueck & Windischler, supra note 176, at §24 Rdn 30.

\(^\text{238}\). Handelsgesetzbuch [HGB] [Commercial Code], § 128. The courts apply this section of the commercial code ‘by analogy’ when they pierce the corporate veil, see BGH Nov. 14, 2005; 2006 NZG 350 ¶ 10.


\(^\text{240}\). Fastrich, supra note 224, § 13 Rdn 45.
breach can result in claims by the company for restitution and damages.\textsuperscript{241} In addition, the shareholders may also be liable for “annihilating interference” under section 826 of the BGB as discussed earlier.

It is not the element of intent that distinguishes commingling from these other situations that give rise to claims against shareholders because sections 30 and 31 of the GmbHG and “hidden allotment of corporate assets” do not require the company or creditors to experience any intentionally committed harm. For the remedy of restitution that results in the return of assets to the company, no subjective mental element is necessary. Only when the company additionally claims damages do these subjective elements such as knowledge play a role. Instead, commingling is an exceptional situation where the financial situation of the company is so muddled that applying the principles of depletion of assets and the consequential claims for their return to the company is of no use. The drastic situation that corporate assets are indistinguishable from shareholders’ personal assets justifies the harsh consequence that the shareholders responsible for commingling are personally and directly liable to the company’s creditors.

These principles of commingling have not been rendered obsolete by the (slightly later) decisions on personal liability to the company resulting from “annihilating interference.” The BGH emphasized in its judgment of November 14, 2005 that the newly-contoured cases on liability for “annihilating interference” leave the principles of veil-piercing under the commingling exception intact,\textsuperscript{242} although this statement was made at a time when the BGH still recognized that a shareholder’s direct liability could result from such “annihilating interference.” Such direct liability has since been ruled out. Regardless of this immense swing in doctrinal analysis, the BGH clarified in \textit{Trihotel} that the principles applied in situations of commingling remain applicable.\textsuperscript{243}

A different type of commingling must be distinguished from the one just discussed. Under the term \textit{Sphärenvermischung}, academic commentators have discussed whether a shareholder should be held personally liable when he commingles his own affairs with those of the company, i.e., commingles the two separate spheres. Such an issue occurs when the shareholder conceals from third parties that the company and himself are different legal persons, e.g., by using similar names, the same premises and employees. In an old case, where the sole shareholder-director of a GmbH negotiated with creditors and did so as a director of the company in some instances and as a private person in others, the BGH

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\footnotetext[241]{\textsc{Christian Hofmann, Der Minderheitsschutz im Gesellschaftsrecht} 315–17 (2011) (on the principles of “hidden allotment of corporate assets”); \textit{id.} at 25–67 (providing a comparative analysis of the principle of good faith in German company law and the role of fiduciary duty in US company law). On good faith in German company law, see also BGH II ZR 205/94, Mar. 20, 1995 \textit{(Girmes)}, 1995 NJW 1739.}
\footnotetext[242]{BGH Nov. 14, 2005, 2006 NZG 350 ¶ 14.}
\footnotetext[243]{BGH \textit{Trihotel}, 2007 NJW 2689 ¶ 27.}
\end{footnotes}
held this shareholder personally liable and applied the principle of good faith in section 242 of the BGB. The court reasoned that the shareholder had acted as one and the same person in all instances, which justified not distinguishing between his position as a legal representative of the company and an independent sole proprietor, so as to hold him personally liable for all obligations under the legal relationship with the third party. 244

The case has remained an outlier, and the BGH abstained from using any terminology that is commonly related to veil piercing. Instead, it relied on the principle of good faith, which supports the argument that it was not a case of veil-piercing. The BGH disapproved in more general terms of the shareholder’s conduct and relied on the general principle of good faith to reach a result that seemed fair in the circumstances. 245 These findings blend in with some of the earlier suggestions made in the discussion of the US position. At common law, it may on occasion be more fruitful to rely on concepts such as estoppel or misrepresentation rather than veil piercing.

Further scenarios that may be regarded as veil-piercing in other jurisdictions

The above discussion reflects the cases decided by German courts. As demonstrated, veil-piercing in Germany only applies in one scenario, the commingling of assets, while the courts analyzed a number of other situations on the basis of tort law, the principles of good faith, or by relying on provisions in the GmbHG. However, what about all other scenarios well-known from case law in the common law jurisdictions? American, English and Singaporean case law covers a wider range of situations, and the question arises of how German law would deal with them.

The answer reads: all other instances in which third parties have rights against shareholders are not considered exceptions to the principle of limited liability. Instead, the principles of the law of obligations as well as teleological interpretations of statutory provisions and widely-understood contractual terms apply and protect third party interests. In all these instances, the shareholder is held liable for what he did or promised to the third party, but not because of his role in the company. The role of the company in such scenarios is that of a silent bystander.

The following provides a few illustrative examples. If a company is used as a scheme to trick third parties into contracting because they would never contract


245. Commentators that are generally supportive of veil-piercing categorize this case as one of commingling of spheres, see Lutter & Bayer, supra note 201, at ¶ 24, while others who are less supportive of this doctrine do not include it in the list of decisions dealing with veil-piercing, see Fastrich, supra note 224, § 13 Rdn 46.
with the shareholders of the company, e.g., because they are convicted bankrupts or fraudsters, German law applies general principles of private law to free the third parties from any obligations they entered into. It may also grant them damages against the shareholders, not because the corporate veil was pierced, but because of a wrong they directly committed to such third parties.

The fact that the shareholders incorporated and used the company as part of their fraudulent scheme represents the very wrong for which they are held liable. Section 123 BGB\textsuperscript{246} entitles third parties to avoid the contract, rendering it void \textit{ab initio}. The other party to the contract is the company and not the shareholder, but in cases when the shareholder commits deceit, the company must accept that the deceived party can avoid its declaration of consent to the contractual agreement if the company knew or should have known of the deceit. Since in such scenarios the fraudster shareholders are inevitably also the directors of the company, their knowledge is attributed to the company based on section 166 BGB. The knowledge of the directors is the knowledge of the company, and their mistakes are the mistakes of the company.\textsuperscript{247} In addition, the shareholders are liable to the deceived parties under tortious principles, particularly in the application of sections 826 and 823(2) BGB read with section 263 StGB, the provision of the Criminal Code that sanctions fraud. In addition, a shareholder may be liable if he breaches duties of care and diligence in his role as the legal representative of the company and as part of a fraudulent scheme. Such liability requires that the shareholder enjoys a high degree of trust from the deceived party and substantially influences the pre-contractual negotiations between that party and the company.\textsuperscript{248} Under these preconditions, a so-called “legal relationship without primary obligations” exists between the shareholder and the third party and may lead to the shareholder’s liability for breaches of the duties of care and diligence under sections 311(2), 241(2), 280(1) BGB.\textsuperscript{249}

A second example involves a shareholder who is bound by a non-competition clause with his former employer that states that the employee is prevented from

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\textsuperscript{246} BGB, § 123 reads:
(1) A person who has been induced to make a declaration of intent by deceit or unlawfully by duress may avoid his declaration.
(2) If a third party committed this deceit, a declaration that had to be made to another may be avoided only if the latter knew of the deceit or ought to have known it. If a person other than the person to whom the declaration was to be made acquired a right as a direct result of the declaration, the declaration made to him may be avoided if he knew or ought to have known of the deceit.
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\textsuperscript{247} On these generally accepted principles of attribution, see Wolfgang Zöllner & Ulrich Noack, GMHG § 35 Rdn 146 (Adolf Baumbach & Alfred Hueck eds. 20th ed. 2013); HUECK & WINDBICHLER, supra note 176, § 9 Rdn 3.
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\textsuperscript{248} These are requirements under the BGB: BGB, § 311 para. 3.
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\textsuperscript{249} Such legal relationships are very common in German law and have no direct equivalent in French or common law. In the context of this article, they result from the situation where a third party involved in contractual negotiations dominates the negotiations or enjoys a high level of trust by the parties, a situation typical of agents and organs of a company.
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running a business in the same district where the employer is based. In order to avoid liability under the clause, he incorporates a company which becomes the owner of a business that competes with the shareholder’s former employer. German courts or scholars would never consider this a case of veil-piercing. If a party to a contract is held to a valid non-competition clause, this party is prevented from engaging in any activity that falls under the respective clause. Sections 133 and 157 BGB require contracts to be interpreted as required by good faith, taking customary practice into consideration, and to ascertain the true intention rather than adhering to the literal meaning of the declaration. The courts have always applied an objective test that interprets declarations of parties to a contract in the way that a prudent third person would have understood it.

These principles of interpretation would lead to the understanding of the non-competition clause in a broad way. The prudent third party would have understood that the former employer can operate free from any disadvantage that might result from the former employee using his professional knowledge and experience in the employer’s district, be it by running his own business, i.e., as a sole proprietor, or by forming any type of business entity that engages in such a business and which the former employee supports with his expertise. The scenario of a company whose director-shareholder the former employee becomes would clearly be covered by the non-competition clause, and since the employee himself is found in breach of his contractual agreement with the former employer, the employer could successfully seek a prohibitory injunction under sections 823(1) and 1004(1) BGB. The same would apply if the former employee only had a contract of employment with another company that placed him in a position of some materiality, such as being a director or having some other management position. On the other hand, there would be no breach if the shareholder was merely a passive investor in a business, even if that business was in competition with his former employer.

These two examples show that the principles of veil-piercing are not needed in Germany to deal with scenarios in which a shareholder tries to hide behind the principle of limited liability and which are commonly discussed as veil-piercing cases in other jurisdictions. It has been shown that the courts disregard the principle of limited liability and allow creditors of the company to pursue claims directly against shareholders in one narrow situation only: when shareholders commingle the company’s assets with their own. The climate in Germany is increasingly becoming hostile against any attempts to pierce the corporate veil.

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250. As in Gilford [1933] Ch 935 where the corporate veil was pierced.
251. Such clauses are sometimes considered invalid as contrary to public policy when they disproportionately limit a person’s occupational freedom as guaranteed by the constitution: BGB, § 138 paras. 1–2; GRUNDEGEBETZ [GG] [BASIC LAW], art. 12 para. 1, translation at https://www.gesetze-im-internet.de/englisch_gg/englisch_gg.html#p0071.
252. Sections 133 and 157 BGB as generally interpreted by the courts, see e.g., BGH X ZR 37/12, Oct. 16, 2012, 2013 NJW 598 (599 at ¶ 17).
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Many commentators argue that the concept should be abandoned altogether, and the BGH’s change of heart in the “annihilating interference” cases shows that it might well be moving in that direction.

As explained, German company law relies heavily on principles of initial capitalization and strict capital maintenance rules. It follows that the question whether the principle of limited liability should be disregarded in instances where shareholders adhere to capital maintenance rules but seek to take advantage of the corporate veil in other ways should be answered in the negative. Not corporate law, but general principles of the law as found in tort law and the law of obligations stand ready to deal with these situations. Consequently, it is submitted here that even in the situation involving commingled assets the Court could apply principles of tort law and hold the shareholders liable if they overstep the line drawn by section 826 BGB. It is not evident why the law should look less favorably at a shareholder who may be disorganized or unsophisticated and has therefore indistinguishably commingled his and the company’s assets than another who systematically strips the company of its assets.

People’s Republic of China

As mentioned earlier, China (unusually) has a specific legislative provision that provides an exception to separate personality and limited liability. Article 20 of the 2005 Company Law, after restating the general principle that the shareholders of a company should not abuse shareholders’ rights, the company’s legal person status, or shareholders’ limited liability, provides in the third paragraph:

“Any of the shareholders of a company who abuses the independent legal person status of the company and the limited liability of the shareholders to evade the payment of the company’s debts, thus seriously damaging the interests of the company’s creditors, shall bear joint liabilities for the debts of the company.”

Article 20 establishes a four-pronged legal test, or a standard comprising four elements, for judicial application of the doctrine. First, it must be proven that

253. See e.g., Fastrich, supra note 224, § 13 Rdn 44.
254. Lord Neuberger of the UK Supreme Court was sympathetic to such a view, see Prest [2013] 3 WLR 1 [79].
255. There was a revision to the legislation in 2013. All references to China’s Company Law are to the 2013 revised legislation unless otherwise stated.
257. The standard has been articulated in different ways by judges of China’s Supreme People’s Court in their scholarly writing. See Judges XI XIAOMING (奚晓明) and JIN JIANFENG (金剑锋), GONGSI SUSONG DE LILUN YU SHIWU WENTI YANJIU (公司诉讼的理论与实务问题研究) [Beijing: People’s Court Press, 2008], pp. 562-564; Judge JIANG BIXIN (江必新) et al., ZUIGAO RENMIN FAYUAN ZHIDAOXING ANLI CAIPAN GUIZE LIHE YU SHIYONG (GONGSI JUAN) (最高人民法院指导性案例裁判规则理解与适用 (公司卷)) [THE UNDERSTANDING AND APPLICATION OF JUDGING RULES IN 186
the shareholder concerned has abused the company’s legal person status and the shareholder’s limited liability. The abuse of the company’s legal personality and that of shareholder limited liability are not separate acts, but rather understood as two sides of the same coin.\textsuperscript{258}

Second, the purpose of the aforesaid abuse must be to “evade” the payment of debts to the company’s creditors. This has been interpreted by some judges of China’s Supreme People’s Court (“SPC”) as the use of corporate personality to “avoid” contractual or legal obligations.\textsuperscript{259} Another SPC judge, Yu Zhengping, maintained that the wording of Article 20 “undoubtedly requires the existence of a subjective intent” to evade debts.\textsuperscript{260}

Third, the interests of the creditors must be damaged “seriously” (yanzhong). Needless to say, Company Law does not define “seriously,” and courts will interpret its meaning on a case by case basis. Zhou suggests that the court should consider three factors when determining whether the damage is serious enough to activate veil piercing: (1) the actual damage to the creditors; (2) the debt-paying ability of the company; and (3) the subjective intent of the shareholder concerned.\textsuperscript{261}

Fourth, there must be a causal link between the shareholder’s abusive behavior and the damage/losses suffered by the creditors.\textsuperscript{262}

Since 2006, when the new Company Law took effect, Chinese courts have decided hundreds of veil piercing cases, and researchers within and outside China are producing a growing body of academic literature.\textsuperscript{263} Thus far, the


262. See Xi and Jin, supra note 257, at 564; Jiang, supra note 257, at 87.

literature, including both empirical studies and doctrinal analyses, seems to overwhelmingly suggest that Chinese courts have been enthusiastic in piercing the corporate veil, or, at least, “Chinese judges are clearly much more willing to pierce a company veil and shift liability to its owners on the basis of statutory authority than their common law counterparts relying on judicial doctrines.”\(^{264}\)

The literature also suggests that Chinese courts practiced “judicial activism” in veil piercing cases.\(^{265}\)

*The evolution of the veil piercing doctrine in China*

To fully understand veil piercing in Chinese law, it is necessary to appreciate the position prior to the 2005 Company Law, as veil piercing was not officially recognized in Chinese law prior to this. There was, however, a loosely crafted legal framework to allow veil piercing under limited circumstances. This ambiguous and confusing framework was established through “judicial practice,” or *sifa shijian*, which refers to the practice of the judiciary to develop jurisprudence and legal doctrines, mainly through the SPC’s issuance of judicial interpretations and selected case reports, as well as the legal enactments of the State Council, China’s Central Government.\(^{266}\) It has been stated: “[a]lthough the 1993 Company Law did not include veil-piercing doctrine, the Chinese judiciary cautiously applied it even without a clear statutory basis before its codification in 2005.”\(^{267}\)

The introduction of the veil piercing doctrine started with a regulation issued by the State Council on 12 December 1990, titled Guanyu Qingli Zhengdun Gongsi zhong Bei Chebing Gongsi Zhaiquan Zhaiwu Qingli Wenti de Tongzhi ([Circular on Questions relating to the Claims and Debts of Companies Dissolved or Merged with Others in the Campaign for Sorting Out and Consolidating Companies] [关于清理整顿公司中被撤并公司债权债务清理问题的通知]). Some people believe that the 1990 Circular is the first law to offer an exception to the doctrine of limited liability, which was well established in China through various regulations but not codified yet into a national company law. It provided that investors or incorporators of the company should directly assume the debts of the company but that such liability was limited to the extent that the

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investors/incorporators benefited from the company’s operations or misappropriated the company’s assets.\textsuperscript{268}

The first judicial interpretation on veil piercing by the SPC is believed to have taken place in 1994 in a reply to a question submitted by the Higher People’s Court of Guangdong Province (Zuigao Renmin Fayuan Guanyu Qiye Kaiban de Qiye bei Chexiao huo Xieye hou Minshi Zeren Chengdan Wenti de Pifu (最高人民法院关于企业开办的企业被撤销或歇业后民事责任承担问题的批复) [Reply of the Supreme People’s Court on the Civil Liability of Enterprises Whose Subsidiaries were Revoked or Shut Down]). This judicial interpretation made an effort to strengthen the traditional mandate of limited liability, as it first required the investing enterprise to undertake civil liability to the extent of the unpaid capital contributions in the subsidiary’s registered capital, and “if no capital was actually contributed to the terminated company, or the amount was not sufficient according to the law, then the company will be determined not to be a legal person and its full civil liability will be assumed by the enterprise that established the company.”\textsuperscript{269}

The SPC issued two judicial interpretations in 2001 and 2003 to further develop the piercing doctrine. The 2001 judicial interpretation, captioned Guanyu Shenli Jundui, Wujing Budui, Zhengfa Jiguan Yijiao, Chexiao Qiye he yu Dangzheng Jiguan Tuogou Qiye Xiangguan Jiufen Anjian Ruogan Wenti de Guiding (关于审理军队、武警部队、政法机关移交、撤销企业和与党政机关脱钩企业的相关纠纷案件若干问题的规定) [Provisions of the Supreme People’s Court on Several Issues on the Trial of Cases concerning Enterprises transferred by the Army, Armed Police Force and Judicial Bodies, Enterprises Whose Licenses have been Revoked, and Enterprises Which Have beenDisconnected from Party and Government Agencies], mainly addressed legal issues relating to business enterprises owned by the army, armed police force, and judicial bodies, and provided that a shareholder/investor was no longer liable if it made its legal or contractual obligations with respect to capital contributions. It is important to note that this interpretation was aimed to clarify a confusion caused by the 1994 Reply which had encouraged many lower courts to impose unlimited liability improperly on shareholders.\textsuperscript{270}


\textsuperscript{269} David M. Albert, Addressing Abuse of the Corporate Entity in the People’s Republic of China: New Thoughts on China’s Need for a Defined Veil Piercing Doctrine, 23 U. PA. J. INT’L ECON. L. 873, 883 (2002). A historical analogy may be drawn with the pre-incorporation joint stock companies that were not legal entities but partnerships and therefore the “shareholders” were ultimately liable for any shortfall in the assets of the joint stock company. Given that Chinese law did recognize the doctrine of limited liability, this is a somewhat strange judicial interpretation.

