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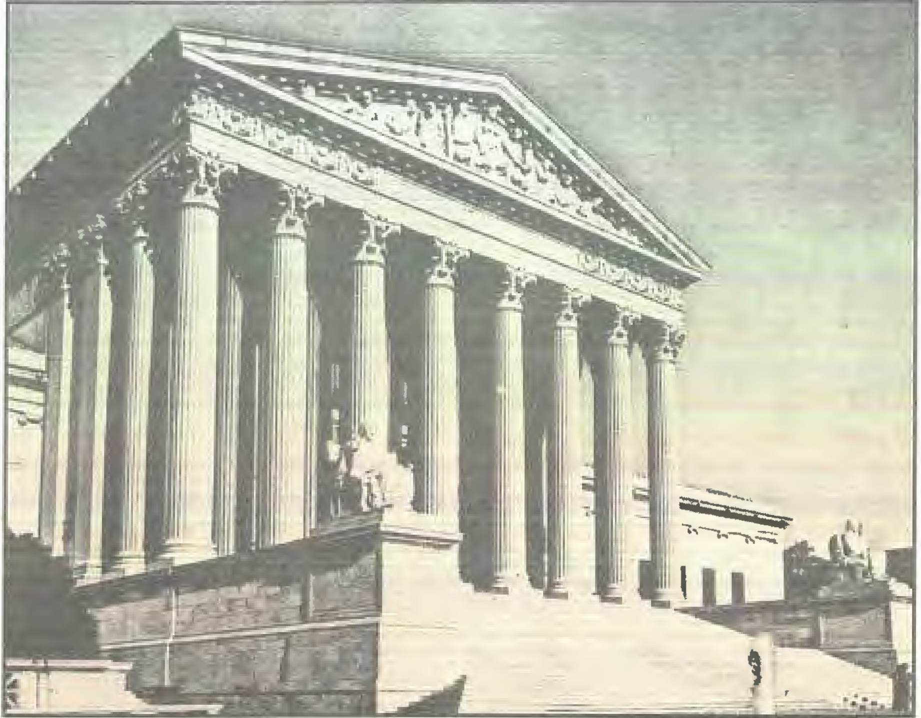

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LENDER LIABILITY UNDER CERCLA: AN OVERVIEW FOR BUSINESS LAW COURSES

by

Peter A. Martin* and Susan Lorde Martin**

INTRODUCTION

In 1980 Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).[1] The statute created a stir within the lending institution community that, despite various changes in the law, still exists today. This paper discusses the lender liability provisions of CERCLA. It is concerned with the mortgage lender who, without actively participating in the management of a company, forecloses on the company's property when the company declares bankruptcy after having contaminated the property with hazardous waste. Under current law, it is possible, but by no means definite, that such a lender would be held liable for the costs of cleaning up the contaminated site. That situation is not in the best interests of either lenders or the environment. This paper advocates a return to a sensible but voided 1992 EPA rule in order to achieve a greater consistency in the law, a better business climate for lenders, and a cleaner environment. The importance of these three goals and their interaction makes CERCLA a suitable topic for inclusion in survey business law or legal environment courses.

This paper traces the history of lender liability law under CERCLA. The first section notes the relevant statutory language of CERCLA itself, case law, the significant EPA regulation, and some state statutes. Then the paper shows how current law applies to the potentially liable lender who forecloses and suggests actions a lender can take to avoid CERCLA liability. In so doing, it points out the flaws in the current law and suggests alternative amendments. The next section concludes that for the good of lending institutions, businesses, and the environment, Congress should amend CERCLA's secured creditor exemption so that it resembles the now voided EPA rule. The final part discusses how and why this topic fits into the business law curriculum.

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Development of Foreclosure Issues under CERCLA

CERCLA

CERCLA was enacted in 1980 to provide a means to clean up contaminated hazardous waste sites and to hold those parties deemed responsible for the contamination, liable for cleanup costs.[2] This statute immediately changed how creditors evaluate the risk in making mortgage loans to companies that produce hazardous wastes. Normally, a lender will evaluate market risk, that is, the risk that interest rates will go up, and credit risk.[3] Credit risk is the risk that the borrower will fail to perform its contractual obligation to repay the loan.[4] To assess the credit risk of a commercial borrower, the mortgage lender would ordinarily consider such factors as cash flow, payment history, and a business history of stability or growth.[5] After the enactment of hazardous materials. Such risks are difficult to calculate, especially when the lender does not become significantly involved with the company's decision making or ownership unless and until the company enters bankruptcy and the lender then forecloses on its contaminated site. The difficulty exists because the statutory language of CERCLA does not clearly indicate under which specific circumstances such a lender should be liable for cleanup costs.

CERCLA imposes liability upon the following general categories of responsible parties: (1) present owners and operators of a facility in which hazardous substances are located; (2) owners and operators of the facility at the time of disposal of hazardous substances; (3) generators of hazardous substances; and (4) persons who accept hazardous substances for transport to disposal sites or treatment facilities.[6] In addition, CERCLA creates a security interest exemption, stating that an "owner" or "operator" "does not include a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility."[7] By failing to define vague terminology like "indicia of ownership," and "participation in the management," Congress left it to the courts to determine if and when lenders are "owners" who are liable for cleanup costs.

Early Cases under CERCLA

With such vague statutory language, it is not surprising that different courts interpreted the statute differently, confusing a lender's risk calculation process even more.[8] Several well known cases illustrate the problem.

In *United States v. Maryland Bank & Trust Co.*,[9] the United States District Court in Maryland focused on the "owner and operator" language of CERCLA and determined that Congress intended to hold liable owners of contaminated sites who were not operators, that is, owners who were not involved in the management of the company, as well as owner/operators.[10] Therefore, the court concluded that a bank which had foreclosed on a contaminated site primarily to protect its security interest was an owner, and was liable for cleanup costs under CERCLA.[11] The court noted that if the bank were exempted from liability, the federal government would have to pay for the cleanup and then the bank would enjoy a windfall, profiting from the increased value of the decontaminated property.[12] The court pointed out, however, that in the instant case, the foreclosing bank had held the property for nearly four years, suggesting that it was the length of time that made this lender a liable party under CERCLA.[13]

If the Maryland court was indicating that a lender would not be an "owner" if it sold the foreclosed property more quickly, then its decision is consistent with the ruling of the United States District Court for the Eastern District of Pennsylvania in *United States v. Mirabile*,[14] a case decided several months before *Maryland Bank*. In *Mirabile*, the bank that foreclosed, held title to the contaminated site for four months before assigning it. Although the Pennsylvania court's opinion focused primarily on determining what constitutes participation in management, it also asserted that mere foreclosure does not necessarily impose liability upon a lender.[15] As long as the lender limited its involvement with the property to the "financial aspects of management" without managing the quotidian production aspects of the business, then the lender would escape CERCLA liability.[16] This formulation recognized the legitimate protection of a security interest by foreclosing and taking title.

Other CERCLA cases concerning lender liability emphasized the lender's behavior in the period of time before foreclosure and the issue of participation in management, arriving at varied conclusions about whether or not mere foreclosure was enough to impose liability.[17] However, these issues of pre-foreclosure behavior on the one hand, and foreclosure followed by some post-foreclosure behavior on the other, overlapped in *United States v. Fleet Factors Corp.*[18] That case arose after Fleet agreed to lend money to Swainsboro Print Works obtaining as collateral a security interest in Swainsboro's textile facility and all of its equipment.[19] Five years later Swainsboro entered into bankruptcy, and Fleet foreclosed on its security interest in some of the inventory and equipment.[20] Approximately two years later the Environmental Protection Agency (EPA) inspected the facility, found large amounts of toxic chemicals and asbestos on the premises, and incurred $400,000 in clean-up costs.[21] The EPA then sued the principal officers and stockholders of Swainsboro and Fleet to recover the cost of cleaning up the toxic materials.[22] The district court denied Fleet's motion for summary judgment and Fleet appealed to the United States District Court for the Eleventh Circuit.[23]

The Eleventh Circuit determined that the critical issue was "whether Fleet participated in management sufficiently to incur liability" or was an "operator" under the statute and would, therefore, not be entitled to CERCLA's exemption for a holder of "indicia of ownership primarily to protect his security interest."[24] This case was the first federal appellate court case to consider this issue.[25] The Eleventh Circuit rejected as too permissive the *Mirabile* court's approach of exempting from liability lenders who were involved in financial management of a facility but not in operational management.[26] Instead, the Eleventh Circuit held that a secured creditor would be liable for environmental clean-ups if it was sufficiently involved in the financial management of the facility "to influence the corporation's treatment of hazardous wastes."[27]

Although this case strictly focused upon the time period before foreclosure, its holding could have ramifications for lenders whose involvement in management takes place post-

foreclosure, therefore, this decision caused a certain wariness in lenders of all levels of involvement at all times. The standard articulated in *Fleet* has the potential for being extended to incorporate a lender whose "capacity to influence" occurs only post-foreclosure, when the lender actually "owns" the site.

EPA's Lender Liability Rule

In 1992 the EPA promulgated its own lender liability rule.[28] It clarified CERCLA's security exemption rule, undercutting the strictness of the *Fleet Factors* rule, and specifically shielding from liability lenders who had minimal roles in the bankrupt company's operations until foreclosure. The rule explicitly defined, *inter alia*, the terms "indicia of ownership"[29] and "primarily to protect a security interest."[30] Most importantly for a lender, the rule stated that the lender can avoid liability when foreclosing on a contaminated site,

> provided that the holder [i.e., lender who forecloses] undertakes to sell, re-lease property held pursuant to a lease financing transaction (whether by a new lease financing transaction or substitution of the lessee), or otherwise divest itself of the property in a reasonably expeditious manner, using whatever commercially reasonable means are relevant and appropriate with respect to the vessel or facility, taking all facts and circumstances into consideration, and provided that the holder did not participate in management.[31]

This rule had some vague terminology of its own, such as "reasonably expeditious manner," but nevertheless went far in clarifying what actions a lender could take in foreclosure proceedings without incurring liability. It provided more structure and better guidelines for lenders than did most of the case law existing at the time of its promulgation. It specifically described the procedures a lender can and must take before, during and after the foreclosure process in order to preserve the exemption.