\textsuperscript{270} See Jin, supra note 268, at 123 (noting that, after the 1994 Reply, some courts asked the investing shareholders to repeated “making up for the differences” in their capital contribution because of the lack of a definition about capital in the 1994 Reply).
The 2003 judicial interpretation, titled Guanyu Shenli yu Qiye Gaizhi Xiangguan de Minshi Jiufen Anjian Ruogan Wenti de Guiding (关于审理与企业改制相关的民事纠纷案件若干问题的规定) [Provisions of the Supreme People’s Court on Several Issues concerning the Trial of Cases of Civil Disputes Related to Enterprise Restructuring], offered a relatively more precise legal test for veil piercing in the context of a merger and acquisition transaction. Article 35 provided that the holding or parent enterprise shall be responsible for the debts of the subsidiary where the subsidiary’s inability to pay off its debts was caused by the holding enterprise’s own acts to withdraw capital from the subsidiary to evade its debts, if the holding enterprise achieved its controlling stake through a merger and acquisition.271

The veil piercing rule eventually codified into the 2005 Company Law was certainly built upon the aforesaid judicial interpretations, but it differs from the SPC’s interpretations in at least two ways. First, the consequence for the court’s application of the veil piercing rule merely means that the effects of corporate personality are not applicable to the extent determined judicially. The shareholders concerned will be held liable for the debts in the case in question, but the company will still be a going concern and keep its legal personality with limited liability. In contrast, the judicial interpretations issued before 2005 aimed to hold the shareholders and investors liable in the course of a company’s liquidation, which would lead to the company’s termination. The rationale was that the business license was issued by the national or local Administration for Industry and Commerce and hence an administrative act. While the court would normally respect such acts, the court is not bound by it if it discovers that the conditions provided for in the national laws or administrative regulations were not met. In comparison, under Article 20 of the Company Law the court orders veil piercing as an isolated case to ask the shareholder to bear joint and several liability for the debts owned by the company to the creditor(s) who brought the veil piercing lawsuit. It requests the responsible shareholders to pay for company debts but will not terminate the company by any means.

Second, prior to the Company Law, the extent of the liability of the shareholders or investors was confined to their unpaid capital contributions to, or undeserved benefits received from, the company; in other words, liability was confined to what was due to the company or benefits improperly obtained from the company. For example, an investor or shareholder would be responsible for the debts of the company to the extent it received money or other assets, without proper consideration, from the company. Likewise, it was responsible to the extent of the money and assets it had illegally withdrawn from or transferred out of the company or hidden from outsiders.272 Such liability to make compensation

271. Wang, supra note 66, at 80.
was fault-based. However, in the case of veil piercing under the Company Law, fault is not necessarily an element for applying Article 20.\textsuperscript{273}

The broader historical background of the above-mentioned judicial interpretations is also of notable importance. As clearly suggested by the stated purpose and explicit language in those judicial rules, the rudimentary veil piercing framework then was largely developed to address the abuse of power by shareholders or investors, especially state investors, in the subsidiaries established by them.\textsuperscript{274} The intention of the SPC was to strike a balance between the rights of shareholders and creditors. As noted, the application of the judicial interpretations would lead to the termination of the subsidiary enterprises concerned. In this process, they would hold accountable not only the shareholders or investors, but also government agencies which approved the establishment of the enterprises.\textsuperscript{275} This is further indication that the main targets of the judicial interpretations were abusive state-owned enterprises. On the other hand, the veil piercing doctrine seems thus far to have been rarely invoked against state owned enterprises since it was adopted in the 2005 Company Law.

\textit{Grounds for veil piercing in judicial practice}

While Article 20 of the Company Law sets out a general principle, scholarly writing has suggested the following circumstances that are capable of giving rise to sufficient abuse to warrant veil piercing.\textsuperscript{276}

The first is undercapitalization, where either the shareholder did not make adequate contributions to the company’s registered capital or that such capital, including corporate cash and assets, was improperly withdrawn from the company by the shareholder. The second is where the company has been used as a device to evade contractual obligations. This occurs when the shareholder, who has to refrain from doing something under a non-competition agreement or

\textsuperscript{273} Fault or even negligence is especially not considered in veil piercing cases concerning comingling of assets of corporate affairs. See Jiang Bixin et al., \textit{supra} note 257. In a veil piercing case adopted by the PRC Supreme Court as a Guiding Case with binding force on lower courts, it was ruled by the Jiangsu High People’s Court veil piercing should be ordered simply because the three defendants had comingled personalities in terms of “comingled personnel”, “comingled business” and “comingled finances”. See Xugong Jituan Gongcheng Jixie Gufen Youxian Gongsi Su Chengdu Chuanjiao Gongmao Youxian Zeren Gongsi Deng Maimai Hetong Jiufen An (徐工集团工程机械股份有限公司诉成都川交工贸有限责任公司等买卖合同纠纷案) [XCMG Construction Machinery Co., Ltd. v. Chengdu Chuanjiao Industry and Trade Co., Ltd. et al., A Sale and Purchase Contract Dispute], (2011), adopted as the Supreme People’s Court Guiding Case No. 15 on 31 January 2013, available at http://www.court.gov.cn/fabu-xiangqing-13321.html. English information about this case is available at Stanford Law School’s China Guiding Case Project at https://cgc.law.stanford.edu/guiding-cases/guiding-case-15/.

\textsuperscript{274} See generally Wen, \textit{supra} note 263.

\textsuperscript{275} Jin, \textit{supra} note 268, at 124.

\textsuperscript{276} Wang, \textit{supra} note 66, at 81–82; See also Liu, \textit{supra} note 258, at 668–71; Xi and Jin, \textit{supra} note 257, at 560–62.
confidentiality agreement, incorporates a company to evade his obligations. Another example is when a shareholder uses the company to defraud creditors. A third situation arises in circumstances where the company is a device to evade statutory restrictions and involves illegal activities such as tax evasion or money laundering. Finally, it has been suggested that veil piercing can take place where there has been a lack of formality or confusion of affairs. In such cases, the shareholder himself disregards the separate legal personality of the company and makes the company an alter ego of the shareholder. This could include the control of the company so that the decision-making of the company is entirely dominated by the shareholder, or there is confusion or intermingling of the assets, business, affairs, and even management personnel of the company and the shareholder. It is clear that these instances where veil piercing may take place have parallels in other jurisdictions discussed previously.

Although it would appear that there are many instances of veil piercing in China, the exceptional nature of the doctrine has also been articulated. For example, two former prominent judges of the SPC have noted:

The fact that the doctrine of piercing corporate veil only serves to complement [the principle of separate legal personality of the company law] determines that the application of the doctrine must be exceptional... Our country’s Company Law has to establish the system of corporate veil piercing because of practical needs. However, it must be emphasized that the courts must be firmly cautious when applying this system and always be mindful of any abuse of it. Cautious application of the doctrine means, whenever a problem can be solved by the normal rules in the civil law, the piercing corporate veil rule must be avoided so as to protect the principles of independent legal personality and limited liability of modern corporate law. The application of the veil piercing doctrine must be the last resort, not a regular tool for the court.

This cautionary statement should be contrasted with the sometimes made assumption that undercapitalization is the most important ground for piercing in China. Xi and Jin, on the other hand, express that undercapitalization should not be the only reason to pierce the corporate veil, stating that “only in the case where the company’s capital was extremely inadequate should the court disregard corporate personality on the ground of undercapitalization.”

One empirical study has found that undercapitalization was the least important reason for veil piercing. Huang examined court decisions in a five-year period from 2006 to 2010 and found ninety-nine cases on veil piercing. Chinese courts ordered piercing in sixty-three cases, leading to a high frequency of 63.64%. It was further found, of the 118 requested grounds for veil piercing, seventy-four

277. This seems similar to the cases in England on evasion, see Gilford [1933] Ch 935.
278. See Xi & Jin, supra note 257, at 559. Again there are parallels with judicial statements elsewhere.
279. For example, see Liu, supra note 258, at 667–670.
280. Xi & Jin, supra note 257, at 560.
281. Huang, supra note 256, at 748–49.
involved commingling or confusion of assets, business or personnel; thirty-two concerned fraud or other improper conduct; eleven were about undue control; while only one case was based on undercapitalization. Even in that single case, the court rejected the request and refused to lift the veil on the ground of undercapitalization.\(^{282}\)

The case of *China Orient Asset Management Co Ltd v. The Xi’an High-Tech Area Branch of China Construction Bank*\(^{283}\) may illuminate the approach towards the ground of undercapitalization. In this case, China Construction Bank made a loan to a company named Jinling Co. Jinling, however, failed to repay the China Construction Bank. The debt was eventually transferred by the bank to the plaintiff, China Orient Asset Management Co Ltd. (COAMC). COAMC brought a lawsuit against several shareholders of Jinling, asking them to be jointly liable for the debt, because four of the shareholders made false capital contributions and one shareholder withdrew RMB2 million from Jinling. At first instance, the Xi’an Intermediate People’s Court upheld the plaintiff’s allegation. It said:\(^{284}\)

> According to paragraph 3 of Article 20 of the Company Law of the People’s Republic of China, shareholders of a company who have abused the company’s independent legal person status and shareholders’ limited liability, evade the payment of the company’s debt so as to harm the interests of the company’s creditors, should be jointly liable for the company’s debt. On this basis, the request of COAMC to ask the shareholders to be jointly liable to the extent of their false capital contributions should be upheld.

However, the appellate court – in this case the Shan’xi Higher People’s Court, disagreed with such legal reasoning. The appellate court ruled that the application of the veil piercing doctrine was wrong. On this point, the Higher Court opined:\(^{285}\)

> Undercapitalization as a ground for piercing the corporate veil does not mean that a court can simply make such determination by comparing the company’s existing capital to the minimum registered legal capital prescribed in the Company Law. Instead, it means the company’s actual capital is excessively lower than the risks that are generated by the business nature of the company. Thus, in this case, the court cannot apply the piercing corporate veil rule simply on the grounds that the shareholders had made false capital contribution or withdrawn capital from the company.

In the end, the appellate court still ordered the shareholders to compensate the plaintiff for the same amounts, but it was fashioned on a different legal basis,

\(^{282}\) *Id.* at 760–61.


\(^{284}\) *Id.*

\(^{285}\) *Id.*
namely that the shareholders were held to have the liability of *buchong peichang*, or complementary liability.\textsuperscript{286}

The difference between the Chinese and German positions is notable. At one time, both countries adopted a similar approach.\textsuperscript{287} However, as discussed above, Germany now no longer considers undercapitalization that does not involve a breach of the capital maintenance requirements as capable of leading to shareholder liability to third party creditors. The BGH considers such an approach to be inconsistent with limited liability. Interestingly, both the aforementioned first instance and appellate courts in China ordered the shareholders to compensate COAMC to the extent of the false capital contributions and wrongful withdrawal of capital. It is suggested respectfully that care should be exercised in fashioning such a remedy, as the court must be reasonably satisfied that there are no other creditors of the company which appeared to be effectively insolvent. Payment by the shareholders of the capital they should have injected or not withdrawn ought to be a complete discharge of their obligations which would leave other creditors of the company without a remedy. This seems particularly unfair if the capital should have belonged to the company in the first place and therefore distributed to creditors on a *pari passu* basis. The application of a ‘proper plaintiff’ rule in this context seems apposite.

Based on the opinion of the Shan’xi High People’s Court, veil piercing based on undercapitalization in China need not be limited to the statutory minimum required by law. Where payment is ordered to be made directly to some creditors where there are other possible creditors, the risk is that, from a practical standpoint, the latter may not be able to recover meaningfully if the shareholders’ assets are depleted from earlier judgments. It places well-resourced and better-informed creditors in a superior position. This note of caution applies not only to China. Where undercapitalization gives rise to a remedy and has also led to insolvency, it may be more optimal to explore means to facilitate a corporate claim—the success of which will benefit the creditors collectively—rather than to allow veil piercing actions by individual creditors.

Leaving aside undercapitalization, the other three grounds of commingling, undue control, and fraud or other improper conduct, mentioned by Huang as grounds for veil piercing, are matters that would support veil piercing in some other jurisdictions as well. It would appear, nevertheless, that a success rate of 63.64% of veil piercing cases over a five-year study period seems significantly

\textsuperscript{286}. Wen, *supra* note 263, at 344 states that under Article 23(2) of the Company Law, a required precondition of incorporation is having capital contributions of shareholders reach the statutory minimum amount of capital. If shareholder’s capital contributions fail to meet the minimum legal threshold, the company will never be duly incorporated and thus will not have separate personality in the first place. Such cases should not be regarded as veil piercing cases but some courts have mistakenly relied on Article 20.

\textsuperscript{287}. Alting, *supra* note 79, at 210.
higher than that found in major common law jurisdictions. Another survey of published cases from 2006 to the end of 2012 found that the court lifted the veil in 75.27% of cases. Yet Huang rightly states that caution should be exercised in drawing conclusions, as the numbers may be affected by several contextual factors such as the stage of economic development and the number of firms in each jurisdiction. Some indication of the former may be seen by the fact that a substantial percentage of piercing cases were brought in economically less developed regions of China, and cases from such regions were more likely to have high rates of veil piercing. Abuse of the corporate form is possibly more prevalent in economically less developed regions due to lesser knowledge of corporate law and thus a higher level of corporate irregularities. If Huang’s finding is true, it also raises the question of whether judges in such regions have the same appreciation of corporate law as their brethren in more economically sophisticated regions do.

One reason for the higher rate of piercing in China may be that judges in some cases have been overly enthusiastic in their approach towards veil piercing. This can be seen by analyzing some of the commingling cases which constitute the largest number of cases brought and where veil piercing occurred. Commingling has certain aspects and is distinguished from misappropriation. Where shareholders (or the corporate parent) do not properly distinguish between corporate assets and their assets, it raises the issue of whether the shareholders treated the corporation as a mere extension of themselves. By not recognizing the integrity of the corporate entity as a matter of fact, the court may infer that the real parties to the apparent corporate transactions were the shareholders and not the corporation itself. Using the language of Lord Sumption in Prest v. Petrodel, the shareholders were merely concealing their true involvement. Another aspect of commingling is that the financial affairs of the company and that of another person, usually a shareholder, are such a “mess” that it is impossible to distinguish which person is the owner of the assets in question. Whatever the approach, the essence of commingling is that no distinction is made or can be made between the assets of the company and that of its shareholders. They are therefore to be treated as one and the same for this purpose. If this is the correct conclusion, no part of the commingled assets should be regarded as

288. Huang, supra note 256, at 748. However, the system of law reporting in China is by no means as comprehensive as that found in major common law jurisdictions and therefore there is a danger of reading too much into this statistic.
290. Huang, supra note 256, at 748.
291. Id. at 751.
292. Contra Hawes et al, supra note 263, at 351–52 which found no significant distinction between economically developed and less-developed regions, or between lower-level and higher-level courts.
293. Huang, supra note 256, at 760.
294. Prest [2013] 3 WLR 1 [28].
having ever properly been owned by the company, given that the company’s involvement is merely illusory, or it is impossible to make any distinction between corporate and personal assets. In some instances, the court may even conclude that the company simply held the assets on trust for the shareholders. There is a subtle but real difference between commingling and the misappropriation of corporate assets by the company’s shareholders. In the latter, the shareholders recognize that the assets belong to a separate entity but improperly/dishonestly withdraw such assets. The corporation may therefore maintain a claim for the recovery of its assets. Misappropriation is a form of theft that can also give rise to criminal prosecution and, in this context, requires a particular mental state involving some element of dishonesty.

In *Wuhan Vegetables Co. v. Wuan Jiutian Trade Development Co.*, the plaintiff transferred its equity interest in Baishazhou LLC to Tianjiu Co. Tianjiu never fully paid the plaintiff for this transfer. Tianjiu later transferred part of this equity interest to Mrs. Wang Xiuqun, making her a shareholder with a 70% interest in Baishazhou. Two subsequent transfers then occurred. First, Mrs. Wang transferred her equity interest in Baishazhou to China Velocity Group Limited, and subsequently she transferred her equity interest of 96% in Tianjiu to two individuals, Huang Yi and Tao Xin. The court allowed the corporate veil to be pierced against Mrs. Wang. In the court’s view, the aforementioned acts of Mrs. Wang, the majority shareholder who had absolute control of Tianjiu, coupled with the fact that she did not have evidence to prove that consideration was duly paid to the plaintiff for the transfer of its equity interest, indicated that Mrs. Wang had successfully “escaped” from Tianjiu by transferring her equity ownership in Tianjiu to others. The court concluded that she had negatively affected the realization of the debt claims of the plaintiff as a creditor of Tianjiu. Accordingly, Mrs Wang was jointly liable for Tianjiu’s debts under Article 20(3) of the Company Law. One way of analyzing this case is that it is an example of a shareholder abusing the corporate form to defraud creditors. Another explanation is that the defendant, Mrs Wang, had misappropriated the assets the company had purchased from the plaintiff. This single act of misappropriation was held to constitute evidence of commingling of assets, thus justifying veil piercing. If this is the correct explanation of the case, in addition to the point

296. *See e.g., Asteroid Maritime Co Ltd v The owners of the ship or vessel “Saudi al Jabail”* [1987] SGHC 71; *Gencor ACP v Dalyby* [2000] All ER (D) 1067.
297. *See e.g.,* section 403 of the Singapore Penal Code (Cap. 224) and section 1 of the UK Theft Act 1968.
made earlier regarding the distinction between commingling and misappropriation, it is difficult to see how a single act such as this could have amounted to commingling. Commingling usually requires a pattern of activity that demonstrates unequivocally that the separate personality of the corporation was not respected.

Another decision where the same criticism can be made is *Yueyang Shenyu Grease Trading Ltd. v Lin and Others*, a decision of the Yueyang Municipality Intermediate Court. In this case, the defendant company had two shareholders, Mr. Liu and Mr. Hu. The company hired Mr. Xu as the CEO and Mr. Peng as the finance manager. It was orally agreed that Messrs Liu, Xu and Peng would be the shareholders of the company holding 40%, 40% and 20% respectively. Notwithstanding this agreement, Mr. Liu and Mr. Hu remained the only shareholders on record, although Messrs. Liu, Xu and Peng were regarded within the company as the actual shareholders and controllers. The plaintiff made a number of payments to the company for purchases of cotton. The finance manager deposited these payments into his personal bank account to minimize the company’s income for tax purposes. When the cotton that the plaintiff ordered was not delivered, the plaintiff brought a claim against the company and joined its shareholders as defendants, as the company did not have sufficient assets.

At first instance, the court ruled that the three shareholders who were regarded as actual shareholders, namely Messrs Liu, Xu and Peng, had abused the company’s independent legal personality by commingling personal assets with corporate property. They were therefore held jointly liable for the company’s debts. Mr. Hu, on the other hand, was not liable. The appellate court revised the first instance decision. It ruled that Mr. Liu, as the company’s legal representative and a registered shareholder, had indeed abused the company’s separate personality and harmed the interests of creditors. The corporate veil was therefore correctly lifted in relation to him. As Mr. Hu was also a shareholder, he too was liable for the company’s debts. The finance manager, on the other hand, was not a shareholder and therefore veil piercing was inapplicable. The court did not consider Mr. Xu’s case as he had accepted the first instance decision.

If the purpose for placing the monies in the finance manager’s bank account was tax evasion, the characterization of the case as one involving commingling may not be correct. Rather, it is a case of shareholders recognizing that they were removing corporate assets with a view to under-declaring the company’s income. The proper remedy would appear to lie with the company for the recovery of its

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assets against the finance manager and possibly other persons engaged in the scheme as co-conspirators or joint tortfeasors. The finding of liability against Mr. Hu seems particularly harsh given that he was not an active shareholder, presumably because it was intended that at some point there would be a transfer of his shares. It is difficult to see how in this context he could be regarded as a shareholder who had abused the independent legal status of the company. It would seem over-inclusive and contrary to the public policy underlying incorporation to impose liability on shareholders who are merely passive investors and therefore not involved in any abusive conduct.

The position regarding commingling in the Chinese context is also unusual in the context of one-person companies. The burden of proof in the case of such companies is that the shareholder must establish that the property of the company is independent of his own. If he cannot do so, he becomes personally liable for the debts of the company. This is set out in Article 64 of the Company Law:

Where the shareholder of a one-person company with limited liability cannot prove that the property of the company is independent of his own property, he shall assume the joint and several liability for the debts of the company. This is set out in Article 64 of the Company Law: 303

It has been argued that it is extremely difficult for a defendant shareholder to discharge the burden. If this is correct, it provides another explanation of why veil piercing takes place more frequently in China. Yu and Kraver go further and suggest that beyond single-shareholder companies the courts have appeared to shift the burden of proof from creditors to companies and their shareholders more than the legislative language implies and this is the most plausible explanation for the higher frequency of veil piercing in China. This shift of onus in veil piercing cases is allied to the absence in Chinese veil piercing cases of the responsibility of creditors to protect themselves.

However, this argument lacks support from cases. The cited support for this broad proposition is not compelling. The case of Shanghai Zhongbo Company (Appellant) v. Anhui Water Conservancy Construction Engineering Corporation

301. For example, at common law joint tortfeasance may be established by showing that Messrs Liu and Xu procured or authorized the finance manager to commit the wrongful act, see e.g., Mentmore Manufacturing Co v National Merchandise Manufacturing Co (1978) 89 DLR (3d) 195; C Evans & Son Ltd v Spritebrand Ltd [1985] 1 WLR 317; Gabriel Peter & Partners v Wee Chong Jin [1997] 3 SLR(R) 649.

302. Hawes et al, supra note 263, at 364 state that the finance manager had purchased the shares from the seller, presumably Mr Hu, but the share transfer had not been registered. This may not be entirely accurate. While the oral agreement contemplated that the finance manager would be made a shareholder, there was no sale of Mr Hu’s shares to the finance manager.


304. Huang, supra note 256, at 765–66, citing as an example the case of Zhao Yongying v Quzhou Weini Huagong Shiye Youxian Gongsi deng Maimai Hetong Jufeng An, (赵庸英诉衢州威尼化工实业有限公司等买卖合同纠纷案) [Zhao Yongying v Quzhou Weini Chemical Industrial Ltd Co], (2010) Qu Shang Chu Zi No. 1130, People’s Court of Qujiang District of Quzhou City of Zhejiang Province, 2010. See also Yu & Krever, supra note 263, at 76, 80–81.

305. Yu & Krever, supra note 263, at 82–84.
and Others (Respondents)\textsuperscript{306} is cited as a typical example of the tendency to shift the burden of proof away from creditors. The shareholders’ argument was that debts could not be paid in the course of liquidation and the liquidation process was taking a lengthy period of time because of \textit{inter alia} complications from partial ownership of assets and difficulties dealing with competing claims from other creditors. The appellate court did not require the plaintiffs to show abuse; rather, the court indicated that the defendants had failed to provide proof of the reasons offered for the delay and treated the non-payment for an extended period as abuse. It is said that in the same fact situation, a common law court might very well have come to a similar conclusion, but first, such a court would have required the creditor plaintiffs to prove abuse by showing there were no legitimate reasons for extending the liquidation period for such a long time.\textsuperscript{307}

However, it is difficult to expect creditors in all instances to prove that there were no legitimate reasons for the length of the liquidation period. These may not be matters particularly within the knowledge of creditors. Given that the liquidation process had already been going on for five years, together with the defendant company’s lack of cooperation during the process, a common law court might have concluded that there was some prima facie evidence of unreasonable delay such that the burden of proving that the delay was justifiable had shifted to the defendant. Issues relating to the burden of proof are not static\textsuperscript{308} and can shift where, as in this case, the objective facts call for an explanation that only the defendant can reasonably provide. If the defendant cannot do so, it is not unreasonable for a court to only attribute the fault for delay to the defendant. Whether this should amount to abuse is a separate issue. There are at least two possibilities. First, it may be arguable that if a defendant company and its shareholders were intransigent in the liquidation process, the court could infer from the circumstances as a whole that the corporate structure had been used in an abusive manner. The decision, however, proceeded on the second possible mode of analysis, namely that responsibility for the failure to complete the liquidation process ought to be placed on the shareholders. The trial preferred the first possibility, while the appellate court preferred the second one. Relying on Article 20 of the Company Law, the court ruled that, based on the evidence available (including evidence provided by the parties which also comprised the repeated applications from the company to delay the first-instance trial), it was clear that the shareholders intended to abuse the independent corporate personality of the company and the shareholders’ limited liability, with the


\textsuperscript{307} Yu & Krever, \textit{supra} note 263, at 83.

\textsuperscript{308} See also Wen, \textit{supra} note 263, at 352 on the dynamic nature of the burden of proof.
consequence that the company’s veil should be lifted. On either analysis, there
is no basis to state that the courts have illegitimately shifted the onus of proof
from creditors to shareholders.

Beyond whether Chinese judges have adopted an overly broad view of
commingling, and if the burden of proof has been unfairly shifted from creditors
to shareholders, it has also been suggested that loopholes regarding shareholder
performance in corporate liquidation may have led judges to use veil piercing to
play a gap-filling role. It is argued that, unlike many other jurisdictions that have
rules to prevent the liquidation process from being unduly influenced by
shareholders, many of these rules are scarce in China’s company law context.
Rather than independent liquidators who are insolvency professionals, Chinese
company law allows shareholders of a limited liability company to form a
liquidation group, the composition of which must be determined by the
shareholders’ meeting. This has led to courts using veil piercing to impose
liability on shareholders where the liquidation process is not completed or does
not proceed reasonably.

If this is one of the reasons that have led to a more liberal approach towards
veil piercing in China, it appears unjustified. Two points can be made. First, it is
undoubtedly true that under the Company Law creditors do not have a general
right to initiate a corporate winding up through the appointment of a liquidator
or equivalent institution. Pursuant to Article 180 of the 2013 Company Law, a
company is to be liquidated if: (1) the circumstances for liquidation provided for
in the articles of association of the company occur; (2) the shareholders’ meeting
passes a resolution to liquidate; (3) a corporate merger or division compels
liquidation; (4) the company’s license has been revoked or the company is
ordered to close in accordance with the law; (5) shareholders who own at least
10% of the ownership of the company request it in cases involving a corporate
deadlock.

Corporate creditors are relegated to a secondary role. For example, where a
company is dissolved as a result of factors (1), (2), (4) and (5) in the preceding
paragraph, the company shall, within 15 days from the date when the reasons for
dissolution prevail, set up a liquidation team to begin the process. Where a
company fails to do so, its creditors may apply to the court to designate relevant
people to form a liquidation team. Creditors may also petition the court to
develop a liquidation team in other circumstances such as when a liquidation
team has been developed but has deliberately delayed the liquidation, or when a
wrongful liquidation may seriously damage the interests of the creditors or
shareholders.

309. See Shanghai Zhongbo case, supra note 306.
311. PRC Company Law, art. 183.
312. SPC Company Law Interpretation (II), Article 7.
It is understandable that where shareholders are in control of the liquidation process, such control ought not to be unqualified as it can lead to prejudice to other stakeholders, in particular, creditors. Accordingly, in addition to creditors being allowed to file a petition to the court in certain circumstances, there are also instances where shareholders can be held directly liable to creditors. First, if a company does not form a liquidation team within the statutorily prescribed period of 15 days and this has caused the depreciation, loss, damage or disappearance of corporate assets, the creditors can ask the court to hold the responsible shareholders liable for compensation to the extent of the value of the said assets.\footnote{313} Second, if the failure in performing the aforesaid obligations has caused the loss of essential documents and accordingly made it impossible for the liquidation to proceed, the court, at the request of the creditors, can additionally hold the responsible shareholders jointly liable for the company’s debts.\footnote{314} Third, creditors can ask the court to make the shareholders liable to provide compensation if the shareholders (and directors in joint stock limited companies) maliciously disposed of corporate assets and caused losses to the creditors after the company’s dissolution, or if the shareholders wrongly caused the companies registration authority to deregister the company without it being lawfully liquidated.\footnote{315} Also, if the company does not have sufficient assets to satisfy the claims of the creditors at the time of its dissolution, the creditors can ask the court to hold the shareholders liable to the extent of their unpaid capital contributions.\footnote{316}

Members of the liquidation team, which may include shareholders, can also be liable to creditors when they do not discharge their obligations properly, such as when they fail to give notice to all known creditors of the company’s liquidation; the liquidation team implements a liquidation scheme that is not confirmed by shareholders or the court as the case may be; or there has been violation of laws, administrative regulations, or the company’s articles of association, thereby causing loss to creditors or the company.\footnote{317}

While the application of these rules may lead to shareholder liability, it is incorrect to regard them as veil piercing cases. Insofar as the shareholders are liable to creditors, the liability arises when the company is liquidated for dissolution and deregistration. The legal test of Article 20 of the Company Law does not apply in these circumstances. The shareholders will be held liable to provide compensation to creditors jointly and severally for the debts of the company if, in the course of and related to the liquidation process, they were directly or indirectly involved in acts that made the company unable to repay its debts.
debts, including non-payment of outstanding capital contributions. Liability is premised on the liquidation having been conducted improperly and is different from shareholders’ abuse of the independent legal status of corporate personality and shareholders’ limited liability as required by Article 20 of the Company Law. The relevant rules in the aforesaid judicial interpretations are not aimed at clarifying Article 20, and hence are not interpretations about the doctrine of veil piercing.

The second point is that there is another legislation that allows creditors to initiate the liquidation of a company. The PRC Enterprise Bankruptcy Law 2006 governs bankruptcy issues of all legal business persons including companies established under the Company Law. Under the law, where a company fails to repay its debts and its assets are not sufficient to pay all debts that are due, or the company is obviously incapable of paying its debts, its creditors can petition the court for revival (re-organization), compromise, or bankruptcy liquidation. 318 Even if the liquidation process under the Company Law has commenced, creditors are free to petition the court to initiate the bankruptcy procedure under the Enterprise Bankruptcy Law as long as it can be established that the conditions of Article 2 are met. These two forms of liquidation found in different Chinese legislation are not unusual and can be broadly equated with voluntary and creditor windings-up in Commonwealth jurisdictions such as the UK and Singapore. It is sensible for a liquidation regime to allow shareholders to liquidate a company in certain circumstances, for instance, where the objectives set out in the constitution have been fulfilled, or the requisite majority of shareholders pass such a resolution while allowing creditors to do so if the corporation becomes insolvent. This is because where a company is insolvent, its remaining assets effectively belong to creditors since they are the ones who are entitled to the residue in priority to shareholders. Therefore, creditors should have the right to commence liquidation to ensure an orderly distribution of corporate assets.

Given the above, if cases in the insolvency setting have contributed to the greater than average percentage of successful veil piercing cases, the number of such cases has been overstated by the inclusion of cases that ought not to involve piercing at all. In addition, if veil piercing has taken place because of a perceived gap in the insolvency framework, this is also not justified. One example of the former is *Hengsheng Co. Ltd v Xianglan Co. Ltd*. 319 Hengsheng had purchased RMB 2.2 million worth of electric cables from Xianglan from 2000 to 2003. Hengsheng failed to repay Xianglan. In March 2003, the parties reached a
repayment agreement under which Hengsheng was obliged to make payment in full before 2007. Hengsheng’s business license was revoked by the local Administration of Industry and Commerce on May 30, 2005 because it failed the government’s annual inspection of business enterprises. According to Article 184 of the Company Law, the shareholders of Hengsheng, Mr. Zheng, Mr. Li and Mr. Zhang, should have initiated liquidation of the company within 15 days.

Hengsheng failed to make payment as had been agreed, and Xianglan brought legal action in 2011. An order was made in favour of Xianglan, and it applied to enforce the order. On June 30, 2015, the Court issued its enforcement decision, in which Article 20(3) of the Company Law and Article 18 of Company Law Interpretation (II), among others, were relied upon as the legal basis on which the court ordered that the aforementioned Messrs. Zheng, Li, and Zhang were persons against whom the agreement could be enforced. The court held that the corporate veil should be pierced against them, as their failure to liquidate the company constituted an abuse of corporate personality and limited liability. Although Article 18(2) of Company Law Interpretation (II) was also properly invoked, it is questionable if veil piercing should have been relied upon.

**SOME CONCLUDING OBSERVATIONS**

This paper goes beyond the traditional functional method in comparative law, which mainly looks at how different legal systems offer solutions to the same problems. Undoubtedly, the doctrine of veil piercing has been adopted in all the jurisdictions under comparison in this paper, and there is also a striking similarity in the notion of abuse that is said to underlie the disregard of the corporate form to hold shareholders personally liable for corporate debts. In addition, the history of how corporate law came into existence is a factor that has influenced the shape of the doctrine. The law in Singapore for example demonstrates the effect of transplantation with strong similarities with the legal approach in England. China, on the other hand, appears to resemble the United States more closely. This is not surprising given the more recent influence of US corporate law in China and that it has a specific statutory provision that recognizes veil piercing, thereby implying a broader role for the doctrine.

By critically examining the relevant statutory provisions as well as judicial reasoning in veil piercing cases against the doctrine’s underlying conceptual framework we can see how the doctrine is used, arguably misused, or even sidelined in the jurisdictions under comparison. In particular, we caution against the indiscriminate use of veil piercing where more appropriate legal tools are available. Veil piercing can be a blunt and simplistic instrument to achieve perceived justice without addressing the real policy issues that are at the heart of

320. ZWEIGERT & KÖTZ, supra note 183, at 34.
other areas of the law. We find, for example, that the doctrine has become largely unnecessary in Germany because of other remedies that provide more direct and effective solutions. In England (and perhaps Singapore if the courts adopt the approach advocated by Lord Sumption), veil piercing may follow the same route, given that before Prest v. Petrodel the approach towards veil piercing in both jurisdictions was in any event conservative. Lord Sumption’s approach leaves very little room for the veil piercing doctrine to operate. It is interesting to observe that both countries are highly mercantilist in outlook, which may (at least partially) explain the strong tendency not to disregard corporate personality as evidenced by the paucity of veil piercing cases. Judicial policy is inclined towards giving businesses certainty.