Furthermore, the rule gave lenders greater leeway in dealing with foreclosed property without risking CERCLA liability as an owner. Provided that the lender did not "participate in management" prior to foreclosure,[32] the rule allowed the lender to engage in procedures to liquidate or transfer the property, or wind up operations on the site without subjecting itself to CERCLA liability.[33]

Kelley v. EPA

The EPA rule was judicially challenged in 1994 in *Kelley v. EPA*.[34] In that case the United States Court of Appeals for the District of Columbia Circuit held that Congress had not granted the EPA the authority to identify specific circumstances under which a lender should be deemed an owner or operator under CERCLA.[35] The court explained that CERCLA specifically authorizes the EPA to promulgate rules and regulations concerning various activities,[36] and these activities do not include further definition of CERCLA terminology to determine lender liability.[37] Thus, the court voided the EPA lender liability rule, and with it any decisions which had relied upon the EPA rule. In 1995 the EPA removed the rule from the Code of Federal Regulations.[38] The *Kelley* decision created a general uncertainty like that existing prior to the promulgation of the EPA rule. Of most concern to lenders, it potentially returned the state of the law back to the vagueness, and possible strictness, of the *Fleet Factors* rule that suggested that any financial management by lenders might create CERCLA liability.[39]

Pro-lender Law Despite Kelley

Despite this setback for lenders, recent case law has signified a trend towards more favorable rulings for lenders. There had been several decisions favoring lenders before *Kelley* that did not rely upon the EPA rule. Therefore, despite *Kelley*, the following pro-lender cases are still persuasive.

In *United States v. McLamb*[40] the United States Court of Appeals for the Fourth Circuit held that although a bank "owns" a property when it forecloses on it, if the bank takes swift action to place the property on the market, does not use or manage the property during its ownership, and sells the property promptly, the bank is acting "primarily to protect its security interest" and, therefore, is not liable under CERCLA.[41] In this case the Wachovia Bank & Trust Company had taken a security interest in 217 acres of land as collateral for a loan it had made to the land's owner, Otto Skipper.[42] When Skipper defaulted on the loan the following year, Wachovia purchased the land as the sole bidder at a foreclosure sale.[43] Prior to Skipper's borrowing from Wachovia, he had allegedly disposed of toxic waste on the land which was subsequently cleaned up by the United States Coast Guard.[44] Wachovia asserted that the only reason it bought the property at the foreclosure sale was to protect its security interest.[45] Several days after the purchase, Wachovia signed a contract with local realtors to sell the property, and it was sold shortly thereafter.[46] Following the foreclosure, Wachovia made no attempt to develop or manage the property.[47]

In the court's opinion, the bank's actions indicated that the bank had no profit motive for acquiring the property through foreclosure.[48] The court's rationale is significant because it relied directly upon the language of CERCLA to formulate its holding. The EPA rule, still valid at the time this case was decided, was mentioned and addressed merely as a supporting argument.[49]

The United States Court of Appeals for the First Circuit has ruled on this subject twice.[50] In *Waterville Industries v. Finance Authority* the court opined that the maturation of ownership of a holder of a security interest does not cause the holder/owner to lose CERCLA's security interest exemption as long as the lender/owner divests itself of ownership within a reasonable time.[51] The court explained that although CERCLA does not explicitly sanction a safe divestiture period, such a "safety zone" must be implicit in the statute otherwise lenders with unwanted ownership thrust upon them would be subject to a sudden CERCLA liability.[52] In so ruling, the First Circuit acknowledged that the EPA regulations comported with its own decision, but emphasized that the court reached its own conclusion "independently of the regulations."[53] The court mentioned the dearth of case law on the subject, noting that the United States District Court for the Eastern

District of Pennsylvania[54] and the United States Bankruptcy Court for the Northern District of Ohio[55] supported their approach while the United States District Court for the Western District of Pennsylvania[56] opposed their position, choosing a stricter interpretation of CERCLA.[57] The court distinguished their case from *Maryland Bank* because the lender in the latter case failed to promptly resell the property after foreclosure.[58]

State Statutes

Recently enacted state statutes assessing liability for clean-up costs caused by the state-prohibited release of hazardous materials also reflect a pro-lender trend. For example, New Jersey has passed a lender liability statute similar to that of the now voided EPA rule.[59] It specifically delineates the procedures a lender must take after foreclosure in order to escape toxic waste cleanup liability when attempting to divest itself of the property.[60] Delaware law simply exempts any "commercial lending institution which acquires ownership or control of a property to realize a security interest,"[61] while Texas law exempts lenders who own a security interest in a storage tank unless the state determines that the lender's control is a contributing cause of the release of contaminants from the tank.[62]

ANALYZING CURRENT LAW

Strategies for Lenders to Avoid CERCLA Liability

Considering the law as it stands, there are several courses of action lenders can take to avoid CERCLA liability. They could take the extreme position of avoiding dealing with any industry group that generates hazardous wastes, or at least those known to be likely to contaminate above specified levels. This would, however, result in the loss of many potentially profitable business opportunities. Yet, in many circumstances and for many lenders, avoiding the CERCLA situation may be the most economically viable option.[63] The cost of cleanup could far outweigh the value of a contaminated site.

Alternatively, because cases in certain jurisdictions have demonstrated that lenders who foreclose can escape liability, a careful lender who accurately calculates the risks might be able to successfully transact business with industry groups known to contaminate. A lender that passes on too many of these business opportunities may find itself in poor financial condition.

A wise lender, even under the current law, might be able to take necessary steps to avoid liability except in the strictest jurisdictions. First and foremost, prior to any initial agreement with a company, the lender should conduct an environmental site assessment. This environmental audit requires a physical inspection of the site in order to find out if there is any present contamination or risk of potential future violations. If there is none, an adequate environmental assessment could provide the basis of an "innocent purchaser" defense under CERCLA.[64] CERCLA provides that there will be no liability for a person "who can establish by a preponderance of the evidence that the release . . . of a hazardous substance . . . [was] caused solely by . . . an act or omission of a third party [and that] he exercised due care . . . and he took precautions against foreseeable acts or omissions of any such third party."[65] The foregoing defense may not be available if the guilty third party was acting in connection with a contractual relationship with the asserted "innocent purchaser."[66] However, CERCLA also provides that such a contractual relationship (as would exist between a bank and its borrower) would not preclude the "innocent purchaser" defense as long as the person asserting the defense "did not know and had no reason to know [at the time of acquiring the property] that any hazardous substance . . . was disposed of on, in, or at the [property]."[67] In order to establish that he had no reason to know about any contamination, the "innocent purchaser" would have to "have undertaken . . . all appropriate inquiry into the previous ownership and uses of the property."[68]

Thus, the lender should review the company's files for indications of contamination problems. The lender should also review the law in the relevant jurisdiction. If the environmental inquiries indicate contamination or the potential for contamination then the lender would have crucial information for making an informed decision whether to proceed with the transaction. Furthermore, and very importantly, the lender should be sure to carefully structure the language of the loan agreement, so that it clearly excludes the type of involvement or day-to-day management of the company that would deem the lender liable under strict interpretations of CERCLA, such as that in *Fleet Factors*. A wise lender could make a case by case analysis of the environmental risks to arrive at an informed business decision concerning whether or not to proceed with the loan transaction.

The situation changes, however, if unexpected contamination on the site occurs after the loan agreement has been made, and the company enters bankruptcy[69] forcing the lender, under ordinary circumstances, to foreclose on the property. In this event, the lender should follow the now voided EPA rule's guidelines: it should immediately put the property on the market and demonstrate a serious effort to transfer the property, selling it upon receiving the first fair offer. By so doing, a lender would be able to show that it was acting primarily to protect its security interest, and would most likely escape liability, except in jurisdictions like the D.C. Circuit which choose to use the stricter interpretations of CERCLA. The problem with this course of action is that a lender making a good faith effort to sell the property might have difficulty in doing so because buyers would be wary of acquiring title to a contaminated site, and running the risk of liability. A potential buyer might much prefer to spend more money to operate a facility on a new, uncontaminated site rather than pay less for the contaminated site and assume cleanup costs. With this potential situation, it would be wise for the lender to have another environmental audit performed before foreclosing. If the assessment indicates that the site is severely contaminated, the lender might choose not to foreclose at all, but to cut its losses and abandon the property.

Such a sequence of events creates serious environmental concerns. CERCLA's liability scheme certainly serves as a deterrent to toxic contamination; however, it also serves to force industries to make economically justifiable decisions to contaminate new sites ("greenfields") instead of reusing already contaminated sites ("brownfields").[70] This results not only in an inefficient use of land, but it also contributes to urban decay. As contaminated sites in urban areas

become abandoned, industries flock to greenfields, risking contamination to previously untainted properties.[71] CERCLA does not address this negative effect. As long as it remains economically sound, companies will continue this process, thereby putting the public surrounding these abandoned brownfields at risk as well as continuing to further contaminate greenfields.

Problems with the Current Law

Because the cost of cleaning up a hazardous waste site is so high, it takes only a very minimal risk of contamination to deter a lender from doing business with any industry group that might create hazardous waste. This might seem beneficial: if lenders refuse to do business with hazardous waste producing companies and choose to deal only with low risk industries, these high risk groups would be forced to find ways to reduce their risk of contamination. However, for many industries, it is technologically and/or economically impossible to rid themselves completely of their hazardous waste products. Because some of these industries are vital, it is necessary for them to be able to receive fair loans. CERCLA, by requiring hazardous waste producers to clean up contaminated sites, usually at great cost, already creates enough of an incentive for these high risk groups to reduce their potential risk of contamination without putting additional pressure on the lenders.[72]

A survey conducted by the American Bankers Association, a trade association of commercial banks, after the *Fleet Factors* decision indicated that eighty-eight percent of the commercial bank respondents changed their lending practices to avoid CERCLA liability by making fewer loans to companies generating hazardous waste.[73] More than sixty-two percent reported rejecting loan applications if there was any possibility of hazardous environmental liability.[74] More than forty-five percent stopped making loans to any business that used chemicals, such as dry cleaning establishments, gas stations, and, ironically, environmental cleanup firms.[75] This is not a desirable outcome. These businesses provide necessary services, and they cannot do so without using chemicals that are potential contaminants. The threat of having to pay to clean up any land they contaminate should be enough to get these businesses to use environmentally sound procedures for disposing of their byproducts. Putting them out of business by denying them financing is not an appropriate means for achieving a safe environment. Current law unnecessarily deters lenders from transactions that would be beneficial to both the lender and the borrower, without achieving a concomitant environmental benefit.

The current law also creates problems because of its encouragement of using greenfields instead of reusing brownfields. Moreover, the inconsistency in various courts' interpretations of CERCLA creates problems of its own. A lender could have entirely different risk calculation strategies depending upon the location of the transaction. The law concerning CERCLA liability should be changed. At the very least, it should create some consistency in this area of the law.

CORRECTING CERCLA'S PROBLEMS

The simplest and most reasonable alternative is a return to the now voided EPA rule. Either Congress should specifically authorize the EPA to promulgate this rule through an amendment to CERCLA, or it should amend CERCLA's secured creditor exemption so that it resembles the EPA's lender liability rule. Either amendment would encourage lending to companies with small risks of potential contamination that might be denied capital under the current law. At the same time, although the amendment would be giving more deference to lenders, it would not encourage lenders to make environmentally detrimental business transactions. Lenders would not want to undertake the difficulties of foreclosing on contaminated property that would have to be transferred expeditiously.

Another alternative that is used in other countries and has been advocated by industry groups would be to amend CERCLA's rule of joint and several liability that holds all potentially responsible parties liable for one hundred percent of the cleanup costs, and create instead a "fair share" liability scheme in which parties would be liable only to the extent that they are actually responsible.[76] This plan, however, would tip lenders' risk calculations too far the other way, encouraging lenders to make some loans they would not under the current law or the proposed return to the EPA rule. To remove all lender liability would create fewer incentives to be diligent about creating a safe environment. Congress should amend the secured creditor exemption of CERCLA and incorporate the language of the EPA rule into it. The EPA rule would create circumstances under which both economic and environmental interests would be satisfied.

USING CERCLA'S LENDER LIABILITY PROVISIONS IN THE BUSINESS LAW CURRICULUM

Today's American college students have known about, and been concerned about, environmental issues since elementary school. Often, however, their ideas on the subject are rather absolute and unsophisticated. They know that the air and water should be the cleanest they can be and all hazardous waste should be cleaned up. They have given little thought, however, to what "cleaning up" hazardous waste actually entails, what it costs, and who should pay for it. Considering the issues involved in lender liability created by CERCLA gives students the opportunity to think about the ramifications of environmental legislation for the business community, and the desirability of aligning business interests and environmental interests.

A review of the circumstances of the enactment of CERCLA, following the debacle at Love Canal, gives students a feel for the legislative process: that major legislative changes generally are a response to major societal crises. A discussion of why Congress decided to hold responsible for cleanup costs parties who may not be morally responsible at all, can encourage consideration of the economics of environmental health. Comparing court opinions that use similar facts to arrive at disparate conclusions should suggest to students that it is difficult to arrive at "right" answers in the law; it is the well reasoned response we are seeking. The CERCLA statute and the EPA rule provide opportunities to view the relationship between Congress and administrative agencies, as well as the relationship between a statute, an administrative regulation, and court opinions. Finally, considering the role of lenders in the business community and the role they should play in environmental situations can provide an opportunity for critiquing current law and creating a new and better statute.

ENDNOTES

1.42 U.S.C. § 9601 (1992).

2 Walls v. Waste Resource Corp., 823 F.2d 977, 980 (6th Cir. 1987) (quoting United States v. Reilly Tar & & Chem. Corp., 546 F.Supp. 1100, 1112 (D. Minn. 1982).

3.See, e.g., Grant E. Buerstetta, Notes and Comments, Creating a Flexible Fiduciary Duty Rule for Banks Entering into Proprietary Derivatives Contracts, 15 Ann. Rev. Banking L. 395, 408, 431 n. 91 (1996).

4.Id. at 431 n. 90.

5.See, e.g., Rosemary C. Kehr, Policies for Rating of Commercial and Residential Real Estate, in Securitization of Commercial Real Estate 1988, at 69, 73-78 (PLI Real Estate Law & Practice Course Handbook Series No. N4-4484, 1988).

6.42 U.S.C. § 9607(a) (1992).

7.42 U.S.C. § 9601(20)(A) (1992).

8.For a detailed discussion of relevant cases see e.g., Nill V. Toulme and Douglas E. Cloud, The Fleet Factors Case: A Wrong Turn for Lender Liability under Superfund, 26 Wake Forest L. Rev. 127 (1991); David Shanks, Comment, Lenders Seek Safe Harbor from CERCLA Liability after Eleventh Circuit Fleet Factors Decision, 35 St. Louis U. L.J. 733 (1991).

9.632 F. Supp. 573 (D. Md. 1986).

10.Id. at 578.

11.Id.

12.Id. at 580.

13.Id. at 579 ("The exclusion does not apply to former mortgagees currently holding title after purchasing the property, at least when, as here, the former mortgagee has held title for nearly four years. . . .").

14.15 Envtl. L. Rep. (Envtl. L. Inst.) 20,994 (E.D. Pa. 1985).

15.Id. at 20,996.

16.Id. at 20,995.

17.Compare Guidice v. BFG Electroplating and Mfg. Co., 732 F. Supp. 556 (W.D. Pa. 1989) (focusing on "participation in management" issue, but noting that foreclosure itself was enough for lender to be liable; bank had held title to property for eight months) with Kemp Ind., Inc. v. Safety Light Corp., 857 F. Supp. 373 (D. N.J. 1994) (holding that holder of paper title is not necessarily owner of facility for CERCLA purposes; that security interest exception requires determination of why titleholder has indicia of ownership).

18.Fleet Factors II, 901 F.2d 1550 (11th Cir.), reh'g denied, 911 F.2d 742 (11th Cir. 1990), cert. denied, 111 S. Ct. 752 (1991).

19.Id. at 1552.

20.Id.

21.Id. at 1553.

22.Id.

23.Id.

24.Id. at 1555-56.

25.Id. at 1556.

26.Id. at 1557.

27.Id.

28.40 C.F.R. § 300.1100 (1992) (removed from C.F.R., 60 Fed. Reg. 33,912 (1995)).

29.40 C.F.R. § 300.1100(a) (1992). Indicia of ownership means evidence of a security interest including title to property acquired incident to foreclosure, mortgages, liens, and assignments. Id.

30.40 C.F.R § 300.1100(b) (1992). "Primarily to protect a security interest does not include indicia of ownership held primarily for investment purposes." Id.

31.40 C.F.R. § 300.1100(d) (1992). "Participate in management" is defined in §300.1100(c). It means "actual participation in . . . management or operational affairs . . . and does not include the mere capacity to influence." Id. To participate in management a lender would have to exercise decisionmaking control over the borrower's environmental compliance, such that the [lender] has undertaken responsibility for the borrower's hazardous substance handling or disposal practices; or . . . has assumed . . . responsibility for the overall management of the enterprise. . . . actions that are consistent with holding ownership indicia primarily to protect a security interest do not constitute participation in management.

Id. A lender will be considered to be merely protecting a security interest by listing the property with a broker within twelve months following foreclosure or by advertising that the property is for sale. Id. If the lender acts upon an offer of fair consideration within ninety days of receiving it or within six months following foreclosure, the lender will also not incur CERCLA liability. Id.

32.Id.

33.40 C.F.R. § 300.1100(d)(2) (1992).

34.15 F.3d 1100 (D.C. Cir.), reh'g denied, 25 F.3d 1088 (D.C. Cir. 1994), cert. denied 115 S.Ct. 900 (1995).

35.25 F.3d 1088, 1089.

36.E.g., 42 U.S.C. § 9603(d) (1992) (permitting EPA to promulgate rules and regulations specifying record keeping requirements for facilities which contain, use, or generate hazardous substances).

37.25 F.3d 1088, 1089 (rehearing dealing specifically with this issue in response to concerns of dissent in original opinion).

38.60 Fed. Reg. 33,912 (1995).

39.Since that time the EPA has been encouraging Congress to grant it the authority to promulgate such rules and regulations including, where necessary, definitions. See e.g., The Superfund Reform Act of 1994, S.1834, 103d Cong., 2d Sess. (June 17, 1994).

40.5 F.3d 69 (4th Cir. 1993).

41.Id. at 73.

42.Id. at 70.

43.Id.

44.Id. at 70-71.

45.Id. at 71.

46.Id.

47.Id.

48.Id.

49.Id. at 73. It is interesting that although the lender had full knowledge that the site was contaminated, the lender neglected to disclose this information to the buyer. The court held that this had no bearing on whether or not the bank was liable under CERCLA. Id.

50.Northeast Doran, Inc. v. Key Bank, 15 F.3d 1 (1st Cir. 1994); Waterville Indus. v. Finance Auth., 984 F.2d 549 (1st Cir. 1993).

51.984 F.2d at 553.

52.Id.

53.Id.

54.United States v. Mirabile, 15 Envtl. L. Rep. 20994, 20996 (E.D. Pa. 1985).

55.In re T.P. Long Chem.,Inc., 45 B.R. 278, 288-89 (Bankr. N.D. Ohio 1985).

56.Guidice v. BFG Electroplating & Mfg. Co., 732 F. Supp. 556 (W.D. Pa. 1989).

57.984 F.2d at 553 & n. 7.

58.Id.

59.N.J. Stat. Ann. § 58:10-23.11g1 to 6 (West 1994).