On the other hand, the United States, also a common law country, is significantly more liberal in piercing the veil even though its courts articulate that this should be done exceptionally. Similarly, the Chinese courts also adopt a more liberal approach towards veil piercing, and we believe that our analysis of the veil piercing doctrine in Chinese company law offers an original perspective of how this doctrine is misunderstood and applied by Chinese courts through judicial interpretations and judgments. The evolution of the doctrine in China to its final codification into the Company Law (and the approach taken by the other jurisdictions discussed) is one indication of the strong trend of convergence of corporate law across the world. Yet the doctrine’s application by Chinese courts is also a demonstration of a material degree of divergence. Formal law which has converged in this area, and the law in practice, can be very different in China and elsewhere. Where China is concerned, divergence in practice is partly caused by the uniqueness of the business context which, because of its stage of economic development, is less attuned to developed notions of governance. We also argue that some of the interpretations by Chinese courts are doctrinally questionable, which partly explains the significantly higher number of successful veil piercing cases, though we disagree with some of the reasons advanced by others for this. As the doctrine is a relatively new transplant to China, it is understandable that it will take some time before the law “settles.”

321. Indeed, Lord Neuberger in Prest [2013] 3 WLR 1 [79] was initially strongly attracted by the argument that the veil piercing doctrine “should be given its quietus”.

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Corporate Criminal Prosecutions and Double Jeopardy

Robert E. Wagner*

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Double Jeopardy has been an important feature of legal systems dating back to the Code of Hammurabi. This concept has been refined and implemented in numerous legal documents such as the Magna Carta, every state’s constitution, and in the Fifth Amendment of the federal Constitution. That said, the concept has changed considerably over the centuries and today offers more protection to defendants than ever before, while offering very little protection to the government. Meanwhile, the definition of criminal defendants has expanded to include corporations. At the time double jeopardy doctrines were originally developed, corporations were not able to be criminally prosecuted, so application of the doctrine to corporations was not explored. Over the centuries, the necessity of prosecuting corporations for criminal activity became apparent and was enacted. Once that happened, court after court started applying double jeopardy protection to corporations. Most courts, including the Supreme Court, never gave it serious analysis and simply

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assumed that corporations should have this protection. This Article argues that this assumption is wrong. This Article begins by examining how corporations came to be prosecuted criminally and how a lot of criminal procedure protections have been applied to corporations. It then looks to the history of the Double Jeopardy Clause and shows how this history does not support applying it to corporations, and in fact argues against it. Analysis of the principles of the Double Jeopardy Clause reveals that they do not warrant protecting corporations. Thus, this Article proposes that courts not allow corporations to invoke double jeopardy and that under special circumstances we even modify doctrines such as res judicata to allow for subsequent corporate prosecutions.

I. INTRODUCTION

Corporations are a vital part of our economy, but they also have the potential to engage in widespread criminal action. How should society protect itself from this possibly significant threat? As this Article discusses, courts have adapted criminal laws to be applicable to these types of organizations. At the same time, over the years and decades, courts have also developed and applied procedural protections for this context. Corporations hold more rights than at any other time in history. These increased rights came to mass attention with the Supreme Court case Citizens United a little over ten years ago. This case also began my investigation of what rights (in particular, those related to criminal law) a corporation should have. I have written several law review articles addressing protections like the right to remain silent, the exclusionary rule, admissibility of character evidence, and the right to be free from cruel and unusual punishment, which I extend here to the double jeopardy clause. In these articles, I examine both the goal behind a given general rule of evidence or constitutional provision, and analyze whether applying said rule or provision to corporations accomplishes that goal. The answers are mixed and complex, depending on the rule or provision.

This Article examines where the Double Jeopardy Clause of the Fifth Amendment falls on this spectrum. As this Article argues, the Double Jeopardy Clause contains many tensions, some of which are exacerbated when applied to corporations. In the next section, Part II, I examine the basis of prosecuting corporations for crimes in the first place. I look at the origin of this practice and its development in recent decades. I continue this examination by examining the possibility of classifying a corporation as a “person” and what impact that

has on criminal prosecutions. I conclude Part II by moving from the nature of the corporation to a focus on the nature of criminal law itself and the goals that it is trying to achieve.

In Part III, I analyze the Double Jeopardy Clause itself, beginning with the extensive history of the doctrine of double jeopardy that dates back several millennia. I then investigate the interests protected by the Double Jeopardy Clause, ending with a discussion of the significant issues in the general application of double jeopardy.

In Part IV, I combine the insights of the two previous parts by looking at how double jeopardy affects corporations specifically. I begin with an examination of current law and the way that double jeopardy has been applied to corporations for decades, often without any discussion of whether this is warranted. Next, I turn to the problems associated with applying double jeopardy to corporations, concluding that double jeopardy ought to cease benefiting such entities. Instead, corporations should be limited to using other procedural protections (such as res judicata) that may themselves be restricted in some circumstances at the discretion of judges.

II. CORPORATE CRIMINAL LIABILITY

A. The Framework of Corporate Criminal Liability

There is a strong public interest in the government exercising reasonable and effective regulations on corporations. However, for over a hundred years, there has been a debate about both the existence and appropriate level of corporate criminal liability. Originally, corporations were not subject to the criminal law. William Blackstone, whose commentaries have been called the “most influential law book in Anglo-American history” and is cited approximately ten times a year by the U.S. Supreme Court, believed that the correctness of not holding a corporation criminally liable was so clear that it did not need to be elaborated upon. In 1701, American courts addressed the question and held that only individuals could be charged criminally. After

6. Albert W. Alschuler, Two Ways to Think About the Punishment of Corporations, 46 AM. CRIM. L. REV. 1359, 1363 (2009) (stating William Blackstone’s opinion that “[a] corporation cannot commit treason, or felony, or other crime” (quoting 1 WILLIAM BLACKSTONE, COMMENTARIES *476)).
considerable debate and over two hundred years later, in the beginning of the twentieth century, the U.S. Supreme Court finally established corporate criminal liability in New York Central & Hudson River Railroad Co. v. United States\(^8\) and used the respondeat superior principle to determine guilt.\(^9\)

Today, a corporation can be held criminally liable for virtually every crime on the books, except those which need an actual body in their commission,\(^10\) such as for rape.\(^11\) The opponents of corporate criminal liability recognize that the survival of corporations is very dependent on positive public perceptions, which can be dramatically affected by criminal proceedings.\(^12\) These critics view corporate criminal liability as an “inefficient relic” that can better achieve its goals in the civil system or they believe that, even worse, corporate liability is a useless overreaction from an ignorant society.\(^13\) They are partially concerned with the fact that all corporations, large and small, cannot avoid the potentially devastating impact on public attitude of a criminal conviction.\(^14\)

Even accusations can be very damaging to a corporation’s image, an image it may have crafted through great expense and planning.\(^15\) On the other hand, many people think that more corporate prosecutions would be appropriate, as evidenced by the Department of Justice’s increased focus on corporate crime over the last decade.\(^16\)

Yet, given the fact that a corporation has no body itself and that how it makes decisions is clearly different than the way a natural person does, what does it mean to say that a corporation has committed a crime or wrong? Many have asserted that we should ask if someone with a high level of decision-making authority in the corporation has committed a wrong.\(^17\) Shareholders are not usually able to affect the management of their corporation because the decision-making authority rests with the board and, on a day-to-day basis, with

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9. N.Y. Cent., 212 U.S. at 494 (imposing penalties on the corporation for an act committed by an employee on the premises).


15. Kane, supra note 2, at 748.


various levels of corporate officials. Therefore, some argue that it is appropriate to hold either the managers or employees liable for any criminal conduct, but not the corporation itself; they argue that it is unfair to punish innocent shareholders by imposing criminal penalties on the whole entity when only a small part may have done anything wrong. So when courts do impose criminal liability on corporations, the shareholders and employees become “collateral damage.” This point was raised in New York Central, when the defendants argued that when one punishes the corporation, one actually punishes innocent shareholders, and that it is impossible for the corporation as an entity to commit a crime because those actually making the decisions could not legally authorize criminal acts. At the time, this was not an unusual belief, given the current understanding that a corporation could not possess the moral blameworthiness necessary to perpetrate an intentional crime. Eventually courts determined that holding corporations criminally liable was necessary and used the tort law liability framework of respondeat superior as a viable criminal law theory.

Nevertheless, the use of a tort principle in criminal law was quickly attacked. People thought that its use was inconsistent with the purpose of criminal law (namely the punishment of those who are morally blameworthy) because it does not rely on personal fault but instead is based upon vicarious guilt. Critics also attacked the use of respondeat superior to criminally prosecute corporate behavior based on the claim that it was “overly broad.” For example, even if the corporation itself is a victim and it had told the employee specifically not to perform the action, it is still possible for a court to hold a corporation liable for the actions of its employee.

Some corporate convictions were based on individual actions, which resulted in disastrous results for the corporation, its employees, shareholders, and other stakeholders. For example, the collapse of Arthur Andersen resulted in 85,000 people losing their jobs and untold difficulties not only for those employees but also for people who relied on those employees and people

20. See Alschuler, supra note 6, at 1359.
23. Khanna, supra note 3, at 1484.
24. Id. at 1484-85 (footnote omitted).
25. Sheley, supra note 8, at 236.
27. Alschuler, supra note 6, at 1367 (“The embarrassment of corporate criminal liability is that it punishes the innocent along with the guilty.”).

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whose injuries were not rectified even though a court later reversed the conviction. 28 In addition to the existence of inadvertent victims, scholars have argued that corporate criminal liability is unnecessary and in fact can lead to corporations spending more money avoiding crime than they should, which results in so-called overdeterrence. 29 The concern is that a corporation will spend more money avoiding the violation than the harm could have caused, thereby resulting in a net loss.

Nonetheless, while corporations are almost unquestionably an essential part of modern life and bring many advantages, they also have the ability to cause a significant amount of harm. 30 It is possible for a corporation to have as much or even more coercive power than a sovereign government. 31 In fact, large modern corporations are very similar to sovereignties; they can have more economic power than nations, they often form alliances and partnerships with foreign entities, and some even have their own security forces. 32 In addition to their possible size and power, corporations have taken actions that have contributed to, if not caused, many types of disasters. 33 Their complexity, resources, and size enables them to commit significantly larger and more damaging crimes. 34 There is also a possible expressive value of punishing corporations, and because of societal perceptions, if the government fails to punish corporations, the criminal law may seem less legitimate. 35 A related argument used to justify corporate criminal liability is that it allows the community to express its moral judgment. 36

If people think that a corporation should be held criminally liable and it is not, that could weaken the criminal justice system because of appearances of favoritism and unequal application of the law. 37 Perception could exacerbate this effect because people reportedly experience a heightened sense of moral indignation when dealing with a corporation than they do for a natural person,

28. Id. at 1364-66.
30. Gilchrist, supra note 13, at 3-4 (discussing the BP Gulf disaster as an exceptional instance of harmful corporate conduct).
32. Id. at 949-50.
35. Sheley, supra note 8, at 227.
37. Gilchrist, supra note 13, at 51.
even when dealing with the same crime. As a consequence, there would be a situation in which people feel that the criminal justice system is functioning below the norm when it should actually function at a higher level than the norm.

On the other side of the spectrum, there are those who conceive of corporations as mere legal fictions referring to those people and agreements that make up the organization; therefore, any liability should only attach to these individuals. That said, this model of the corporation has received numerous criticisms. One such criticism is that corporations have cultures that are different from those of the individuals in them. Another problem with imposing criminal liability only upon individuals is that, due to the nature of a large corporation and the possible complexity of its various hierarchies, determining which individual may have violated the law can be difficult, if not impossible. Furthermore, the individuals alone may not be perpetrating, or at least not orchestrating, the criminal behavior; rather, it may be an actual business strategy or a simple standard operating procedure that creates the criminal behavior. A corporation’s policies can encourage criminal behavior. In fact, there are many ways that corporate culture and organizational structure can influence individual decision-making. If the criminal law attributes the criminal behavior of corporations to the individual alone, it may disregard the institutional processes occurring within the organization that may have at least contributed to, if not caused, the criminal behavior. A famous and disturbing example of corporate misconduct inextricably tied to the character and culture of the corporation was the tobacco industry’s ‘longstanding pattern of fraudulently misleading regulators and the public about the obvious and known health risks involved in smoking.’ The final argument in favor of corporate criminal liability is that it can protect corporations, or at least law-abiding corporations. In many circumstances,
corporations that disregard the law otherwise have a competitive advantage over corporations that follow the law.\textsuperscript{48}

It is possible that civil enforcement could control corporate misconduct, but this may also be ineffective because civil fines cannot replicate the reputational harm of criminal sanctions.\textsuperscript{49} Part of a criminal sanction is the stigma that attaches and will attach whether it is an individual’s or corporation’s sanction.\textsuperscript{50} This reputational damage stemming from criminal convictions is also problematic. The unpredictability associated with reputational damage may be advantageous,\textsuperscript{51} and yet, the general nature of reputational damage and the seeming inconsistency could lessen this advantage.\textsuperscript{52} Even though there clearly remain many objections to and detractors from the concept of corporate criminal liability, the supporters also very much outnumber their opponents.\textsuperscript{53} If we accept that criminal prosecution of some sort is useful when applied to corporations, we need to discuss which substantive laws and legal processes should then be applied to corporations. To do this, it is important to start by understanding the nature of corporate entities.

\textbf{B. Corporations and Personhood}

Most people recognize that the corporate structure is needed in the modern business world, and that the pooled resources at their command have been the source of most, if not all, the great modern enterprises.\textsuperscript{54} Nevertheless, since a corporation is unlike a natural person, it may face special challenges in criminal proceedings. In fact, scholars and commentators realized almost a hundred years ago that juries are more likely to find corporations guilty than they are to find individuals guilty.\textsuperscript{55} This may be somewhat ironic since many early corporations were explicitly benevolent institutions, including several new church congregations.\textsuperscript{56} In fact, corporations have a dramatic range of purposes, and many different types of organizations are formed as corporations, running the gambit from churches and the Guardian Angels (self-appointed public protectors) to the Ku Klux Klan.\textsuperscript{57} A corporation actually funded the

\begin{thebibliography}{99}
\bibitem{48} Mary Kreiner Ramirez, \textit{The Science Fiction of Corporate Criminal Liability: Containing the Machine Through the Corporate Death Penalty}, 47 \textit{ARIZ. L. REV.} 933, 942 (2005).
\bibitem{51} See Buell, supra note 49, at 514.
\bibitem{52} Gilchrist, supra note 13, at 38.
\bibitem{56} Goforth, supra note 18, at 625.
\bibitem{57} Miller, supra note 31, at 906.
\end{thebibliography}
first permanent new world colony, and the first Thanksgiving was instituted by a corporation. The first great corporation of the United States was the Bank of the United States, and even back then it was commonly criticized for having too much political and economic power.

Nonetheless, one must remember that most corporations are small in size and influence: Of the three million businesses that belong to the U.S. Chamber of Commerce, more than ninety-five percent have fewer than 100 employees, and of all federally taxed corporations, more than seventy-five percent have less than one million dollars in receipts reported per year. But in terms of purpose and/or size, the Supreme Court rarely differentiates between different types of corporations.

Many people are concerned with protecting democracy from the corruptive and often distorting effect of massive amounts of money collected through the corporate structure. Illustrative of the Founding Fathers’ common concern with corporations, James Madison stated that “the indefinite accumulation of property” was “an evil which ought to be guarded against,” and that the “power of all corporations ought to be limited in this respect.” This fear of corporations led to a number of people referring to them as “soulless,” and some—such as President Thomas Jefferson—fearing that they “would subvert the Republic.” This fear is based at least partly on the claim that if corporations have the same constitutional rights as individuals but hold increased power, the result is clearly the supremacy of the corporate form over the natural form of personhood. The fear or dislike of corporations is far from universal, and many scholars maintain that while it may be true that corporations have been given too much power, this does not mean that they are “bad.” It is possible that corporations are in fact beneficent entities that simply need a certain level of control placed upon them and perhaps fewer constitutional protections.

Historically, at different points, American and English corporations have had limited constitutional protections when compared with individuals. Originally, corporations were not significantly addressed in the Constitution.

58. Winkler, We the Corporation, supra note 5, at 6.
59. Id. at 17.
60. Id. at xxi.
61. Id. at 36.
63. Winkler, We the Corporation, supra note 5, at xxi.
64. Miller, supra note 31, at 896 (quoting McConnell v. FEC, 240 U.S. 93, 205 (2003)).
65. Winkler, We the Corporation, supra note 5, at 4.
67. Mayer, supra note 54, at 658.
The word corporation is not in the federal Constitution. In fact, only four states (Connecticut, Pennsylvania, Massachusetts, and Vermont) mention corporations in their original constitutions, and in situations in which state constitutions did award specific rights to corporations, these were different than those given to individuals. At the federal level, some courts (for example, during the Lochner era) took the position that in terms of constitutional protection of criminals, corporations were different and were entitled to the right of property but not liberty. Jurists dispute whether the corporation is an entity beyond the people involved and its legal status. One of the first descriptions of a corporation was from Chief Justice John Marshall, who described a corporation as “an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it . . .” Put succinctly, a corporation is not allowed to conduct business beyond the scope of its charter. In a very recent description of the corporate entity, the Court stated:

A corporation is simply a form of organization used by human beings to achieve desired ends. An established body of law specifies the rights and obligations of the people (including shareholders, officers, and employees) who are associated with a corporation in one way or another. When rights, whether constitutional or statutory, are extended to corporations, the purpose is to protect the rights of these people.

Justice Stevens stated that even though corporations make many significant contributions to society, they are not members of society. In a similar vein, the Court has indicated that, while it is appropriate for courts to protect corporations from unlawful investigations, they do not have equivalent rights with people in terms of privacy. Justice Sotomayor has suggested the central problem is in giving corporations any constitutional rights. In a less critical position and in part because of the idea that corporations derive their existence and hence all privileges from the state, courts have limited corporations’ rights. For example, at one point, a Supreme Court Justice asserted that if a law enforcement agency was simply “curious” about a corporation, it would
have the legitimate right to satisfy that curiosity by conducting investigations.  

In the instance of such investigations, there would be some protection against the invasion of privacy but at a very minimal level; in fact, the only significant limitations were that the inquiry had to deal with subject matter in the domain of particular agencies, that the information requested could not be too indefinite, and that the information had to be reasonably relevant.

The Court’s decision in *Santa Clara County v. Southern Pacific Railroad Co.* portrays an alternate view that a corporation has rights and duties conferred upon it stemming from the rights and duties of its human members. This sentiment continues today, in that courts treat corporations in many ways as though they are natural people. For example, not only can corporations be held responsible for criminal actions, but they can also be parties to contracts, own property in their own name, and sue others in court or be sued by them.

Most would agree that the law should treat actors differently if they are in fact different, but should treat them the same if they are significantly similar.

From a constitutional perspective, treating entities that clearly differ from one another the same is just as large an error as treating those that are the same differently.

The Supreme Court declared in 1886 that a corporation is a person for at least some constitutional purposes. However, as Justice Stevens pointed out, corporations have several unnatural and distinguishing attributes that increase their ability to raise capital and use that capital in ways that maximize investors’ returns. These attributes include limited liability, the separation of control from ownership, possibly unending life, and favorable legal treatment of both the accumulation of assets by the corporation and the eventual distribution of those assets.

Justice Ruth Bader Ginsburg agreed with Justice Stevens that corporations do not have a conscience, belief, feelings, thoughts, or desires.

There are at least three different ways that the law can view a corporation as a person: a moral person, a natural person, and a legal person. Though impossible to argue that a corporation is a natural person, and equally

83. Id. at 652–53.
85. Id. at 396.
89. *Santa Clara*, 118 U.S. at 396.
92. Kim, *supra* note 38, at 784.
impossible to argue it is not a legal person, one could argue that a corporation is a moral person, making it therefore appropriate to hold it morally accountable.\textsuperscript{93} Thus, a corporation is both the same and different in terms of whether the law should treat it in the same manner as an individual. Taking a different approach, some scholars claim that because corporations are not humans or citizens, and in fact are just tools to human ends, society has no need to honor any claim of autonomy unless that autonomy is itself useful for humans.\textsuperscript{94} Further evidence against a corporation’s personhood claim is that corporations can only decide, act, or intend anything through the human members of the corporation; without them, the corporation could not function or even have an identity.\textsuperscript{95} At the same time, this view of the corporation as an extension of the humans involved is undermined by the fact that even if every human involved has died, the same corporation can live on for several generations.\textsuperscript{96} An even stronger link to personhood is demonstrated by the fact that each corporation is unique and has its own personality and character that are social realities in the eyes of the American people.\textsuperscript{97}

After \textit{Citizens United v. FEC},\textsuperscript{98} some commentators have gone so far as to say that corporations are people, at least for First Amendment purposes.\textsuperscript{99} \textit{Citizens United} caused a backlash and inspired many to call for a constitutional amendment eliminating all constitutional protections for corporations.\textsuperscript{100} Relatedly, Justice Stevens explained that people with differing understandings of the nature of corporations can see that corporations are distinguishable from human beings and the government must therefore regulate them differently.\textsuperscript{101}

That said, the dispute about whether corporations should have constitutional protections did not begin with \textit{Citizens United}, but in fact, has been raging for two centuries.\textsuperscript{102} The actual decision in \textit{Citizens United} does not use personhood to grant the constitutional protections, but rather, focuses

\textsuperscript{93} \textit{Id.}
\textsuperscript{95} Ripken, \textit{supra} note 33, at 100-01.
\textsuperscript{97} Andrew E. Taslitz, \textit{The Expressive Fourth Amendment: Rethinking the Good Faith Exception to the Exclusionary Rule}, 76 Miss. L.J. 483, 486–87 (2006).
\textsuperscript{98} 558 U.S. 310 (2010).
\textsuperscript{100} Winkler, \textit{We the Corporation}, \textit{supra} note 5, at 326.
\textsuperscript{101} \textit{Citizens United v. FEC}, 558 U.S. at 466 n.72 (2010) (Stevens, J., concurring in part and dissenting in part).
\textsuperscript{102} Winkler, \textit{We the Corporation}, \textit{supra} note 5, at 36.
on the rights of people like shareholders and listeners.\textsuperscript{103} Most decisions granting corporations rights do not rely on corporate personhood.\textsuperscript{104} In fact, corporate personhood has actually been used to limit the rights of corporations.\textsuperscript{105} One of the most ardent objectors to the rights of corporations was Justice Roger Taney, infamous author of the \textit{Dred Scott} case.\textsuperscript{106} The Taney court embraced the corporate personhood argument and used this reasoning to restrict the rights of corporations.\textsuperscript{107} The debate has continued for such a long time and become so entrenched in controversy that it is possible that the United States may need a constitutional amendment to determine a corporation’s ultimate status.\textsuperscript{108}

One suggestion is to establish a constitutional amendment that states that corporations only have the rights specifically granted to them.\textsuperscript{109} Until such an amendment is passed, we need to decide which protections apply, which ones do not, and which ones apply in a different way. One approach that seems more promising than asking about the personhood of corporations, is to look at what the criminal law is attempting to accomplish in the first place.

\textbf{C. The Purpose of Corporate Criminal Liability}

Organizations are uniquely limited to being punished with fines and other non-incarcerating criminal penalties,\textsuperscript{110} but they are still subject to significant repercussions.\textsuperscript{111} As some have argued, it is possible that when a court punishes a corporation, what really happens is that the court punishes its stockholders, most of whom were perfectly innocent, and essentially deprives them of their property without the ability to object or even be heard regarding the issue.\textsuperscript{112} At the same time, scholars have argued that because of the difficulty involved in identifying and prosecuting an individual participating in corporate activities, the legal system needs to be able to use vicarious attribution for corporations.\textsuperscript{113}

All that said, criminal prosecutions of corporations have occurred even when corporate management apparently took significant steps to avoid the

\begin{itemize}
\item\textsuperscript{103} \textit{Id.} at 364.
\item\textsuperscript{104} \textit{Id.} at 37.
\item\textsuperscript{105} \textit{Id.} at xx.
\item\textsuperscript{106} \textit{Id.} at xix.
\item\textsuperscript{107} \textit{Id.} at 75.
\item\textsuperscript{108} Mayer, \textit{supra} note 54, at 651.
\item\textsuperscript{109} Dibadj, \textit{supra} note 68, at 782.
\item\textsuperscript{110} Alan L. Adlestein, \textit{A Corporation’s Right to a Jury Trial Under the Sixth Amendment}, 27 U.C. DAVIS L. REV. 375, 387 (1994).
\item\textsuperscript{111} \textit{Id.} at 386-87.
\item\textsuperscript{113} Adlestein, \textit{supra} note 110, at 385.
\end{itemize}
commission of criminal activities. To better understand the specific prosecutorial options for corporations, it is useful to look at how the underlying goals of the criminal law interact with corporations generally and specifically. The generally accepted goals of criminal prosecutions are deterrence, retribution, rehabilitation, and incapacitation. When it comes to corporations, the Supreme Court has held that deterrence is an appropriate purpose of criminal liability and that retribution is another legitimate basis for criminal corporate prosecutions because corporations can appropriately be considered blameworthy. In addition to these goals, helping to shape and convey society’s feelings of condemnation is a possible goal of criminal law. There is almost always some level of condemnation involved in imposing corporate criminal punishment, and some argue that this expression serves purposes beyond deterrence.

Even though there are other significant goals of criminal law, many scholars and judges treat deterrence as the primary, if not sole, goal for such liability. Deterrence is divisible into specific and general deterrence. Specific deterrence is directed at the actual (or specific) person or institution that committed the offense and tries to prevent that entity from committing the same or similar acts in the future. General deterrence, on the other hand, refers to the idea that even those who are not themselves punished can be deterred from committing a crime by observing or at least being aware of the punishment that others received for the same crime. To successfully use the deterrence rationale, and thereby justify corporate criminal liability as opposed to simply individual liability, one needs to show that corporate criminal liability provides at least some increased deterrence in addition to what individual liability alone would accomplish. The survival and proliferation of these laws results partly from the law’s ability to simultaneously achieve expressive benefits, positive consequential benefits, and retributive and just goals. In relation to corporations, the existence, need and proliferation of these types of laws is only part of the question of how the law punishes or should punish them. The other part of the question is what types of protections a corporation should be able to

114. Id. at 386.
115. See Brickey, supra note 7, at 605–06; Sheley, supra note 8, at 230.
117. See Kenneth G. Dau-Schmidt, An Economic Analysis of the Criminal Law as a Preference-Shaping Policy, 1990 DUKE L.J. 1, 37.
119. Khanna, supra note 3, at 1494 nn.91–93.
120. Brickey, supra note 7, at 606.
121. Id.
122. Khanna, supra note 3, at 1494-95.
123. See Baer, supra note 19, at 1-2.
raise. The most formidable of defenses are those based in the Constitution. I have addressed the applicability of many other constitutional provisions to corporations in previous work, while Part III will focus on the Double Jeopardy Clause.

III. THE DOUBLE JEOPARDY CLAUSE

A. The History of Double Jeopardy

The Double Jeopardy Clause of the Fifth Amendment states: “[N]or shall any person be subject for the same offense to be twice put in jeopardy of life or limb.” The Supreme Court has “found more guidance in the common-law ancestry of the Clause than in its brief text.” The Court has gone so far as to state that “[s]ince the prohibition in the Constitution against double jeopardy is derived from history, its significance and scope must be determined, ‘not simply by taking the words and a dictionary, but by considering (its) origin and the line of (its) growth.’” The roots of double jeopardy have been firmly established, extending far back into not only the common law but also ancient history. It was one of the limitations of governmental power specified in the Magna Carta in 1215. Even before that, it extends back as early as Ancient Greek, Roman and Biblical times. Amazingly, laws against changing final judgments can be traced all the way back to the Code of Hammurabi. Even in the Dark Ages when very little protection of criminal defendants existed, double jeopardy did. The prohibition against double jeopardy is in every state’s constitution and has been described as “a part of all advanced systems of law.”

Modern double jeopardy “had its origin in the three common-law pleas autrefois acquit, autrefois convict, and pardon. These three pleas prevented the retrial of a person who had previously been acquitted, convicted, or pardoned for the same offense.” In an early and influential treatise on the law, 

124. See supra note 1.
126. Id.
130. Lissa Griffin, Untangling Double Jeopardy in Mixed-Verdict Cases, 63 SMU L. Rev. 1033, 1033 (2010) [hereinafter "Griffin, Untangling"].
Blackstone stated that “the plea of autrefois acquit, or a formal acquittal, is
grounded on this universal maxim of the common law of England that no man
is to be brought into jeopardy of his life more than once for the same
offense.”136 Blackstone stated the rule as “[W]hen a man is once fairly found
not guilty upon an indictment, or other prosecution . . . he [can] plead such
acquittal in bar of any subsequent accusation for the same crime.”137 The
ancient version of the right, however, also has significant differences.
Originally, common law jeopardy only extended to felonies,138 and, in
Blackstone’s time, the right also applied to limit a defendant’s ability to appeal
a sentence.139 In fact, with autrefois acquit and autrefois convict there was
originally no possibility of appeal or new trial by the defendant.140 In
discussing the Double Jeopardy Clause, the Framers were concerned that the
defendant be entitled to an appeal if it was warranted.141 “It was not until 1896
that it was made clear that a defendant could seek a new trial after conviction,
even though the government enjoyed no similar right.”142 The Double Jeopardy
Clause did not apply to the states until 1969.143 Its application took place via
the Fourteenth Amendment144 in Benton v. Maryland145

Arguably, over the years, the Court has added to the complexity of the
Double Jeopardy Clause by moving it farther from its original intention as a
narrow but categorical protection.146 Possibly the “most fundamental rule in the
history of double jeopardy jurisprudence has been that ‘[a] verdict of
acquittal . . . could not be reviewed on error or otherwise, without putting [a
defendant] twice in jeopardy, and thereby violating the Constitution”147 The
Court has described three protections of the Double Jeopardy Clause, which are
that “[i]t protects against a second prosecution for the same offense after
acquittal, that it protects against a second prosecution for the same offense after
conviction and finally that it protects against multiple punishments for the same
offense.”148 Notably, the Court draws a distinction between protecting against

137. Griffin, Untangling, supra note 130, at 1043 (citation omitted).
139. Ex Parte Lange, 85 U.S. 163, 169 (1873).
140. Daniel K. Mayers & Fletcher L. Yarbrough, Bis Vexari: New Trials and Successive
Prosecutions, 74 HARV. L. REV. 1, 4 (1960) (citation omitted).
1551, 1564-65 (1996) (citation omitted).
143. Carissa Byrne Hessick & Andrew Hessick, Double Jeopardy as a Limit on Punishment, 97
146. Henning, Rehabilitation, supra note 36, at 3.
multiple prosecutions and multiple punishments.\textsuperscript{149} Scholars have even argued that the primary motivation for the Double Jeopardy Clause is the prohibition against multiple punishments.\textsuperscript{150} That said, the question of whether a punishment is multiple and therefore prohibited is one of legislative intent.\textsuperscript{151} In some cases, the Double Jeopardy Clause does nothing more than prevent a court from sentencing a defendant to more than what the legislature intended.\textsuperscript{152} Even if the historical purpose of the right against double jeopardy was both to prohibit two punishments for the same crime as well as two prosecutions for the same crime, today the focus is much more on two prosecutions.\textsuperscript{153} This makes sense given that “[t]he fear and abhorrence of governmental power to try people twice for the same conduct is one of the oldest ideas found in western civilization.”\textsuperscript{154}

Double jeopardy is one of the “great principles of government which have been made the basis of our governmental system, which we deem essential to the rule of law and the maintenance of individual freedom.”\textsuperscript{155} Indeed, “[t]he theory of double jeopardy is that a person need run the gantlet only once.”\textsuperscript{156} That said, the phrase “twice running the gauntlet” has been criticized by scholars and justices as leading to a “decision by slogan.”\textsuperscript{157} Furthermore, noted scholars have claimed that the language of the Fifth Amendment does not fit the modern way that the Court has interpreted it.\textsuperscript{158} For example, the term “life or limb” has not been interpreted to limit the clause to the death penalty or removal of a limb, and the clause instead applies to a vast array of punishments including fines;\textsuperscript{159} apparently “[l]ife or limb should be understood as a vivid and poetic metaphor for all criminal punishment.”\textsuperscript{160} Double jeopardy applies to all essentially criminal sanctions, and even misdemeanors qualify for the protection.\textsuperscript{161} Given its importance and the fact that it applies to such a broad category, what does it actually do?

At its core, the Double Jeopardy Clause, “prevents the retrial of a defendant on the same criminal charges.”\textsuperscript{162} The Court has repeatedly stated that the

\textsuperscript{149} Anne Bowen Poulin, \textit{Double Jeopardy: Grady and Dowling Stir the Muddy Waters}, 43 RUTGERS L. REV. 889, 907-08 (1991) (citation omitted) [hereinafter “Poulin, Waters”].
\textsuperscript{150} Hessick & Hessick, \textit{supra note 143}, at 45.
\textsuperscript{153} Hessick & Hessick, \textit{supra note 143}, at 46.
\textsuperscript{155} Kepner v. United States, 195 U.S. 100, 122 (1904).
\textsuperscript{157} Griffin, \textit{Untangling, supra note 130}, at 1040 (citation omitted).
\textsuperscript{159} Hessick & Hessick, \textit{supra note 143}, at 63 (citation omitted).
\textsuperscript{160} Amar, \textit{supra note} 158, at 1810.
\textsuperscript{162} Kane, \textit{supra note} 2, at 727 (citation omitted).
prohibition is not only against being punished twice, but also against being tried twice for the same offense.163 Unfortunately, when the Double Jeopardy Clause was proposed, there was no clear understanding of what was meant by the “same offense.”164 The Framers used ambiguous language when drafting the Clause, possibly because at the time there were very few statutory crimes.165 Today, the standard test for double jeopardy asks whether all the elements of one crime are part of another, such as how a crime for felony-murder based on a homicide committed in the middle of a robbery could not be later prosecuted as a robbery. This is because all the elements of the robbery charge were a part of the felony murder prosecution.166 This is commonly referred to as the Blockburger test, under which “[a] single act may be an offense against two statutes; and if each statute requires proof of an additional fact which the other does not, an acquittal or conviction under either statute does not exempt the defendant from prosecution and punishment under the other.”167 The Blockburger, or Same-Elements, test asks whether each offense contains an element not contained in the other, if they do not, they are the “same offense” for double jeopardy purposes.168 The government cannot try a defendant for a greater offense once he has been convicted of a lesser included offense.169 In fact, prosecuting either a lesser included offense first or second is equally offensive under the double jeopardy clause.170 It is possible that if the facts necessary for the greater offense were not discovered despite due diligence before the first trial, an exception to the prohibition may apply.171 There are some limited exceptions, for example when a victim later dies from the injuries sustained by the attempted murder.172 The same-elements test is applied in both the multiple-punishments setting and the multiple-prosecution setting.173

Double jeopardy begins (or attaches) at two different points: in a jury trial, when the jury is empaneled and sworn in, and in a bench trial, when evidence begins to be heard.174 After double jeopardy attaches a second trial is usually allowed, but there are exceptions. First, if a defendant has bribed a juror or

164. Henning, Rehabilitation, supra note 36, at 7.
166. Poulin, Waters, supra note 149, at 893.
170. Id. at 151.
171. Id. at 152.
172. Id. at 1813 (citations omitted).
judge, double jeopardy will not apply, one can argue that the defendant was not really in jeopardy during the first trial.175 “An accused must suffer jeopardy before he can suffer double jeopardy.”176 Second, a defendant can elect to have two trials without offending double jeopardy.177 After a defendant’s successful appeal there can be a second trial.178 This is allowed because the defendant waived his right with the appeal. An alternative explanation is that the jeopardy did not end until the verdict was final.179 If a reviewing court overrules a conviction for insufficient evidence, then no retrial is allowed, and the double jeopardy clause will bar the subsequent retrial in that situation.180

It has been long established that double jeopardy cannot be avoided by “artful pleading.” For example, where felony murder is based on a robbery, the government cannot charge felony murder and then charge the robbery later if needed.181 In order to avoid this problem, the Double Jeopardy Clause prevents the government from relitigating any issue that had been necessarily decided by a jury’s acquittal in a prior trial. This is arguably a departure and expansion from the historic roots of double jeopardy.182 As Justice Ginsburg stated, “[i]n criminal prosecutions, as in civil litigation, the issue-preclusion principle means that ‘when an issue of ultimate fact has once been determined by a valid and final judgment, that issue cannot be litigated between the same parties in any future lawsuit.’”183 The Supreme Court has pointed out that claim preclusion has been a long-standing part of civil litigation and is part of the Constitution’s prohibition on successive criminal prosecutions.184

Similar to double jeopardy, res judicata is a possible defense to a subsequent proceeding in both civil and criminal proceedings.185 Res judicata will prevent a rehearing of the same cause of action, and collateral estoppel will preclude a rehearing of previously litigated issues even if the cause of action is different.186 It is clear that Congress can impose both a criminal sanction and a civil sanction for the same act or omission.187 Simultaneous civil and criminal

176. Serfass, 420 U.S. at 393.
181. Thes, supra note Error! Bookmark not defined., at 279.
184. Bravo-Fernandez, 137 S.Ct. at 357.
proceedings have been increasing and becoming the norm in economic criminal settings for over 25 years.\textsuperscript{188} Neither double jeopardy nor \textit{res judicata} is a bar in a civil proceeding following a criminal trial due to the difference in degree of the burden of proof.\textsuperscript{189} In a civil trial, the defendant typically only has to be shown to be guilty by a preponderance of the evidence as opposed to beyond a reasonable doubt as required in a criminal trial.