60.Id. The New Jersey statute is similar to the EPA regulations not only in substance, but also in language, such as the use of the terminology "reasonably commercial" to describe the permissible time period for completing a sale of foreclosed property, and to describe the lender's general efforts to transfer the property. Id.

61.Del. Code Ann. tit. 7, § 9106 (1993).

62.Tex. Water Code Ann. § 26.3514 (West 1994).

63.Compare George A. Nation, Life Without EPA's Rule Interpreting CERCLA's Secured Party Exemption, 111 Banking L.J. 499 (1994) (supporting idea that under current law, lenders should completely avoid all transactions with any company whose facility reveals presence of hazardous substances) with Howard M. Shanker, A Lender's Guide to Environmental Policy Development, 111 Banking L.J. 540 (1994) (suggesting lenders, through careful information gathering process, can avoid liability by calculating risks and making informed business decisions).

64.42 U.S.C. §§ 9607(b)(3), 9601(35) (1996).

65.42 U.S.C. § 9607(b)(3) (1996).

66.Id.

67.42 U.S.C. § 9601(35)(A) (1996).

68.42 U.S.C. § 9601(35)(B) (1996).

69.A company cannot, however, abandon contaminated property that puts the public health or safety in danger. See Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (holding that a bankrupt company could not opt to abandon property which contained 470,000 pounds of highly volatile contaminated oil).

70.See, e.g., Philip H. Gitlen, Voluntary Clean Up Programs, 1 Albany Envtl. Outlook 28, 28 (1995); Richard D. Morse & John D. Chirlin, Environmental Enforcement and Compliance in New York State, 1 Albany Envtl. Outlook 50, 52 (1995); Terry J. Tondro, Reclaiming Brownfields to Save Greenfields: Shifting the Environmental Risks of Acquiring and Reusing Contaminated Land, 27 Conn. L. Rev. 789 (1995).

71.See generally Douglas A. McWilliams, Environmental Justice and Industrial Redevelopment: Economics and Equality in Urban Revitalization, 21 Ecology L.Q. 705 (1994).

72.But see Sara A. Goldberg, Lender Liability under CERCLA: Shaping a New Legal Rule, 4 N.Y.U. Envtl. L.J. 61, 74-77 (1995) (asserting that CERCLA should require lenders to monitor borrowers so that lenders have "gatekeeper liability").

73.Id. at 69-70.

74.Id.

75.Id.

76.See Thomas W. Church & Robert T. Nakamura, Beyond Superfund: Hazardous Waste Cleanup in Europe and the United States, 7 Georgetown Int'l Envtl. L. Rev. 15, 35 (1994) (noting Dutch statute has "fair Share" liability standard); Michael J. Gergen, Note, The Failed Promise of the "Polluter Pays" Principle: An Economic Analysis of Landowner Liability for Hazardous Waste, 69 N.Y.U. L. Rev. 624, 691 n.195 (1994) (citing Chemical Mfrs. Ass'n, A "Fair Share" Liability System for Superfund 1-2 (Aug. 17, 1993)).

EXAMINING THE PRIMA FACIE CASE IN MENTAL DISABILITY DISCRIMINATION CASES and RAISING QUESTIONS ON SHIFTING BURDENS

by

Rosemarie Feuerbach Twomey*

Introduction

The Americans with Disabilities Act of 1990, the Rehabilitation Act of 1973, and state disability discrimination laws, all of which prohibit discrimination against persons with handicaps or disabilities, require employers to think twice before taking action against applicants or employees who fall into this legally protected category. Though the common perception that the primary beneficiaries of these laws would be the wheelchair-bound, hearing or vision impaired persons, and others with various physical ailments, a study by the National Center for Health Statistics showed that as of December 1994, psychiatric impairments were the second largest category of complaints to the EEOC--at 11%. The largest category was persons with back-related problems [1]. The numerous forms that mental disabilities take present unique problems to parties concerned with implementation of, or compliance with, those laws. Learning disabilities alone (just one of the many mental disability categories) have had a major impact, not only on educational institutions and employers, but also on professional licensing bodies which administer proficiency tests--for example, in 1994, of the 1,250 applicants who requested accommodations for taking the LSAT test, 62% claimed to have a learning disability [2].

Recent cases alleging discrimination by persons claiming mental disabilities in an employment context are the focus of this paper. After extensive discussion of the prima facie case and what factors are considered by the courts when faced with mental disability discrimination cases, the focus shifts to an examination of the shifting burden of proof in these cases. The author concludes that there is a lack of consistency in court cases on the issue of burden of proof. This inconsistency makes it difficult to predict how any court will decide a particular disability case.

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Hypothetical Scenarios

(1) An emotionally vulnerable female employee was a clerk for an unreasonably demanding and crude supervisor. She eventually had a nervous breakdown and took two weeks sick leave. The employer discharged her. She filed suit for disability discrimination, claiming Avoidant Personality Disorder as diagnosed by her psychiatrist.

(2) John Doe took a pre-employment test which screened applicants for police work. Because the test results indicated personality traits unsuited to police work, he was rejected. He filed suit for disability discrimination, claiming Schizotypal Personality Disorder as diagnosed by his psychiatrist.

(3) A manual laborer took a position at a construction site. His work was satisfactory, but he was fired because he refused to climb ladders. He filed suit for disability discrimination, claiming Acrophobia as diagnosed by his psychiatrist.

(4) An attorney used monies entrusted to him by clients for his own personal needs and lied to his clients and to the Bar about his actions. The state bar association disbarred him. He filed suit for disability discrimination, claiming he suffers from bipolar disorder which precludes his ability to distinguish right from wrong.

Mental Disabilities

There are two points to be noted about the above scenarios: First, prior to the passage of the Americans with Disabilities Act in 1990, employers not subject to the federal Rehabilitation Act or a state disability protection statute had no reason for concern about liability in those situations. Unless the employers violated their own employment contracts with those persons or violated other statutes, they were within the law in taking the actions they took. Second, all the situations involve mental, not physical, disabilities.

The differences between mental disabilities and physical disabilities are of concern, not only in disability discrimination law, but also in other areas of law--workmen's compensation, family leave, and supplemental social security, in particular. There have been arguments and claims that persons with mental problems are not compensated as well or dealt with equitably under those laws--some even claim constitutional violations on equal protection grounds [3]. With regard to the enforcement and interpretation of disability discrimination laws, there are several reasons that mental disabilities pose particular problems to both the courts and to the employers (and other institutions) who must abide by their restrictions. Some of those reasons are the following:

1. Mental disabilities are not as visible as most physical disabilities.

An employer must be informed of a disability if an applicant or employee seeks protection under the disability laws. The "invisibility" of mental problems presents a dilemma for the disabled person who would often prefer that others not know of his or her mental condition. The "invisibility" factor also is problematic for employers who may face a Catch-22 situation. EEOC regulations stipulate that they cannot perform pre-employment medical testing on applicants, and the mental condition of an applicant may not be readily apparent. If they unwittingly hire someone who has a mental disability, and whose condition causes harm to others at work, the employer may face liability on two possible fronts: (1) from the employee who may argue the employer should have known of the illness (i.e., based on absences, behavior, statements, etc.) and should have "accommodated" it, and (2) from the person who was harmed, based on a "negligent tort" theory--that is, the victim would not have been injured if the employer had not been negligent in hiring (or retaining) someone with a mental problem.

As noted above, because mental disabilities are not easy to detect, an issue that arises in disability cases is whether an employer must accommodate a person about whom there is no factual dispute concerning the existence of a legally recognized mental disability when the employer had no knowledge of its existence at the time of discharge or other unfavorable employment decision involving the plaintiff. The courts are generally in agreement that lack of knowledge on the part of the employer results in a judgment in favor of the employer, and does not give rise to a duty to accommodate. In *Miller v. National Casualty*, 61 F.3d 627, 1995, the only knowledge the employer had of plaintiff's disability--a manic depressive condition--was a medical excuse from a nurse practitioner citing a diagnosis of "situational stress reaction" and a telephone message from the plaintiff's sister that "She's falling apart. She's really lost it. We're trying to get her into a hospital." The court did not believe this to be sufficient information to impose a duty of reasonable accommodation on the employer [4].

2. A stigma attaches to mental disabilities.

Regardless of its nature, there is often an inordinate fear or concern about associating with, or delegating responsibility to, someone who suffers from a mental problem. For this reason, employers are reluctant to hire, retain, or promote them. Furthermore, the victims of such disabilities avoid seeking help and often feel compelled to lie about their illness to prospective employers and others. It is this stigma that led legislators to include in the definition of persons with a disability those who have a "record of such impairment" or are "regarded as having" such an impairment--even if they in fact are not so disabled, e.g., they have successfully recovered from a mental illness.

3. Mental disabilities are not easily understood.

Causes and cures of many mental problems are unknown, and there is a belief on the part of many people that persons claiming a disability are simply not trying hard enough or are just not acting responsibly. A National Health Association poll found that 43% of

Americans view depression as a weakness [5]. The effect of this line of thinking can readily be seen in an employment situation.

4. It is difficult to distinguish a mental disability from ordinary personality traits.

Employers would argue that they have the prerogative to set workplace standards of behavior that all employees are expected to uphold. With respect to compliance with disability laws, the questions employers have are: To what extent can they hold an employee responsible for violation of workplace rules when the behavior is triggered by a mental disability? When is an employee's conduct the result of a mental disability as opposed to a mere personality fault, and how would the employer know?

If the conduct stems from mere personality faults, the employer can discipline with impunity, but if it stems from a mental disorder or disease, the employer may be obligated to "accommodate" the employee.

5. Mental disabilities are diagnosed primarily by the subjective statements of the patient.

Mental disabilities are diagnosed primarily by means of the subjective statements of the patient, while most physical disabilities can be diagnosed by objective data. This naturally transfers ambiguity into the legal arena, and permits a certain degree of abuse into the legal system by persons who choose to use the law inappropriately to their benefit.

6. The cost of care for mental disabilities is higher.

The cost of medical care is a barrier to persons suffering from mental illnesses and disorders. Employee benefits and insurance coverage for mental disabilities, in general, are lower than they are for physical disabilities. Again, this acts as a deterrent to disabled persons who will be reluctant to seek the help they need due to the cost involved.