If the two crimes contain the same elements, or the same issue that formed the basis for a verdict, a retrial is prohibited—but what if there is no verdict? Mistrials are a way of avoiding a verdict.\textsuperscript{190} In cases where a mistrial was declared before reaching a verdict, it is clear that jeopardy did attach, but that is only the beginning of the question as to whether double jeopardy bars a retrial.\textsuperscript{191} Once a defendant has been put to trial in front of a jury, even if the jury is dismissed without a verdict and without the defendant’s consent, he may be entitled to protection from a subsequent prosecution.\textsuperscript{192} The Court has pointed out that in addition to those times when a second trial was meant to harass the defendant or allow the state to make a better case against the defendant, other instances of discharging a jury may invoke the Double Jeopardy Clause as well.\textsuperscript{193}

Usually a retrial is allowed if a defendant requests a mistrial, but not if he was goaded into it by the prosecution.\textsuperscript{194} Even in the earliest cases, the Court warned that the ability to dismiss a jury and thereby have another trial should “be used with the greatest caution, under urgent circumstances, and for very plain and obvious causes.”\textsuperscript{195} As far back as 1824, the Court held that in cases of “manifest necessity,” a person can be retried after having gone through an initial trial that ended without a verdict.\textsuperscript{196} The Court has recognized that under some circumstances where “the end of public justice would otherwise be defeated” a defendant can be tried again.\textsuperscript{197} The classic example of a permissible retrial is when there is a mistrial due to the jury being unable to agree, a so-called hung-jury.\textsuperscript{198} “A jury’s inability to reach a decision is the

\textsuperscript{188} Peter J. Henning, Precedents in a Vacuum: The Supreme Court Continues to Tinker with Double Jeopardy, 31 AM. CRIM. L. REV. 1, 4 (1993) [hereinafter Henning, Vacuum].
\textsuperscript{189} Helvering v. Mitchell, 303 U.S. 391, 397 (1938).
\textsuperscript{190} Thomas, supra note 141, at 1554.
\textsuperscript{192} Green v. United States, 355 U.S. 184, 188 (1957).
\textsuperscript{194} David L. Botsford & Stanley G. Schneider, The “Law Game”: Why Prosecutors Should be Prevented From a Rematch; Double Jeopardy Concerns Stemming From Prosecutorial Misconduct, 47 S. TEX. L. REV. 729, 730 (2006) (citation omitted).
\textsuperscript{195} United States v. Perez, 22 U.S. 579, 580 (1824).
\textsuperscript{196} Id.
\textsuperscript{197} Peter J. Henning, The Conundrum of Corporate Criminal Liability: Seeking a Consistent Approach to the Constitutional Rights of Corporations in Criminal Prosecutions, 63 TENN. L. REV. 793, 843 (1996) (citation omitted) [hereinafter "Henning, Conundrum"].
kind of ‘manifest necessity’ that permits the declaration of a mistrial and the continuation of the initial jeopardy that commenced when the jury was first impaneled.”199 The “interest in giving the prosecution one complete opportunity to convict those who have violated its laws justifies treating the jury’s inability to reach a verdict as a nonevent that does not bar retrial.”200 A judge is supposed to discharge a jury before reaching a verdict “only in very extraordinary and striking circumstances.”201 If a defendant moves for a mistrial, this is a presumed waiver of the prohibition against reprosecution. If the defendant does not consent to a motion for mistrial, however, the “doctrine of manifest necessity stands as a command to trial judges not to foreclose the defendant’s option until a scrupulous exercise of judicial discretion leads to the conclusion that the ends of public justice would not be served by a continuation of the proceedings.”202 To satisfy the “manifest necessity” doctrine, the trial court should find that the “ends of public justice” would be defeated by allowing the trial to continue.203 The ends of justice might be defeated when the court finds out that a juror knows the defendant and hence is likely prejudiced against the government.204 In addition to this example, there are multiple other acceptable reasons for not barring a reprosecution including: a letter published in the newspaper raising doubts about a jury’s impartiality, a jury that remained indecisive after forty hours of deliberation, a juror having served on the grand jury indicting the defendant, or a military court martial due to necessities in the field.205 Virtually all the cases of manifest necessity turn on the particular facts and are not easily categorized.206 Manifest necessity has also been called “imperious necessity” and said to be present “only in very extraordinary and striking circumstances”.207

Even after jeopardy has attached and a verdict has been returned, at least one situation remains in which a defendant may be tried twice for the same crime. This can occur if a state and the federal government both decide to prosecute him. The vindication of criminal justice is a compelling counterbalance of which the Founding Fathers were aware and which they intended to have weighed against the possible oppression of the government and callousness of repeated prosecutions.208 Notwithstanding this, two states or sovereigns can prosecute a defendant for the same offense in two separate trials

200. Id. at 117 (citing Arizona v. Washington, 434 U.S. 497, 509 (1978)).
201. Downum, 372 U.S. at 736.
204. Id. at 463.
205. Jorn, 400 U.S. at 481-82 (citations omitted).
without running afoul of the Double Jeopardy Clause.\textsuperscript{209} According to the Supreme Court, two offenses, even if identical, are not the ‘same’ if they are prosecuted by two different sovereigns.\textsuperscript{210} Even though well established, the idea that two different sovereigns can prosecute the same crime has been criticized as inappropriately valuing the interests of the two sovereigns over the interests protected by the Double Jeopardy Clause.\textsuperscript{211} Given this position and the ultimate question of whether the Double Jeopardy Clause can be applied to corporations, it is useful to examine what the purported interests of the clause are.

\textit{B. Interests Protected by the Double Jeopardy Clause}

The reasons behind the Double Jeopardy Clause have been described in multiple ways, but the general idea is to keep an “individual from being subjected to the hazards of trial and possible conviction more than once for an alleged offense.”\textsuperscript{212} Over time, the Supreme Court has offered different specific interests which the Double Jeopardy Clause protects, and phrased them in a variety of manners. The most famous and often repeated statement from the Court is:

The underlying idea, one that is deeply ingrained in at least the Anglo-American system of jurisprudence, is that the State with all its resources and power should not be allowed to make repeated attempts to convict an individual for an alleged offense, thereby subjecting him to embarrassment, expense and ordeal and compelling him to live in a continuing state of anxiety and insecurity, as well as enhancing the possibility that even though innocent he may be found guilty.\textsuperscript{213}

Double jeopardy is “one of the strong bulwarks of liberty: and if it be prostrated, every citizen would become liable, if guilty of an offense, to the unnecessary costs and vexations of repeated prosecutions, and if innocent, not only to those, but to the danger of an erroneous conviction from repeated trials.”\textsuperscript{214} If unlimited prosecutions were possible, it is almost a mathematical certainty that even an innocent man would eventually be convicted.\textsuperscript{215} Related to this mathematical certainty is the fact that plea bargaining is an important aspect of the criminal law\textsuperscript{216} and repeated prosecutions may encourage even an innocent defendant to plead guilty with a generous plea agreement.\textsuperscript{217} The

\begin{thebibliography}{99}
\bibitem{210} \textit{Id.} at 92.
\bibitem{211} Kane, \textit{supra} note 2, at 729 (citation omitted).
\bibitem{213} Green v. United States, 355 U.S. 184, 187-188 (1957).
\bibitem{216} Khanna, \textit{Asymmetric}, \textit{supra} note 175, at 386 (citation omitted).
\end{thebibliography}
Double Jeopardy Clause prevents the state from using the criminal process to harass an accused and wear him out by “a multitude of cases and accumulated trials.” 218 One should note, however, that this type of “interest” arguably relies on the presumption of innocence—if the person is guilty do we not want the state to wear him out even at the risk of harassing him?

More reasons for the double jeopardy protection is to protect the defendant from mounting litigation costs and to prevent the government from previewing and subsequently adjusting to the defense strategy. 219 Continual relitigation would be a drain on the time, energy, and finances of the parties involved. 220 In addition to the defendant, the judicial system also has finite resources and cannot try cases over and over again. 221 Relitigation would not only be a drain on judicial resources but also delay justice to those waiting to get into court. 222 At one point, the Court identified two interests in the clause: one which is concerned about the “preservation of the finality of judgements.” and another which deals with the anxiety found in Green. 223

Originally, the purpose of double jeopardy protection was simply to preserve the finality of judgements. 224 Scholars have suggested that even if a court’s decision is wrong, it is still just as important to have a clear end as it is a clear beginning. 225 The finality of double jeopardy is supported by multiple factors, including the protection of the innocent and the idea of some that a jury acquittal can never be erroneous. Juries have the right to acquit for any reason, including bad reasons, or for no reason at all. 226 In addition to protecting the ability of a jury to nullify, the fact of an acquittal gives an incentive to the government to want to try again and learn from the lesson in the first trial. 227 Justice O’Connor explained that the Double Jeopardy Clause “serves primarily to preserve the finality of judgements in criminal prosecutions and to protect the defendant from prosecutorial overreach.” 228

Double jeopardy, among other things, helps to equalize unequal adversaries. It reflects our respect for juries and our appreciation for the

219. Hessick & Hessick, supra note 143, at 60 (citation omitted).
220. Mayers & Yarbrough, supra note 140.
221. Poulin, Waters, supra note 149, at 910.
222. Mayers & Yarbrough, supra note 140, at 31-32.
226. Griffin, Untangling, supra note 130, at 1044 (citation omitted).
227. Poulin, Waters, supra note 149, at 908-09 (citation omitted).
distinction between prosecution and persecution. As the Court stated, “[e]very person acquainted with the history of government must know that state trials have been employed as a formidable engine in the hands of a dominate administration.” Scholars have pointed out that “the criminal law is the most powerful tool available to the government to silence its detractors. There is no better way to undermine a political dissident’s credibility, impair a candidate’s ability to finance a campaign, or prevent a reporter from presenting a viewpoint than to subject her to a series of criminal trials.”

For several decades, government overreaching has been a significant consideration when determining if a retrial is permissible or not. Not only is the improved government position a concern, but a retrial will arguably undermine the judicial process itself because it disregards the validity of the initial judicial proceeding. Both prosecutors and the public may hold judgments that could be relitigated in contempt. It has been argued that repeat trials undermine the public’s respect for and confidence in the judicial system. Respect for the criminal justice system is necessary for our society and anything that may undermine it should not be undertaken lightly.

In addition to the institutional interests, there are also very personal or individual interests involved in questions of double jeopardy. For example, the Court has used various cases to describe repeated prosecutions as entailing a “heavy personal strain.” In Jorn, the court specifically considered the individual saying, “society’s awareness of the heavy personal strain which a criminal trial represents for the individual defendant is manifested in the willingness to limit the Government to a single criminal proceeding to vindicate its very vital interest in enforcement of criminal laws.”

These interests are not all or nothing, they come in degrees depending upon the circumstances. Before trial, much of the hazards like expense, strain, and embarrassment are not present for a defendant. The level of the burden is often considered; for example, it has been noted that the burden on a defendant who faces an entire new second trial after a full first one is considerably greater

229. Kane, supra note 2, at 727 (citation omitted).
231. Lear, supra note 217, at 645-46.
232. Poulin, Dark, supra note 224, at 645 (citation omitted).
234. Id. at 594.
235. Lear, supra note 217, at 650.
236. Id. at 651.
237. Poulin, Dark, supra note 224, at 649-50 (citation omitted).
238. Henning, Conundrum, supra note 197, at 844 (citations omitted).
than the defendant whose first trial was cut short for various reasons.\footnote{241} Further, we should also note that while a retrial may benefit the interests of the state, there are possible benefits for the defendant as well. An appellate court, or in some circumstances a trial court, may be less likely to rule in favor of the defendant if it knows that the ruling will be unreviewable and allow an almost certainly guilty defendant to go free.\footnote{242} The Court said in \textit{Tateo}: 

Corresponding to the right of an accused to be given a fair trial is the societal interest in punishing one whose guilt is clear after he has obtained such a trial. It would be a high price indeed for society to pay were every accused granted immunity from punishment because of any defect sufficient to constitute reversible error in the proceedings leading to a conviction. From the standpoint of a defendant, it is at least doubtful that appellate courts would be as zealous as they now are in protecting against the effects of improprieties at the trial or pretrial stage if they knew that reversal of a conviction would put the accused irrevocably beyond the reach of further prosecution.\footnote{243}

The Court has said that “[c]orresponding to the right of an accused to be given a fair trial is the societal interest in punishing one whose guilt is clear after he has obtained such a trial.”\footnote{244} There are multiple factors that the Court has said need to be balanced including, “the valued right of a defendant to have his trial completed by the particular tribunal summoned to sit in judgement on him . . . , against the public interest in insuring that justice is meted out to offenders.”\footnote{245}

The Court also demonstrated an important balancing aspect of the Double Jeopardy Clause when it said that “society’s awareness of the heavy personal strain which a criminal trial represents for the individual defendant is manifested in the willingness to limit the Government to a single proceeding to vindicate its very vital interest in enforcement of criminal laws.”\footnote{246} On the other hand, some scholars and courts have stated that when someone has been previously acquitted “no balancing of interests is required to bar subsequent proceedings on the same offense.”\footnote{247} Maximum fairness is arguably the result when the prosecution is allowed one chance to prosecute,\footnote{248} but this may not be accurate. Scholars have argued that some of the holdings in the double jeopardy area seem to have been motivated by a visceral reaction to an abuse of prosecutorial power, rather than a reasoned examination of the defendants’ rights.\footnote{249} This possibly visceral reaction, combined with the multiple interests

\footnote{241}{ Poulin, \textit{Dark}, supra note 224, at 650 (citation omitted).}
\footnote{242}{ United States v. Tateo, 377 U.S. 463, 466 (1964).}
\footnote{243}{ Poulin, \textit{Dark}, supra note 224, at 640 (citation omitted).}
\footnote{244}{ United States v. Tateo, 377 U.S. 463, 466 (1964).}
\footnote{246}{ United States v. Jorn, 400 U.S. 470, 479 (1971).}
\footnote{247}{ Griffin, \textit{Untangling}, supra note 130, at 1043-44 (citation omitted).}
\footnote{248}{ Kane, \textit{supra} note 2, at 732 (citation omitted).}
\footnote{249}{ Henning, \textit{Vacuum}, supra note 188, at 3.}
that the Court has used (in extremely varying degrees), has caused numerous problems with the application of the Double Jeopardy Clause.

C. Difficulties with the Double Jeopardy Clause

The Supreme Court has ruled on an exceptionally large number of cases dealing with the interpretation of the Double Jeopardy Clause.250 In fact, it is one of the most frequently litigated provisions found in the Constitution.251 Both scholars and Supreme Court Justices claim it is one of the least understood provisions in the Bill of Rights.252 The Supreme Court has suffered for many years with the inability to "achieve a stable interpretation of the Double Jeopardy Clause."253 Scholars have noted that the Court changes its mind about this constitutional guarantee seemingly quicker than about any other guarantee.254 The Supreme Court has overruled itself about cases that had just been decided more often in relation to double jeopardy than in any other area of criminal procedure.255 In one situation, the Court overruled a case from less than ten years prior.256 In another case, the Court overruled one double jeopardy case only a few years after it announced the initial decision.257

Double jeopardy has been criticized in many different ways being described as a troublesome concept,258 inconsistent, arguably unprincipled, and very often confusing.259 Specific decisions have also been criticized; Blockburger has been referred to as a "mess" by one of the most prominent constitutional scholars in the country.260 The fact that federalism has allowed dual prosecutions at both the state and federal level has been described as "unfortunate."261 In addition to these criticisms, the Supreme Court’s position in several areas seems problematic, if not simply flawed.

The Court has recognized the inherent weaknesses of not allowing the government to appeal acquittals in criminal cases.262 This is particularly troublesome when one considers the fact that there is no such limitation on the defendant appealing the decision; thus, one could describe this as a defendant...
getting two (or more) bites at the apple and the people only getting one. Nonetheless, a man cannot be retried under double jeopardy even when the acquittal is “based upon an egregiously erroneous foundation.” In Green v. United States, the Court held that double jeopardy barred a retrial even though it was logically impossible for the verdict to be correct: it could not have been arson, as was found by the jury, without also being murder, because there was no question that the woman had died in the fire and by definition that would have been murder. Jury verdicts are often not products of logic, and are frequently due to unknown considerations. However, even if it can be convincingly proven that a jury erred, a new prosecution is barred by the Double Jeopardy Clause. In some ways, “juries are the ultimate referees, who are infallible because they are final.” The Supreme Court has repeatedly said that a jury acquittal’s “finality is unassailable.”

“Under the Sixth Amendment . . . a criminal jury has the right to acquit a defendant even in the face of indisputable factual evidence of guilt.” Furthermore, “[a] jury’s verdict of acquittal represents the community’s collective judgment regarding all the evidence and arguments presented to it. Even if the verdict is ‘based upon an egregiously erroneous foundation’”.

Even though defendants can appeal judgments, a state cannot appeal a judgment against itself regardless of the errors made by the judge or an absolute determination that the jury acted against the evidence. Outside a jury situation, there are other scenarios in which double jeopardy is problematic. Double jeopardy can preclude a retrial even when a judge has inappropriately and unnecessarily declared a mistrial. A wrongly declared mistrial can bar retrial both when it is an innocent mistake and when it is one that was calculated to benefit the prosecution. It is clear that “[a]t times the valued right of a defendant to have his trial completed by the particular tribunal summoned to sit in judgment on him may be subordinated to the public interest—when there is an imperative necessity to do so.” To grant a mistrial, the Court requires necessity, but necessity arguably “is in the eye of the

263. Griffin, Untangling, supra note 130, at 1043 (citation omitted).
265. Id. at 214.
266. Id. at 191.
267. Amar, supra note 158, at 1841.
269. Amar, supra note 158, at 1846.
270. Yeager, 557 U.S. at 122-23 (quoting Fong Foo v. United States 141, 143 (1962)).
273. Id. at 489 (citing Gori v. United States, 367 U.S. 364, 369 (1961)).
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beholder, and the Court’s mistrial doctrine is nearly standardless.” The Court balances the various interests in determining if a mistrial is necessary. Yet, the word “necessity,” much like life and limb, is not taken literally, and in fact courts have referred to degrees of necessity. Both “manifest necessity” and “ends of public justice” are very vague terms. This vague standard gives judges a lot of room to make mistakes. As scholars have pointed out, “[w]hen the trial judge acts ‘irrationally or irresponsibly’... double jeopardy provides the defendant with a windfall from the judge’s precipitous act.” There are many situations in which a judge’s behavior should allow a new trial, but only a few where it does—the most obvious being judges taking bribes to acquit a defendant. Even erroneous application of the exclusionary rule will not allow a prosecutor to appeal an acquittal.

Prohibiting incorrect rulings of law resulting in an acquittal from being reviewed by an appellate court is an “arbitrary windfall to the guilty, not a carefully structured scheme to protect the innocent. It is as if we simply said that every third (randomly selected) defendant should go free without good reason.” Judges have an incentive to rule for the defense because, if acquitted, even if totally wrong, they cannot be overturned. In these types of situations, the inability to appeal denies the public of its “fair opportunity to prosecute a criminal case” and further prevents judges from being held accountable for any errors or other misconduct in which they may have engaged.

In addition to these general problems with double jeopardy, there are many case-driven specific issues that have and will continue to arise. For example, in one case the Court upheld the release of a killer with effectively a slap on the wrist because, at the time, the rule precluded trying him for vehicular manslaughter when he killed a young woman due to the completed adjudication of his traffic violation. Situations involving criminal conspiracies similarly raise case-driven problems. For example, when dealing with a criminal

275. Thomas, supra note 141, at 1554.
276. Id.
277. Id. at 1561 (citation omitted).
278. Id. at 1559.
279. Henning, Misconduct, supra note 180, at 801 (citations omitted).
281. Arguably the exclusionary rule should not apply to corporations in the first place. See Wagner, Corporate Criminal Prosecutions and the Exclusionary Rule, supra note 1.
282. Khanna, Asymmetric, supra note 175, at 350 (citation omitted).
283. Amar, supra note 158, at 1844.
284. Khanna, supra note 175, at 389-90 (citations omitted).
285. Poulin, Accountability, supra note 280, at 954.
286. Poulin, Waters, supra note 149, at 891.
conspiracy, there is no doubt that the commission of the substantive offense and the conspiracy to commit it are separate and distinct offenses. But, given the nature of a conspiracy, when is there one long conspiracy and when are there multiple conspiracies? Even though the courts have not been consistent on this point, arguably since conspiracy is a continuing offense unless there is some evidence to the contrary, the better position usually holds that a defendant has simply continued with one conspiracy as opposed to leaving one and entering another. It is up to the prosecution to prove that there is an additional conspiracy rather than one continual conspiracy. If there is an attempt to prosecute a second conspiracy and it is deemed one conspiracy, the Double Jeopardy Clause will block a potential very meritorious prosecution.

Double jeopardy is unlike many constitutional protections because it is not subject to harmless error analysis, nor does it permit exceptions once it attaches. Double jeopardy has precluded a subsequent trial even when seemingly all the justifications like harassment or anxiety were not present and the second trial was only two days later. Double jeopardy can attach even when there is virtually no way the defendant could have been injured. Arguably, excessive application of the double jeopardy principle “makes an absolute of the interests of the accused in disregard of the interests of society.”

Many, if not all, of the interests supported by the Double Jeopardy Clause have counterarguments purportedly eliminating or, at least minimizing, these advantages. In response to the interest of avoiding a preview of a defendant’s case, or otherwise allowing the state to improve its case, it is odd that one of the arguments supporting double jeopardy boils down to the idea of wanting defendants (particularly guilty ones) to maintain the ability to surprise the state at their trial. Furthermore, scholars have claimed that the argument that double jeopardy protects the defendant from the state’s rehearsing its case is overblown. Relatedly, in response to the interest in avoiding the ability of the state to harass a defendant, a counter-argument maintains that if the defendant is guilty, particularly of a serious offense, why do we care if the state’s repeated attempts to prosecute her result in repeated embarrassment or expense, or wears

288. Theis, supra note 181, at 306.
289. Id. at 307.
290. Henning, Vacuum, supra note 188, at 69.
294. Lippke, supra note 271, at 518.
them down? In response to the cost argument, some have claimed that the inability to appeal may increase the cost spent by the state to maximize the chance of success and hence increase the cost to the defendant in the initial trial as well, in an attempt to keep up with the state’s expenditure. In terms of finality, some have argued that if it is a wrongful conviction, we should never fully close the door to a correction (and in fact we do not, via pardons), so we could argue that closing the door fully to a wrongful acquittal is also problematic. Arguably, “only the guilty have an interest in the ‘final’ finality of mistaken acquittals, and it is presumably not a legitimate one.” Often, an acquittal is the result of a defendant being able to cover up or destroy evidence, or he got lucky and did not have the evidence discovered or understood by the prosecutors. The interest of avoiding convicting an innocent person is countered by the fact that not allowing the prosecution to appeal an erroneous verdict means that the prosecutor may spend more resources in the initial trial than otherwise would have been spent, which possibly increases the chances of an innocent person being convicted. Further decreasing the chance of an innocent person being convicted is the fact that even if a correct acquittal was appealed, the appellate court and then likely another trial court would have to rule against the defendant for an erroneous conviction to occur.

The is no certain way of verifying a verdict, and at best we can review the process for errors. It has been argued that in a criminal trial, both sides should have at least one substantially error-free presentation of the evidence, and if a mistake is made, we should be able to address a mistaken acquittal just as we address a mistaken conviction. One of the rationales for allowing some appellate options for the state after an acquittal is that the “state, like the accused, is entitled to assure itself of a trial ‘free from the corrosion of substantial legal errors’ which might have produced an adverse verdict.”

In some countries the appellate court can substitute a guilty verdict for an acquittal when the court finds it appropriate. For example, England allows an acquittal to be appealed by the government on legal questions.

296. Lippke, supra note 271, at 515.
297. Khanna, Asymmetric, supra 175, at 343.
298. Lippke, supra note 271, at 517.
299. Id.
300. Id. at 519.
301. Id. at 513.
302. Id. at 372.
304. Lippke, supra note 271, at 512.
305. Id. at 513.
308. Khanna, supra note 175, at 353 (citation omitted).
the world the ability to appeal is much more equally shared, as it is in the civil context of both res judicata and collateral estoppel.\textsuperscript{309} Many, possibly the majority of, modern nations that allow the government to appeal.\textsuperscript{310} In countries where prosecutors are allowed to appeal, they seem to do so infrequently.\textsuperscript{311} In the United States, famous scholars and judges have expressed that it would be appropriate to consider a verdict final only after it has fully ripened into a final judgment after appeal whether through a conviction or an acquittal.\textsuperscript{312} In some limited circumstances, an acquittal could be deemed nonfinal, such as a midtrial acquittal where the state has a clearly defined rule establishing it as nonfinal.\textsuperscript{313} But, generally speaking, this is not an available option in the U.S., even though notable scholars argued over fifty years ago that double jeopardy should be modified in all criminal cases to allow a state to appeal.\textsuperscript{314} There have also been calls for more limited revisions of the Double Jeopardy Clause; for example, scholars have advocated limiting the double jeopardy protection in relation to judicial actions,\textsuperscript{315} or one proposed allowing a retrial only where there is new evidence that the state did not have prior to or during the initial trial.\textsuperscript{316} Whether calling for total review of criminal acquittals or limited reviews in some circumstances, the fact remains that there has been a question for at least fifty years, if not longer, on whether the prohibition on the state against appealing an acquittal “best protects the interests of either the defendant or the state.”\textsuperscript{317}

IV. DOUBLE JEOPARDY AND CORPORATIONS

This Section describes the current framework of the law as it relates to applying the Double Jeopardy Clause to corporations and then explains why this is wrong; it proposes that in the end, courts should determine that double jeopardy does not apply to corporations, and that in some limited circumstances a judge could use her discretion to allow a second trial when new evidence has been discovered.

\begin{itemize}
\item \textsuperscript{309} Id. at 344.
\item \textsuperscript{310} Id. at 353-55 (citations omitted).
\item \textsuperscript{311} Id. at 367 (citation omitted).
\item \textsuperscript{312} Amar, supra note 158, at 1842.
\item \textsuperscript{313} Janulewicz, supra note 128, at 867 (citation omitted).
\item \textsuperscript{314} Mayers & Yarbrough, supra note 140, at 35.
\item \textsuperscript{315} Poulin, Accountability, supra note 280, at 978.
\item \textsuperscript{316} Lippke, supra note 271, at 524.
\item \textsuperscript{317} Mayers & Yarbrough, supra note 140, at 4.
\end{itemize}
A. The Current Law of Double Jeopardy and Corporations

The Supreme Court has assumed applicability of double jeopardy to corporations without ever having specifically addressed the issue. Courts of Appeals have specifically held that corporations are entitled to the protection of double jeopardy. Scholars and judges have said that they see no valid reason why a corporation should not be entitled to double jeopardy protection. Further, commentators claim that, on the one hand, depriving a corporation of the protections of double jeopardy would hurt small corporations, and on the other hand, it would not necessarily be fair even to a large corporation. As an appellate court pointed out: “The small entrepreneur is not spared the embarrassment, expense, anxiety and insecurity resulting from repeated trials on criminal charges, simply because he has incorporated his modest business.”

Whether for big or small corporations, the Supreme Court has assumed, and multiple courts have held, that double jeopardy protections attach to corporations. Even though the Court has never expressly discussed the issue of applying double jeopardy to corporations, there have been several lower court cases granting corporations the protection and none in which it was denied. The government has tried unsuccessfully to claim that the Double Jeopardy Clause does not apply to corporations. In Fong Foo, the Supreme Court held that the Double Jeopardy Clause prevented retrying a corporation even though the Court asserted that there was reason to hold that the corporation had been acquitted by grave mistake. They did this without ever discussing if/why the Double Jeopardy Clause should apply to corporations in the first place. That case dealt with fraud on the United States, and a judge who considerably overstepped his power acquitted a corporation and essentially left the U.S. with no recourse due to the Double Jeopardy Clause. In another federal case, the government was prevented from claiming that the corporation was wrongfully acquitted because of an erroneous instruction given to the jury.

318. Henning, Conundrum, supra note 197, at 844.
320. Kane, supra note 2, at 732 (citation omitted).
321. Id. at 732.
323. Id.
325. Id. at 334.
326. Id. at 333.
328. Id. at 145.
by the trial judge. The government claimed the corporation was not entitled to double jeopardy protection. The Court of Appeals pointed out that the Supreme Court “assumed” that corporations had the right. The appellate court rejected the government’s argument that double jeopardy only applies to “life and limb” and hence not to a corporation. The clause has long been construed as applying to much more than its literal interpretation would indicate. The appellate court pointed out that the Supreme Court in Lang recognized that the “life and limb” language was an embodiment of common law principles that encompassed misdemeanors as well. The appellate court stated: “[W]e see no valid reason why a corporation which is a ‘person’ entitled to both equal protection and due process under the constitution... should not also be entitled to the constitutional guaranty against double jeopardy.” Nonetheless, other than pointing out that corporations are of all sizes, can commit all types of crimes, and are organized for “religious, educational, charitable or social purposes, rather than for profit,” the decision did not explain exactly why the corporation should be entitled to claim double jeopardy protection.

It has been argued that a corporation should not have all of its assets drained out by continual prosecutions for the same thing. Furthermore, some courts have said that the goal of avoiding harassment and the concept of fairness would be violated if corporations were allowed to be re-prosecuted. Some courts have actually expanded double jeopardy when dealing with a corporation, stating that even if there is an additional element involved (which would typically mean it was a different offense under the Blockberger test), that element may be deemed not material or substantial enough to override the foundations of fairness and finality which are the basis of the double jeopardy bar.

330. Id.
331. Id.
332. Id.
334. Sec. Nat’l Bank, 546 F.2d at 493 (citation omitted). That said, the common law did not recognize the ability to criminally prosecute a corporation, so one may query how its principles could endorse the application to corporations.
335. Id. at 494.
336. Id.
337. Id.
338. Id.
339. Kane, supra note 2, at 747 (citation omitted).
341. Id. at 623.
Some justices have said in dissent that the Constitution has settled the balancing between societal interests and the defendant’s interests, and has sided with defendants in the end. One federal judge held:

Double Jeopardy is an absolute right, it is not modified such as searches and seizures by the word “unreasonable,” it is not modified as the right of condemnation which must be for “public use,” it is not subject to the elasticity of the phrase “due process of law” and other modifications of other rights, and under that clause, if a person is once placed in jeopardy for an offense he simply cannot be prosecuted for that offense again, regardless of the reasonable [sic] or unreasonableness or the public interest which may bespeak a prosecution.

In this same case in which the court held that double jeopardy was absolute, it also ruled that it is “beyond a doubt [] that constitutional jeopardy extended to ‘persons’ includes corporations.” This absoluteness is connected to some of the reasons why corporations should not be granted double jeopardy protection.

B. The Problem with Double Jeopardy and corporations

Justice O’Connor stated that “[d]ecisions by this Court have consistently recognized that the finality guaranteed by the Double Jeopardy Clause is not absolute, but instead must accommodate the societal interest in prosecuting and convicting those who violate the law.” In some circumstances, “the purpose of law to protect society from those guilty of crimes frequently would be frustrated by denying courts power to put the defendant to trial again.” Even though it is true, as scholars have pointed out “It is a basic principle of constitutional law that the government cannot ignore the Constitution simply because it impedes the government from accomplishing some goal.” That does not mean that those goals should not be taken into account and weighed against the constitutional interest involved. There have been cases in which almost undeniably, guilty corporations successfully used the Double Jeopardy Clause when a procedural or technical issue was violated but at a stage at which jeopardy had attached. In one case, double jeopardy has allowed a corporation to cause the death of eighty-four people and only get a $1,000 fine because the clause prevented it from being charged with more than one count of manslaughter.

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344. Id. at 368.
347. Hessick & Hessick, supra note 143, at 71.
Scholars have pointed out that if the reasoning behind any protections afforded to individuals does not apply to corporations, or if there are specific reasons to deny the protection to corporations that only apply to corporations, then the protection should not be afforded. Both of these conditions are met in the context of corporate double jeopardy protection.

Before discussing the interests involved and how that argues against corporate double jeopardy, it is helpful to begin with a discussion of the history of double jeopardy. The Supreme Court has repeatedly stated that double jeopardy “is derived from history, its significance and scope must be determined, ‘not simply by taking the words and a dictionary, but by considering its origin and the line of its growth’.”

The doctrine of double jeopardy should be interpreted in light of the common law and history from which it came, and which were well known to the framers of the Constitution. Judges have commented on the undesirability of “stretching the immunity from the double jeopardy provision of the Fifth Amendment to embrace a factual situation far beyond the purpose and reasoning of the Founding Fathers.” However, this is exactly what the Court has done in relation to corporations. The Supreme Court has quoted the Blackstone Commentaries reflecting the history of the Double Jeopardy Clause and referring to “autrefois acquit.” The ancient doctrines of autrefois acquit and autrefois convict have been described as applying to a “man.” Furthermore, when recounting the history of autrefois acquit, the Court has referred to Blackstone and the idea that it was established so that the “life of a man shall not be twice put in jeopardy.” The focus is often on a “man” but the Court has not held this language to be significant, despite the fact that when the Bill of Rights was drafted and when the first double jeopardy cases were before the Supreme Court, Blackstone’s Commentaries were still fairly recent and heavily relied upon.