Disability Discrimination Laws - Shields, not Swords

Disabilities laws for the employment arena were enacted to insure availability of opportunities for the disabled to obtain and retain gainful employment. If disabled persons are capable of working, but are denied a job or dismissed from work because of another's perception that they cannot do the work effectively and efficiently, the law requires that they be given the opportunity to work. These goals are laudable and provide a protective shield for disabled workers who are unfairly denied employment. Needless to say, there are persons who will use the law as a sword rather than a shield, and when the disability is mental in nature, the ground is fertile for such abuse. The EEOC and the courts are in the process of defining the parameters within which persons with mental disabilities will be protected while at the same time closing the gates to those who would manipulate the law to gain an unfair advantage. A review of the law and the cases handed down by the courts and the EEOC is presented here in an effort to better understand and predict the rights and responsibilities of employers and employees as they attempt to comply with, and seek protection under, these laws. The focus is on mental disabilities within the context of the prima facie case.

The Three-Pronged Test to Establish a Prima Facie Case

The cases involving alleged violations of the disabilities laws will be presented and discussed within the format that courts use to analyze the facts of these cases in making their decisions: the three-pronged test that is commonly viewed as the plaintiff's prima facie case [6]--i.e., those matters that the complaining party (the disabled person) must establish to have a cause of action. Unless otherwise stated, the cases cited have arisen under either the Americans with Disabilities Act of 1990 or the Rehabilitation Act of 1973. These two federal laws have many similarities and it is the intent of the lawmakers that they be construed harmoniously.

The three-pronged test consists of the following factors:

1. The plaintiff is "disabled" in accordance with the statutory language.
2. The plaintiff is a "qualified" person with regard to the position in question.
3. The action complained of (e.g., discharge) was "based on the disability" [7].

It should be noted that the "reasonable accommodation" requirement--that employers make special provisions for disabled workers when necessary--is not included here as part of the plaintiff's burden in establishing a cause of action. It is a matter of debate whether the plaintiff or defendant bears the burden of establishing the need for accommodation. In *Miller*, above, the court held that the burden to inform an employer of the need for accommodation was on the plaintiff when the need is "not obvious" [8]. Other cases have indicated that the burden of proof shifts to the defendant on the issue of reasonable accommodation after the plaintiff has shown that reasonable accommodation is possible [9]. Two cases which contain discussions of the shifting burden of proof for reasonable accommodation are: *Overton v. Reilly*, 977 F.2d 1190, 1992 which was brought under Secs. 501 and 504 of the Rehabilitation Act, and *Doe v. NYU*, 666 F.2d 776, which noted that allocation of the burden may depend on whether the employer's decision was based on the disability or on other factors. The Interpretative Guidance to the ADA provides that an employer may require that an employee present documentation regarding the need for accommodation [10]. The many concerns and questions involving the "reasonable accommodation" issue will not be a matter of intensive discussion in this paper.

The defense of "undue burden," which is clearly a matter for the employer to establish, is likewise not a matter of lengthy discussion in this paper. If the plaintiff has shown that he or she has a disability, that he or she is qualified, that the action of the employer was based on the disability, and the need for accommodation is apparent, the burden clearly shifts to the employer. If the employer shows that there is no reasonable accommodation

available, or if the accommodation sought would place an "undue burden" on the employer's operations, the employer prevails.

The First Prong: The Plaintiff Must Be "Disabled"

There are several factors which are considered in establishing whether or not the plaintiff is "disabled" under the law [11]:

A. Does the plaintiff have a mental impairment, a record of such an impairment, or is plaintiff regarded as having such an impairment?

B. Does the impairment "substantially limit a major life activity?"

C. Does the law specifically exclude the impairment from the definition of disability?

A. Does the Plaintiff have an "Impairment"?

The EEOC regulations state that a mental impairment is "any mental or psychological disorder, such as mental retardation, organic brain syndrome, emotional or mental illness, and specific learning disabilities" [12]. The legislative history of the ADA refers to the American Psychiatric Association's Diagnostic and Statistical Manual of Mental Disorders (known as DSM-IV) as the appropriate source for determination of what will be considered a mental impairment [13]. Also, courts generally require a diagnosis by a qualified mental health professional who bases his or her findings on the criteria and categories of the DSM-IV. In *Coaker v. Home Nursing Services*, 1996 U.S. Dist. LEXIS 1821, the court noted that the only documentation of plaintiff's mental disability was from her psychologist's report stating that direct patient care would be detrimental to the plaintiff's health. "From this ill-defined proposition, Coaker would have this Court leap to the conclusion that she is disabled." The court added that the psychologist did not even label the plaintiff's condition as post traumatic stress disorder, the disability from which plaintiff claims to suffer [14].

Reference to the DSM-IV does not guarantee a finding that the impairment constitutes a disability. For example, in addition to the specific personality disorders listed, there is a category known as "Personality Disorder Not Otherwise Specified." The EEOC's Interpretive Guidance states that personality *traits* do not amount to a personality disorder which is protected by law. The disorders listed in the DSM-IV are described as collections of personality traits that have become inflexible and maladaptive [15]. There is room, therefore, for challenging a professional's diagnosis of a personality disorder, especially if it is not one of the specific types listed in the DSM-IV.

There may be a finding of disability even when there is no diagnosis of an impairment recognized in the DSM-IV. That is when the plaintiff claims that he or she is "perceived" or "regarded" by the employer as having such a recognized impairment or when the plaintiff has a record of such an impairment and the unfavorable employment decision is based on that perception or record of a disability. In *Daley v. Koch*, 892 F.2d 212 (2d Cir. 1989), an applicant for police work, was disqualified for consideration based on testing which showed that he exhibited "poor judgement, irresponsible behavior and poor impulse control" which made him "unsuitable to be a police officer" [16]. Daley argued that the decision was based on a perception that he was mentally disabled. However, the defendant police department never indicated that it believed plaintiff had a mental disability. In fact, it argued that its decision was based on evidence which supported its finding that he was not qualified for the position due to negative personality traits--not to a perception of mental disability. The plaintiff himself specifically denied having a mental disability, and therefore, was left with no basis on which to claim disability discrimination.

B. Does the Impairment Substantially Limit a Major Life Activity?

There are several factors which enter into a determination of whether an impairment substantially limits a major life activity [17]. Two major factors are:

(i) the nature and severity of the impairment.
(ii) the duration or expected duration of the impairment.

(i) The Nature and Severity of the Impairment

The EEOC regulations state, "Major life activity is substantially limited if the person is unable to do that which the average person in the general population can do, or is significantly restricted as to condition, manner or duration under which the average person can perform the same life activity" [18]. Major life activities include walking, hearing, seeing, and other common abilities needed for functioning in everyday activities. In the March 1995 Interpretive Guidance issued by the Commission, several new major life activities were added, including mental and emotional processes, such as thinking, concentrating, and interacting with others [19].

One of the issues which has arisen in the case law is whether a person should be considered disabled when medication controls the impairment so that major life activities are not limited. The EEOC Compliance Manual and administrative regulations indicate that the taking of medication is a "mitigating condition" which should not be considered in deciding whether an impairment limits a major life activity [20].

A second issue that arises with regard to the substantial limitation of major life activities, deals with the ramifications of the EEOC's designation of "working" as a major life activity [21]. When the disability substantially limits a person's ability to "work," persons seeking the protection of the law must establish that their disability substantially limits their ability to work--which seems tantamount to stating that they cannot perform the essential functions of the job. Paradoxically, the law states that if disabled persons

cannot perform the essential functions of the job at issue, they are not disabled under the eyes of the law and cannot benefit from the protection of the law. The argument the disabled person would then make is that, with reasonable accommodations, he or she could perform the essential functions of the job. When the major life activity that is substantially limited by reason of the disability is "work," the courts consider whether the impairment creates a significant barrier to employment. In so doing, they consider the extent to which the substantial limitation precludes work of a particular and narrow type as compared to limiting the ability of that person to perform most types of work. For example, if a disability only prevents the employee from working for a particularly demanding supervisor because of the stress the relationship creates, but would not prevent the employee from working at any of a number of other positions in the marketplace of jobs in that geographic area for which the employee is qualified, then it is likely the court will conclude that plaintiff is not disabled. In *Forrisi v. Brown*, 794 F.2d 931 (4th Cir. 1986), the plaintiff was held not to be disabled because his disability--acrophobia--only prevented him from doing jobs which required such activities as climbing ladders [22]. His disability did not prevent him from performing many other different types of work. In light of the EEOC's new Interpretive Guidance, it is questionable whether the reasoning in *Forrisi* will predominate--the EEOC's new interpretations changed the scope of "working" as a major life activity. Among other things, it indicates that a person is protected under the law even if the disability precludes performance in only one class of jobs, such as those requiring heavy lifting, or the use of keyboards or computers [23]. Presently, this view is not consistently shared by the courts.

In deciding whether the major life activity of "working" is substantially limited by reason of a person's disability, courts consider several things: (1) the range of occupations that the person would not be precluded from doing, (2) the geographical area to which the person has access, and (3) the training, knowledge, skills, and abilities of the person [24].

A third issue in this category of substantially limiting major life activities is the extent to which ordinary personality traits--not recognized mental impairments--render one so limited; and, therefore, the person alleging disability discrimination is not disabled. In *Adams v. Alderson*, 723 F. Supp. 1531 (D.D.C. 1989) the court held that the plaintiff's inability to work effectively with his antagonistic supervisor, although designated as a "maladaptive reaction to a psychosocial stressor" did not amount to a substantial limitation of major life activities [25]. It was, instead, similar to problems which arise commonly in the workplace.

A fourth issue is the extent to which collateral court or administrative agency decisions regarding the disabilities of an individual affect a determination of disability under the disability discrimination laws. In particular, what bearing would such a decision have on the determination of whether the disability substantially limits a major life activity? One court was confronted with evidence that the plaintiff had applied for, and was eligible for SSA disability benefits. The question of the relevance of this evidence in a claim for protection under the Rehabilitation Act was discussed. That court, in *Overton v. Reilly*, 977 F.2d 1190 (7th Cir. 1992), held that the eligibility for disability benefits under SSA was not inconsistent with a finding that the plaintiff was qualified for the position from which he was fired, noting that "..even if a finding of disability could have preclusive effect in a private lawsuit, such a finding is consistent with a claim that the disabled person is "qualified" to do his job under the Rehabilitation Act... The SSA may determine that a claimant is unlikely to find a job, but that does not mean that there is no work the claimant can do... the determination of disability may be relevant evidence of the severity of Overton's handicap, but it can hardly be construed as a judgment that Overton could not do his job at the EPA" [26].

(ii) Duration or Expected Duration of the Impairment

While it seems clear that "disability" under the ADA or like statutes does not extend to such short term illnesses and conditions as broken bones and the common cold, the finding of a disability can turn on the issue of duration of the condition. The EEOC considers duration of an illness to determine whether it substantially limits major life activity [27]. A Third Circuit Court of Appeals decision in 1995, *McDonald v. Commonwealth of Pennsylvania*, held that a transitory physical condition is not a disability. That case involved a physical condition that required surgery and rehabilitation [28]. Mental disabilities, being more amorphous than physical disabilities, are not as easy to dispose of on this issue of duration. Many mental disabilities are of a long-term nature, but tend to come and go--perhaps in response to environmental factors or because they can be controlled as long as the person takes medication--enabling the person to work for extended periods without problems. In March of 1995 the EEOC issued policy guidance clarifications on the definition of disability which expanded the definition to include a greater number of chronic conditions, including episodic disorders [29].

The issue of duration of a mental disorder arose in *Jane Doe v. The Boeing Company*, a 1992 case alleging discrimination under a Washington state disability statute, in which the plaintiff successfully sued The Boeing Company. The disability was gender dysphoria (transsexualism) and the plaintiff was in the process of preparation for sex reassignment surgery when the company discharged her. The condition was, arguably, a temporary one which would end after the surgery. Nevertheless, the court held that the plaintiff was handicapped under the meaning of the state law and was entitled to accommodation [30]. The plaintiff would probably *not* have been successful in an ADA action for two reasons: (1) among the conditions excluded from coverage under the ADA are transsexualism and gender identity disorders not resulting from physical impairments, and/or (2) the fact that it was a transitory condition may have led to the conclusion that the disorder did not substantially limit a major life activity.

C. Is the Impairment Specifically Excluded from Coverage?

The ADA specifically excludes a number of mental conditions from its coverage: transvestism [24] transsexualism, pedophilia, exhibitionism, voyeurism, gender identity disorders not resulting from physical impairments or other sexual behavioral disorders [32], compulsive gambling, kleptomania, and pyromania [33], and psychoactive substance use disorders resulting from current illegal use of drugs [34]. The Interpretive Guidance issued by the EEOC in March of 1995 gives examples of conditions which are not considered to be impairments. Among them are the following: illiteracy (unless due to a learning disability such as dyslexia), rude, arrogant, obnoxious behavior, or other antisocial conduct (unless it results from a bi-polar disorder or post-traumatic stress disorder) [35]. Cases holding that behavior did not rise to the level of an impairment under the law include *Daley*, above, Fields v. Lyng, a 1988 Maryland case involving shoplifting and an inability to travel [36], and *Adams*, above, involving stress related to difficulty in working with a supervisor [37]. Cases holding that plaintiffs were not impaired due to illegal use of drugs include *Collings v. Longview Fibre* [38] and *Overton*, above.

An example of a state law case finding that a sexual disorder did not satisfy the law's definition of impairment is *A.B.A. v. XYZ Corporation,* a 1995 case brought under the New Jersey Law Against Discrimination [39], in which the plaintiff claimed to suffer from a sexual disorder known as exhibitionism. Though he had an unblemished work record and had been promoted within the company, he had been arrested for indecent exposure in Texas while away on a business trip. As a result of that incident, the company fired him. While the opinion dealt with the plaintiff's request for anonymity, there is ample discussion of the question of whether the disorder should be classified as a disability under NJLAD. In a concurring opinion, Judge Petrella stated, "Merely because a disorder is listed in a medical reference tool such as the DSM does not automatically elevate it to the status of a handicap. Nor does the term disorder equate with the term disability....It strains credulity that the Legislature would prohibit lewdness on the one hand, but condone it on the other hand, by making it a protected handicap under the LAD." The court also acknowledged in a footnote that under the ADA, the particular disorder would be excluded.

Second Prong: The Plaintiff is a Qualified Person

The second prong of the prima facie case is a finding that the plaintiff is a qualified person who can perform the essential functions of the job.

With regard to being a "qualified" person, the courts have discussed several matters, among which are the following:

(A) Whether the person can perform the "essential functions" of the job. If the person cannot, he or she is not qualified.

(B) Whether the person's disability will pose a safety risk to self or others? If so, the person is not qualified.

(C) Whether a record of excessive absenteeism indicates that a person cannot perform the essential functions of the job, and therefore, the person is not qualified?

Many of the factors which enter into the determination of whether the plaintiff is able to perform the essential functions are interdependent with the factors which fall under the third prong. In particular, when there is misconduct involved, some courts hold that the plaintiff cannot prevail because the person is, by reason of the misconduct, not qualified, while other courts hold that the person cannot prevail because the employer's decision was not based on the disability, but on other considerations.

The author suggests that factors (B) and (C) should not be used under the second prong. In fact, these items should come within the defendant's burden and should not be part of the plaintiff's burden of proof.

(A) Can the person perform the "Essential Functions" of the Job?

In determining what constitute the essential functions of a particular job, EEOC regulations indicate that courts could consider written job descriptions prepared before advertising or interviewing applicants for the job, the amount of time spent performing the function, the consequences of not requiring the individual to perform the function under the terms of a collective bargaining agreement, and the work experience of past incumbents in the job and current incumbents in similar jobs [40]. The requirement that the disabled person be able to perform the "essential functions" of the job has caused many employers to rewrite job descriptions to protect themselves from claims alleging discrimination under disability laws. With regard to mental disabilities, employers have been advised to specify, as essential functions, such things as "ability to motivate and deal effectively with subordinates." In addition, they might state the importance of courteous and businesslike behavior in the workplace, and indicate that improper behavior could be the subject of disciplinary action. By doing so, the employers place themselves in a better defensive posture if allegations of disability discrimination are made.

In a related issue, a court considered whether, in trying to ascertain reasonable accommodation, it would be necessary for an employer to revise the essential functions of the position. One court held that accommodation does not require reallocation of essential functions-- *Carroza v. Howard County*, a 4th Circuit case, in 1995 [41].

One of the cases holding that inability to perform essential functions rendered the employee unqualified and, therefore, unprotected under the disability law is *Clement Florida Bar v.*, 662 So.2d 690 (Florida, 1995). The plaintiff, Clement, an attorney, alleged that his bipolar disorder interfered with his ability to distinguish right from wrong, and therefore his disbarment for misuse of client's funds and lying to cover up the wrongful actions constituted illegal discrimination under the ADA. The court stated that "..even if any of Clement's actions occurred when he could not distinguish right from wrong, the ADA would not necessarily bar this Court from imposing sanctions." It

concluded the issue with this statement, "Clement is not 'qualified' to be a member of the Bar because he committed serious misconduct, and no 'reasonable modifications' are possible. [42].

What activities or abilities might constitute "essential functions" of a particular job? The court in *McDaniel v. AlliedSignal Inc.*, a 1995 U.S. District Court case, provides one example. The court stated that being able to maintain security clearances in a government defense contracting position was an essential function of the job in question. The court believed that the plaintiff, who suffered from depression, would not necessarily be able to obtain the clearances, even with a requested accommodation, and, therefore, he was not qualified [43].

(B) Will the Person's Disability Pose a Safety Risk?

Clearly, there is a good argument on the part of employers that persons who pose a potential threat to themselves or to others can, and perhaps ought to be, refused employment or discharged from a job. In the area of mental disabilities, this line of reasoning is particularly apt. Courts generally support employers when the evidence indicates that the threat is real, rather than imaginary, and when there are no reasonable accommodations that would effectively nullify the threat. In *Doe v. Region 13 Mental Health-Mental Retardation Commission*, 704 F.2d 1402 (5th Cir. 1983), a Rehabilitation Act case, the plaintiff suffered from severe depression and worked with patients at a psychiatric facility. She threatened to commit suicide. The hospital feared she would communicate to the patients that suicide was a reasonable alternative. The court supported the hospital's position although there was no direct physical threat involved. That decision stands in contrast *to Collins v. Blue Cross Blue Shield of Michigan*, a lower court review of an arbitration decision [44], in which an employee told her psychiatrist that she hated her supervisor, that her supervisor "is living on borrowed time and she doesn't know it," and that "I have killed her a thousand times in my mind." Although the psychiatrist did not believe the patient would act on her statements, and concluded after counseling that she had recovered from her depression/adjustment disorder, the employer fired her. The court upheld the arbitrator's decision in favor of the employee.

Direct threat is defined in the EEOC regulations as a "significant risk of substantial harm to the health or safety of the individual or others that cannot be eliminated or reduced by reasonable accommodation" [45]. Factors that are to be considered in assessing whether a direct threat exists include: the duration of the risk, the nature and severity of potential harm, the likelihood that the potential harm will occur, and the imminence of the potential harm [46].