In support of the Double Jeopardy Clause, the Court has stated that the historical references, including the idea “to try again one who had been previously convicted or acquitted of the same offense, was ‘abhorrent to the law of England.’” That said, trying a corporation for a crime was also

350. Kane, supra note 2, at 742 (citation omitted).
351. Green v. United States, 355 U.S. 184, 199 (1957) (Frankfurter, J., dissenting) (citation omitted).
354. Green, 355 U.S. at 200 (Frankfurter, J., dissenting).
356. Green, 355 U.S. at 200 (Frankfurter, J., dissenting).
357. Thomas, supra note 141, at 1565.
358. Green, 355 U.S. at 200. (Frankfurter, J., dissenting) (citation omitted).
considered abhorrent in this period.\textsuperscript{359} Double jeopardy was described in very early cases as a “personal rights of the individual.”\textsuperscript{360} This same historic disconnect applies to the Fourteenth Amendment as well as the Fifth. Some justices have pointed out that it is questionable whether a single person who took part in drafting the Fourteenth Amendment had any idea that it would address corporate regulation at all.\textsuperscript{361}

Furthermore, application of the principles of the Fifth Amendment has changed considerably since adoption, making application significantly more difficult.\textsuperscript{362} For example, in an old case discussing double jeopardy, the Court said: “If there is anything settled in the Jurisprudence of England and America, it is that no man can be twice lawfully punished for the same offense.”\textsuperscript{363} This may have been settled then, but it is wrong today—you can be punished twice, if that is the legislative intent, just not tried twice.\textsuperscript{364}

Not only is the history of double jeopardy hostile toward granting it to corporations, but neither are the interests protected. A criminal proceeding “imposes heavy pressures and burdens—psychological, physical, and financial—on a person charged. The purpose of the Double Jeopardy Clause is to require that he be subject to the experience only once for the same offense.”\textsuperscript{365} A district court has stated:

A Power in government to subject the individual to repeated prosecutions for the same offense would cut deeply into the framework of procedural protections which the constitution establishes for the conduct of a criminal trial. And society’s awareness of the heavy personal strain which a criminal trial represents for the individual defendant is manifested in the willingness to limit the government to a single criminal proceeding to vindicate its very vital interest in the enforcement of criminal laws.\textsuperscript{366}

This quotation is from a case in which corporations were defendants, so even though the language and interests seem to apply to a natural person it was in fact applied to the corporation.

Individuals do suffer when a corporation is a defendant, particularly in the case of a small corporation or one with only a single shareholder.\textsuperscript{367} Yet, any such adversity is very different in both kind and level from that suffered by non-corporate defendants. It has been argued that at least in the context of a small corporation, the shareholders would suffer the same “anxiety and

\textsuperscript{359} See supra Section II.A.
\textsuperscript{360} Ex Parte Lange, 85 U.S. at 178.
\textsuperscript{361} Wheeling Steel Corp. v. Glander, 337 U.S. 562, 578 (1949).
\textsuperscript{362} United States v. Scott, 437 U.S. 82, 87-88 (1978) (Frankfurter, J., dissenting).
\textsuperscript{363} Ex Parte Lange, 85 U.S. at 168.
\textsuperscript{364} See supra Section III.A.
\textsuperscript{367} Kane, supra note 2, at 730.
psychological and emotional stress an individual would endure” with repeated prosecutions.\(^{368}\) This does not appear to be correct. Other scholars have already pointed out that the “anxiety” suffered by a corporation is not sufficient to establish the protection of avoiding a subsequent trial.\(^{369}\) Safeguarding a defendant’s state of mind does not apply to corporations, except possibly metaphorically,\(^{370}\) and how a corporation could suffer “emotional stress” is difficult even to imagine. While corporations do not experience emotions, that does not mean that they do not suffer harms, even significant harms to their legitimate interests.\(^{371}\) Nevertheless, these harms are different and should be weighed differently just as they are in other constitutional contexts.

For example, there seems to be a disconnect as to why the emotional appeal of protecting the small business owner provides double jeopardy protection but not the right to remain silent.\(^{372}\) Additionally, one factor the Court has looked at to determine if a sanction is criminal, and hence subject to double jeopardy analysis, is whether it is the “infamous punishment of imprisonment.”\(^{373}\) Furthermore, in looking at what sanctions should be considered criminal, the Court has included “whether it comes into play only on a finding of scienter.”\(^{374}\) Yet, obviously a corporation cannot be imprisoned, and corporate scienter is a very different thing than traditional scienter since there is no actual mind to form an intent or “knowingly” do anything. The government has actually already argued and lost that double jeopardy should not apply because corporations do not experience human emotions and cannot be put in jail.\(^{375}\) That said, it is possible that the government lost because rather than resting on these two points, it should have argued that these are two points in addition to many others. Additional points include the fact that corporations need less help than individuals when dealing with the government.

According to the Supreme Court, double jeopardy “is designed to help equalize the position of government and the individual, [and] to discourage abusive use of the awesome power of society.”\(^{376}\) Nevertheless, given the massive amount of power that some corporations have,\(^{377}\) less equalization is needed with these corporations. On the other hand, scholars have pointed out that the simple fact that a corporation has more resources should not be the basis for depriving it of its protections any more than the rights of a wealthy

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368. Id. at 749 (citation omitted).
369. Henning, Conundrum, supra note 197, at 844 (citation omitted).
370. Id. at 850.
372. Henning, Conundrum, supra note 197, at 848.
374. Id. at 99.
377. See supra Section II.A.
man should be deprived due to his wealth. Its greater resources, however, make a corporation more capable of defending itself, its form often makes prosecution harder, and its resources can make the harm it imposes greater. One reason why corporations have received the rights they now possess is because they have the financial ability to challenge the law when it does not suit their interests. Additionally, corporations have an improved ability to deal with repeated prosecutions or appeals of acquittals. As Justice Ruth Bader Ginsberg pointed out, “[b]usiness can pay for the best counsel money can buy.” Therefore it is appropriate that these differences be considered when determining if and how double jeopardy should be applied.

Scholars have also argued that the double jeopardy doctrine furthers the integrity and efficiency of the judiciary. Yet, this is not always the case, and the alternative is not a free hand for the prosecution but rather, other types of protections that work better.

Courts and commentators have argued that the possibility of misusing prosecutorial power and overwhelming a small business mandates giving double jeopardy protection to all corporations. However, a prosecutor is called upon to “seek justice, not merely to convict” and “to serve as a minister of justice and not simply [as] an advocate.” Vindicating society’s interests and hence a retributive motive for prosecutors is acceptable, even encouraged, but any kind of personal vindictiveness is unacceptable. The Supreme Court has pointed out that a prosecutor’s goal “in a criminal prosecution is not that it shall win a case, but that justice shall be done.” There are multiple ways to protect against improper prosecutorial behavior, ranging from the Due Process Clause to inherent judicial power, which in some states has been used to “bar vexatious or unfair reprosecution.” Prosecutors being allowed to harass the accused with multiple trials and relentless prosecutions, even outside the confines of double jeopardy, has been described by the Supreme Court as “an unseemly and oppressive use of a criminal trial that violates the concept of due process contained in the Fourteenth Amendment.” The prosecutor’s intent is often used by the Court to determine if possible misconduct was a violation of the defendant’s rights. A prosecutor’s discretion can also be limited by the

378. Kane, supra note 2, at 747 (citation omitted).
379. WINKLER, WE THE CORPORATIONS, supra note 5, at 73.
380. Id. at 346.
381. Kane, supra note 2, at 745 (citation omitted).
382. Henning, Conundrum, supra note 197, at 848.
383. Henning, Misconduct, supra note 180, at 727 (citations omitted).
384. Id. at 735.
386. Griffin, Sargasso, supra note 165, at 475.
388. Henning, Misconduct, supra note 180, at 715.

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Equal Protection Clause if a claim of selective prosecution is made, but the number of selective prosecution defenses that have been successful has been fairly low. In addition to selective prosecution defenses, some due process rights belonging to a corporation could also be violated by subsequent trials.

There have even been state court cases in which repeated hung juries allowing multiple trials were eventually deemed inappropriate and the courts used their inherent power to bar further prosecutions. Multiple prosecutions may also rise to the level of harassment that can violate the due process provision of the Fifth Amendment, which reportedly boils down to a “requirement of fundamental fairness and fair play.” Scholars pointed out over fifty years ago that the Court had already implied that consecutive trials could be a denial of due process. There are often situations where the more flexible Due Process Clause would be better than the Double Jeopardy Clause at protecting the fair administration of justice. According to the Supreme Court, both the Equal Protection Clause and the Due Process Clause protect people from punishments that are “downright irrational.” It has also been argued that it is not the Double Jeopardy Clause that is best suited to address unjust punishments in successive actions, but rather the Eighth Amendment prohibition on cruel and unusual punishment.

In addition to the multiple means of supplementing the Double Jeopardy Clause, there are also repeated calls for not implementing double jeopardy itself in a manner where other interests outweigh it. The Court said that “a defendant’s valued right to have his trial completed by a particular tribunal must in some instances be subordinated to the public’s interest in fair trials designed to end in just judgments.” Scholars have argued that “[i]f the government has not manipulated the process to give itself an opportunity to rehearse the case or seek a conviction through repeated trials, then society’s interest in punishing criminals may outweigh a defendant’s interest in preventing a second prosecution.” The Court acknowledges that absolute rules are not always appropriate. Furthermore, the Court says that this type of rule could “create an insuperable obstacle to the administration of justice in

389. Id. at 747.
390. Id. at 748.
392. Griffin, Sargasso, supra note 165, at 509 (citation omitted).
394. Id. (citing Joint Anti-Fascist Refugee Comm. v. McGrath, 341 U.S. 123 (1951)).
396. Amat, supra note 158, at 1816.
400. Henning, Facsimil, supra note 188, at 8.
many cases in which there is no semblance of the type of oppressive practices at which the double-jeopardy prohibition is aimed.” 401 Some of the interests weighed by the Court are also alterable; for example, the Court has pointed out that if a defendant does not rely on the finality of the judgment, some of the prejudice the defendant would experience are avoided. 402 Some justices have also indicated that a number of the interests have shifted over time in that today there is a greater “danger that criminals will escape justice than that they will be subjected to tyranny.” 403

C. Proposals to Change the Rules

Given the dramatically different interests involved in corporate criminal prosecutions, the strict application of the Double Jeopardy Clause should not be granted. Further, given the goal of “fairness” represented by the Due Process Clause, there should be some flexibility on the part of the judge to allow a retrial of corporate defendants in rare circumstances and not follow an absolutely strict adherence even to standard res judicata principles. In terms of withholding double jeopardy protection, one should keep in mind that it is not just repeated prosecutions of acquitted corporate defendants that are prevented by the Double Jeopardy Clause, but also the government’s challenges of errors made in trial after the acquittal of a corporation. 404 A difference between res judicata and double jeopardy is that res judicata can be appealed by the state. 405 A part of the reasoning for issue preclusion, as the Court has pointed out, is the confidence that the result reached was the correct result; a part of that confidence is a result of the appealability of the verdict, and without that appealability there is much less confidence that the result is correct. 406

Decades ago, the government argued that the interests of corporations had been sufficiently protected by res judicata and collateral estoppel. 407 As one decision has stated, “[u]ntil we recognize that the United States, too, is entitled to all the benefits of a fair trial, we are affirmatively contributing to the general breakdown of effective law enforcement.” 408 Justice O’Connor wrote that “absent governmental oppression of the sort against which the Double Jeopardy Clause was intended to protect . . . the compelling public interest in punishing

402. Janulewicz, supra note 128, at 869 (citation omitted).
404. Henning, Conundrum, supra note 197, at 847 (citation omitted).
405. Kane, supra note 2, at 727 (citation omitted).
crimes can outweigh the interest of the defendant in having his culpability conclusively resolved in one proceeding.”

Justices on the Supreme Court have recognized that “a criminal trial is, even in the best of circumstances, a complicated affair to manage.” A corporate criminal trial is even more difficult due to the nature of the corporation and the fact that the law has been extended to apply to corporations. Given this increased difficulty, mistakes are more likely, and the need to address them is more important. The government has been specifically authorized to appeal dismissals of an indictment except where they are prohibited by the Double Jeopardy Clause.

There are multiple ways that this goal could be accomplished. A court could conclude that given the different interests involved and the fact that a corporation is not a natural person, corporations are not entitled to double jeopardy protection at all. This scenario could resemble the situations in some territories of the United States, where historically the government could appeal acquittals that it believed were erroneous and possibly substitute a guilty finding for an acquittal. Another option would be simply to say that given the different interests involved in a corporate prosecution, double jeopardy should be applied in a different manner. For example, under some systems of law, a person is not deemed to have been in jeopardy until a final judgment in a court of last resort. One could regard a trial as one proceeding which continues until it has been concluded in that all possibilities of appealing have been exhausted, and only then would double jeopardy attach to prevent a second conviction following the first. Justices have argued that a statute may authorize an appeal by the government in the same way that an appeal by the defendant is allowed. At least one justice has viewed an appeal as a continuation of the trial and hence not barred by double jeopardy. Furthermore, when considering double jeopardy in the past, the Court has stated that it is the burden of the defendant and not the court to establish that the defense applies in the particular circumstance.

In the corporate criminal setting, a defendant could not make such a showing and the collateral protections would be more effective. A limited

411. See supra Section III.A.
414. Id. at 121.
415. Id.
416. Id. at 136 (Holmes, J., dissenting).
417. Id. at 137 (Holmes, J., dissenting).
version of collateral estoppel could be used in place of full double jeopardy protection. Under collateral estoppel, “where a question of fact essential to the judgment is actually litigated and determined by a valid and final judgment, the determination is conclusive between the parties.”\textsuperscript{419} Collateral estoppel also saves resources and provides finality in civil settings.\textsuperscript{420} There can be a significant impact on a corporation and in particular shareholders of a small corporation if repeated prosecutions are allowed.\textsuperscript{421} That said, it has been argued that the costs could be mitigated by allowing a corporation to recoup attorneys’ fees if a government appeal is unsuccessful.\textsuperscript{422} In England, there is broad judicial discretion allowing courts to prohibit successive prosecutions when there has been an abuse of power.\textsuperscript{423} This type of discretion may be more advantageous for our system as well when dealing with corporations. This would help to avoid the problem of distinguishing small corporations because a judge would be empowered to take into consideration the corporation’s interests, as well as the government’s, when deciding if a successive prosecution is warranted.

Additional limitations could also be imposed to avoid abuse. For example, scholars have called for allowing “acquittals to be quashed if state officials can convince a court that they have fresh, reliable, and compelling evidence of a person’s guilt.”\textsuperscript{424} In this setting, a new trial would be allowed if the prosecutor had new evidence of a corporation’s guilt. This determination would be at the judge’s discretion and allow for recouping of attorney’s fees if the government was ultimately unsuccessful. “Undeniably the framers of the Bill of Rights were concerned to protect defendants from oppression . . . . On the other hand, they were also aware of the countervailing interest in the vindication of criminal justice, which sets outer limits to the protections for those accused of crimes.”\textsuperscript{425} By allowing the government to appeal the acquittal of a corporate defendant and in rare circumstances, retry cases involving new evidence, these goals of the criminal justice system can be achieved.

When the Court changed course and started applying criminal law to corporations, it said that “to give [corporations] immunity from all punishment because of the old and exploded doctrine that a corporation cannot commit a crime would virtually take away the only means of effectually controlling the subject-matter and correcting the abuses aimed at.”\textsuperscript{426} This adage may be overstated in the sense that there are other mechanisms to address criminal

\textsuperscript{419} Griffin, \textit{Untangling}, supra note 130, at 1037 (citation omitted).
\textsuperscript{420} Id. at 1040.
\textsuperscript{421} Henning, \textit{Conundrum}, supra note 197, at 855.
\textsuperscript{422} Id. at 855-56.
\textsuperscript{423} Griffin, \textit{Sargasso}, supra note 165, at 492.
\textsuperscript{424} Lippke, \textit{supra} note 271, at 511.
\textsuperscript{425} Green v. United States, 355 U.S. 184, 218-19 (1957) (Frankfurter, J., dissenting).
\textsuperscript{426} N.Y. Cent. & Hudson River R.R. v. United States, 212 U.S. 481, 495-96 (1909).
conduct, but it is still very relevant in that it highlights the importance of effectively dealing with criminal corporate conduct. The proposal in this Article furthers that goal, and similar to the “old exploded doctrine” referred to by the Court, double jeopardy as well should be put aside. Fortunately, the Court often seems to change course when interpreting the Double Jeopardy Clause, and when dealing with this issue the Court has pointed out the need to apply “realism and rationality.” It is both rational and realistic for the Court to take the first opportunity to specifically address the application of double jeopardy to corporations and change the previously-made assumptions.

V. CONCLUSION

Given that corporations have fewer of the interests designed to be protected by the Double Jeopardy Clause, the interests they do have are lessened; the harms resulting from corporate crimes are harder to prosecute and potentially more damaging than individual crimes; and the history of the clause and the interests it protects do not apply to corporations, the Supreme Court should conclude that they do not have this right. Rather, corporations’ interests are protected by other constitutional provisions and common law rules like res judicata, which themselves may also be modified in rare circumstances where judicial discretion finds evidence that requires a new trial in the interest of justice. Corporate double jeopardy has had its day in the court of judgment, and it has lost—it is time to dismiss it without further appeals.

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427. Poulin, Dark, supra note 224, at 633.