An obvious and ominous problem faced by employers is the possibility that hiring or retaining persons with mental disabilities which include tendencies toward violence will lead, not only to harm, but also to legal liability on grounds of negligent hiring or negligent retention tort theories. In *Yunker v. Honeywell, Inc.*, a 1993 Minnesota case, the estate of a murder victim successfully sued Honeywell in a negligent retention action. Landin, an employee of Honeywell strangled to death a coemployee. After serving a five-year prison sentence, Landin was rehired by Honeywell as a custodian. Landin's criminal behavior continued--confrontations with others, sexual harassment, threats of violence--and the company transferred him to another facility. Eventually, after several more episodes of violent behavior, he committed murder a second time--again the victim was a coemployee. As was pointed out in an article in the *Massachusetts Employment Law Letter*, if Honeywell had not rehired him or had fired him after the recurrence of the abusive behavior, the worst-case scenario might have been losing in a disability discrimination lawsuit, which could have meant up to $300,000 in compensatory and punitive damages plus backpay. In contrast, a negligent retention tort case can cost a company a staggering sum of money for punitive, pain and suffering, and more [47].

(C) Does Excessive Absenteeism Equate with a Determination of "Not Qualified?"

Several cases have explored the issue of whether extended periods of sick leave amount to a justification for firing an employee in spite of a finding that the employee is disabled [48]. The absenteeism itself may be the basis for concluding that the employee cannot perform the essential functions of the job.

The court in *Leatherwood v. Houston Post Company*, 59 F.3d 533 [49], a case argued under the Texas disability law [TCHRA], held in favor of the defendant, primarily based on a finding that the plaintiff could not perform his work during his psychotic episodes of mania and depression. The plaintiff maintained that his disorder did not affect his ability to perform his job as a newspaper editor and that, prior to new management, the Post reasonably accommodated his illness. However, the court stated, "...Leatherwood's disability-based absence from his job as an editor for this daily newspaper, for 33 to 44 percent of his last nine months of employment strongly indicates that, for the purposes of the TCHRA, his disability rendered him unable to reasonably work in this position as a matter of law" [50].

Courts generally agree that an essential function of most jobs is regular attendance. However, depending on the nature of the position, absences do not, per se, prevent a person from performing job duties, and rulings must be made on a case-by-case basis. Closely tied to the issue is whether allowing periodic time off for sick leave due to a chronic mental disorder amounts to a reasonable accommodation under the circumstances. Perhaps work could be done from home or the nature of the work is such that the time off with or without pay will have little impact on whether performance of the essential functions of the job will be affected.

The Third Prong: Action Taken by the Employer was Based on the Disability

The third prong of the plaintiff's Prima Facie Case is the establishment of the fact that the employer made the employment decision based on the plaintiff's disability. Up to this point in the analysis of the case, the plaintiff has shown that he or she has a mental impairment that rises to the level of a disability and that he or she is a qualified person with regard to the position in question. The employer will prevail if the plaintiff cannot show that the discharge or refusal to hire was due to the disability, and not to matters unrelated to the disability.

This part of the prima facie test is somewhat analogous to the requirement in a Title VII discrimination case involving allegations of race, relation, sex, age, or national origin discrimination. Assuming the case has proceeded to trial and that the defendant has not raised an unequivocal defense resulting in a summary judgment in its favor, the plaintiff has at this point raised an inference of disability based discrimination. (This analysis has not appeared in the cases, but it is reasonable to assume that, in fact, this is a correct reading.)

The overlap between the second and third prongs is seen again in the manner in which courts present their analysis of cases involving misconduct. For example, if an employer argues that a discharge decision was based on behavior which was a violation of company rules and that the rules apply to all employees, regardless of the existence of a disability which caused the employee's behavior, is the employer using the second or third-pronged test? One court may conclude that the violation of the rule means the person is not qualified, and the other may conclude that the employer's decision to discharge was not based on the disability, but rather on misconduct. The difference is not an inconsequential one, for the burden of proof is arguably on the plaintiff under the second-pronged argument and on the defendant in the finding that there was misconduct which motivated the employer's decision.

Many cases involving findings of misconduct are drug or alcohol-related situations in which the courts decide in favor of the defendant employer, especially if the company has provided reasonable accommodations in helping the employee deal with the problem. In *Fuller v. Frank*, 916 F.2d 558 (9th Cir. 1990) an alcoholic employee was allowed leaves of absence, was provided with counseling and outpatient treatment periodically and was provided a "last chance" agreement which the employee violated. The court held in favor of the defendant.

Some courts have stated that employers can hold all employees to the same standard of conduct even when the misconduct is caused in part by a disability. Misconduct was an issue in *Oklahoma Bar Association v. Busch*. The plaintiff, an attorney, claimed that his Attention Deficit Disorder was the cause of the behavior which led to his suspension from the practice of law. His misconduct was as follows. He decided not to pursue execution on personal assets in a client's successful malpractice suit (a ten million dollar judgment) because he erroneously believed that the doctor did not have substantial personal assets. He went after the insurance carrier instead. He informed the doctor by letter. The insurance carrier refused to pay and only then was it discovered that the doctor had substantial amounts of money in several different bank accounts. Busch attempted to execute on the judgment but the state court held that the letter to the doctor precluded such action. He filed a notice of intent to appeal, at the request of his client, but failed to file a Petition of Error and did not tell his client. He next filed suit against the hospital, but lost on a summary judgment motion. Again, he agreed to appeal, but ended up appealing one day too late. His psychiatrist testified that ADD causes impulsive and stupid behavior without thought to the consequences. He specifically stated, however, that lying is not a symptom of ADD. The court stated, "While his neglectful behavior may have been influenced by his ADD, his physician testified that lying is not a direct result of the illness. Because we find that the Bar Association has proven by clear and convincing evidence all counts...we agree that discipline is necessary" [51]. It is interesting to note that in the Busch case, the court stated that prior to the enactment of the ADA, courts traditionally held that mental illness did not prevent attorney discipline, although the condition would be considered as a mitigating factor. We are left with the question of what impact the ADA has on these cases: If Busch's misconduct did not include lying, but only the other manifestations of his mental condition, would the court have held in his favor?

Conclusions and Questions on Shifting Burdens

Application of Three-Pronged Test to the Hypothetical Scenarios

If we apply the three-pronged analysis to the hypothetical questions posed at the beginning of this paper, we can make the following predictions as to their outcomes.

(1) The *emotionally vulnerable female* employee with Avoidant Personality Disorder who experienced a nervous breakdown after a noble effort to work under an unreasonably demanding and crude supervisor:

Under the First Prong, she probably loses. If we assume that the disorder is listed in the DSM-IV and her psychiatrist is considered a competent health professional, she has met the burden of showing she has an impairment. However, it is questionable whether courts will find that her impairment substantially limits a major life activity. Not getting along with one's boss is unfortunate, but it does not preclude her from working in general.

(2) The *applicant for police work* who argued that the police department's decision to reject him was illegally discriminatory because he suffers from Schizotypal Personality Disorder:

Under the First Prong, he probably loses. In the absence of a finding that the pre-employment screening was a medical test (which is prohibited by ADA), judgment would probably favor the defendant police department. The disorder will probably not rise to

the level of an impairment recognized by the law as a disability. The distinction between a recognized disorder and a genuine disability may turn on whether the evidence shows a serious psychiatric problem or a mere personality fault. If, however, it is found that the plaintiff has a disability, and it substantially limits a major life activity, the inquiry would proceed to the Second Prong.

Under the Second Prong, he probably loses. A court may find he is not qualified because he did not pass the screening test. The process indicated he was not suited for the work--he could not perform the essential functions of the job.

Likewise, under the Third Prong, he probably loses. He has not demonstrated that the rejection was based on the disability. The evidence shows that the rejection was based on the objective determination that he was unsuited for the job. There was no evidence that the employer knew of his disability or that it "regarded" him as having a disability.

(3) The *manual laborer with Acrophobia* who would not climb ladders:

Under the First Prong, he probably loses. Although the impairment would likely be considered a serious one, it is unlikely that the court would find it substantially limited a major life activity. It effectively prevented him from performing the essential functions of this job, but it would not prevent him from working in general.

(4) The *attorney with bipolar disorder* who stole funds from his client and lied about it:

Under the First Prong, he probably wins. He has a recognized disability. However...

Under the Second Prong, he probably loses. He cannot perform the essential functions of the job. If he argues that he could perform the essential functions of the job with accommodation, move to the Third Prong.

Under the Third Prong, he probably loses. The disbarment decision was based on misconduct, not on the disability.

Shifting Burdens - Questions Raised by Cases

There are several problems in attempting to sort out which factors in a disability discrimination case are matters for which the plaintiff bears the burden of proof and those for which the defendant bears the burden. In the First Prong, it is reasonable that the law require the plaintiff to show that he or she has an impairment which substantially limits a major life activity.

In the Second Prong, however, what do the courts require plaintiffs to show to demonstrate that they are qualified? There are court opinions which find that a disabled person is *not qualified* because the plaintiff's disability would pose a safety risk in the workplace. Is this part of the plaintiff's burden, or is it a defense to be raised by the defendant? If it is part of the defendant's burden, it should not be linked with the issues of whether or not the plaintiff is *qualified*. Other courts have found that a plaintiff was *not qualified* because there were no reasonable accommodations available which would enable the person to perform the essential functions of the job. If it is the defendant's burden to establish the reasonableness and availability of accommodations, it should not be linked to the issue of whether the plaintiff is or is not *qualified*. Others have found that the plaintiff was *not qualified* because he or she violated workplace rules, society's rules, or engaged in some other form of misconduct. If this is a defense, it should not be linked to the issue of whether the plaintiff is or is not *qualified*.

The point to be made here is that, in concluding that a disabled person is not qualified by reason of factors raised by the defendant, such as misconduct or safety risks, it "muddies the waters" with respect to the prima facie case and the burden of proof. One suggestion is to return to the wording of the Rehabilitation Act which required that the disabled person prove that he or she was "otherwise qualified." The plaintiff would bear the burden of proving that "but for" the disability, he or she has the qualifications for the job--the necessary skills, knowledge, credentials, etc. The factors regarding safety, misconduct, and other evidence which the defendants raise would not be commingled with the plaintiff's prima facie case and would not be determinative of the plaintiff's "qualification" for the job. They would, instead, be defenses and part of the defendant's burden of proof.

With regard to the Third Prong--the requirement that plaintiffs show that an employer's decision was based on the disability--other questions arise regarding the shifting burdens. To what extent does the plaintiff have to prove that the employer's decision was based on the disability? Once the plaintiff satisfies Prongs 1 and 2, could it be said that he or she has established a prima facie case?...that a rebuttable presumption has arisen that the employer's action was based on illegal disability discrimination?...that the burden of proof should now shift to the defendant? This is the manner in which Title VII employment discrimination cases are analyzed. The ultimate burden of proving that the employer's decision was based on illegal discrimination would remain with the plaintiff, as it does in the Title VII cases. Although there is very little, if anything, in the disability discrimination cases which indicates that courts use this approach in deciding disability discrimination cases, it would appear to be a workable one, and one that would eliminate some of the confusion that is evident to researchers studying this area of law.

As it stands, the cases involving mental disability discrimination in the employment arena seem to follow an ad hoc analysis with regard to what constitutes the plaintiff's prima facie case and which party bears the burden of proof for the issues that arise. In particular, there is confusion as to whether the plaintiff or the defendant bears the burden of proof in determining the need for and the nature of reasonable accommodation and what is meant by the terms "qualified" and "otherwise qualified."

An example of the confusion that exists is the court opinion in *Moran v. Chassin, Commissioner of the State of New York*, a March 1996 state lower court opinion in which a medical doctor, suffering from epilepsy, a seizure disorder and an emotional disorder, sought relief from a decision permanently restricting his license to practice medicine in the state. One of the doctor's arguments was that the Board's decision was contrary to the ADA and the Rehabilitation Act. The facts are that on the basis of patients' complaints, he was ordered to submit to a psychiatric examination. His refusal to do so resulted in a six-month suspension of his medical license. He was thereafter charged with professional misconduct. An administrative decision suspended his license for three years, but then stayed the suspension and placed him on probation with certain conditions and restrictions.

On appeal, the Administrative Review Board decided to *permanently* prohibit the doctor from engaging in direct patient contact. The case was then appealed to the state court which affirmed the Board's decision. In its opinion, the court stated, among other things, that the petitioner-doctor's contention that he is "otherwise qualified" is unavailing because as "..indicated by petitioner's own witnesses, petitioner cannot perform his functions without some type of modifications. Since the petitioner would need certain modifications at the job site in order to perform the functions of patient care, *he cannot perform in spite of his handicap and, therefore, he is not 'otherwise qualified.'"* [Emphasis added.] It went on to say that while reasonable modifications may sometimes be necessary to assist a handicapped individual in performing tasks, the modifications proposed in this case are unreasonable and would place substantial burdens on others involved [52].

In the *Moran* case, the issues pertaining to the three prongs discussed above are not easy to differentiate. It is not possible to determine which facts constitute the plaintiff's burden and which are the defendant's. Some of the confusion stems from the use (or misuse) of the terms, "otherwise qualified" and "in spite of." The Rehabilitation Act initiated the term, "otherwise qualified," but many disability discrimination cases--even those argued under the Rehabilitation Act--no longer use it. Although the terms "otherwise qualified" and "in spite of" were used in the U.S. Supreme Court's decision, *Southeastern Community College v. Davis* [53], involving a deaf woman's denial of admission to a nursing school, little light was shed on their meaning with respect to burden of proof. The words have not been consistently defined and are, therefore, subject to misinterpretation and confusion. If the finding of "qualified" or "otherwise qualified" were restricted to the plaintiff's burden of showing that he or she is qualified for the job in terms of skills, knowledge, credentials, etc., that would be helpful in distinguishing the plaintiff's burden from the defendant's burden. The misuse of the words and the convoluted reasoning which results is evident in the conclusions of the New York court in *Moran:* the doctor was found to be not "otherwise qualified" because he could not perform the functions of the job without accommodations...he could not perform *in spite of* his handicap and was therefore not otherwise qualified. The court's line of reasoning appears to require that disabled persons be able to prove that they can perform the essential functions of the job in spite of their handicap and without accommodation. Such reasoning would eviscerate the very substance and purpose of many of the Acts' provisions.

A suggestion would be to limit the use of the terms, "qualified" and "otherwise qualified," to those factors which are related to the ability of persons to perform the essential functions of the job in question. The inability to perform because of the disability, then, would be a matter for the defendant to prove--e.g. establish that no reasonable accommodation would enable the plaintiff to perform, show that the plaintiff's disability would pose a risk to the plaintiff or others, or produce evidence to show that the employer's decision was based on something other than the disability--such as misconduct or excessive absenteeism. Whether or not the person was "qualified" or "otherwise qualified" would be a fact clearly within the plaintiff's burden of proof. When the terms, "qualified" and "otherwise qualified" include consideration of other factors, such as plaintiff's misconduct or risks to safety caused by the plaintiff's disability, it is not clear who bears the burden on this matter.

A Suggested Prima Facie Case for Disability Discrimination Cases

To establish a prima facie disability discrimination case, the plaintiff must prove:

1. That he or she has an impairment (pursuant to the statutory language) or is perceived as having such an impairment, or has a record of such impairment.

2. That he or she is qualified for the position at issue (which would be interpreted to mean that plaintiff has the requisite skills, knowledge, experience, education, etc.).

3. That he or she has been the subject of a negative employment decision.

At this point, the plaintiff will have established a rebuttable presumption of illegal disability discrimination, and the burden will shift to the defendant employer to raise defenses. This could involve production of evidence that the impairment poses a safety risk, that the employer is unable to provide reasonable accommodation, or perhaps that the decision was based on factors other than the impairment, such as misconduct.

The burden would shift back to the plaintiff then to allow the plaintiff to prove that the employer's reasons are pretextual--and the real reason for the decision was illegal disability discrimination.

ENDNOTES

1. Kevin J. Conlon, *ADA Still Being Refined For Mental Health Cases,* CHICAGO

DAILY LAW BULLETIN, Nov. 3, 1995, at 6.

2. M.A. Stapleton, *Disabilities Act Brings About Sharp Increase in Student Requests For School, Exam Aide, CHICAGO DAILY LAW BULLETIN,* Dec. 22, 1995, at 3.

3. EEOC Interim Guidance on Application of ADA to Health Insurance, reprinted in Fair Empl. Prac. Manual (BNA) at 405:7115 (1993). See also Hershey Chocolate Co. v. Workmen's Compensation Appeal Bd.,162 Pa. Commw. 23, 638 A.2d 336 (1994), Pa. Commw. LEXIS 61, and Brown v. Campbell County Bd. of Education et al, 915 S.W.2d 407 (1995), Tenn. LEXIS 781. See also James Mc Donald, F.B. Kulick, and M.K. Creighton, *Mental Disabilities Under the ADA: A Management Rights Approach; Americans With Disabilities Act.* 20 EMPLOYEE RELATIONS LAW J., n. 4 at 541.

4. Miller v. National Casualty Co., 61 F.3d 627 (1995), U.S. App. LEXIS 20190, at *629.

5. Conlon, supra, at 6.

6. 42 U.S.C. Sec. 20132 (19). See also Pritchard v. Southern Company Services, 1995 U.S. Dist. LEXIS 6020 (N.D. Ala., March 31, 1995), WL 338662, 6 (N.D. Ala. 1995).

7. See McDaniel V. AlliedSignal Inc., 896 F.Supp. 1482 (1995), 1995 U.S. Dist. LEXIS 12504. See also Austin State Hospital et al v. Laura Kitchen, 903 S.W.2d 83 (1995), 1995 Tex. App.LEXIS 1377, for an analysis of a mental disability case with instructions to a jury.

8. Adams v. Alderson, 723 F. Supp. 1531 (D.D.C. 1989).

9. See Gardner v. Morris, 752 F.2d 1271 (8th Cir. 1985).

10. 29 C.F.R. app. 1630.9 (19).

11. 42 U.S.C. Sec. 12102(2) (19).

12. 29 C.F.R. 1630.2(h) (19).

13. James J. McDonald, F.B. Kulick, M.K. Creighton, *Mental Disabilities Under the ADA: A Management Rights Approach; Americans With Disabilities Act.* 20 EMPLOYEE RELATIONS LAW J., n. 4 at 541.

14. Coaker v. Home Nursing Services, Inc., 1996 U.S. Dist. LEXIS 1821 at *35.

15. DSM-IV, note 1, at 630. See also McDonald, supra, at 548.

16. Daley v. Koch, 892 F.2d 212 (2d Cir. 1989) at 213.

17. 29 C.F.R. 1630.2(j)(2). See also McDonald, supra, at 95.

18. 29 C.F.R. 1630.2(j). Also, "major life activities" are defined at 29 C.F.R. 1630.2(i).

19. Robert L. Duston, *Courts Will Scrutinize EEOCs Definition of Disability,* EMPLOYMENT TESTING--LAW & POLICY REPORTER, July, 1995, at 97.

20. 29 C.F.R. 1630.2(h) (19). See also Castorena v. Runyon, 65 E.E.P. Cases (BNA) 81 (D. Kan. 1994), a Rehabilitation Act case finding that plaintiff's paranoid schizophrenia did not substantially limit a major life activity even without medication. See also EEOC v. Union Carbide & Plastics Co., D.C. E.D. La., August 18, 1995, U.S.Dist. LEXIS 12444, Civ. Action No. 94-103 Section "L," stating that the issue of severity of impairment when medication controlled the disability is for trial.

21. 29 C.F.R. 1630.2(i) (10).

22. Forrisi v. Brown, 794 F.2d 931 (4th Cir. 1986). See also Coaker, supra, at *33.

23. See Robert L. Duston, supra.

24. See Coaker, supra, at *19, footnote #43, stating that the evidence and testimony used in making the determination of whether Coaker--claiming a post traumatic stress disorder--was in fact capable of undertaking work of a varied type available to her in her location.

25. Miller, supra, at *629 and Pritchard v. Southern Company Services, 1995 U.S. Dist. LEXIS 6020 (N.D. Ala., March 31, 1995), WL 338662, 6 (N.D. Ala. 1995).

26. Overton v. Reilly, 977 F.2d 1190 (7th Cir. 1992) at 1192.

27. 29 C.F.R. 1630.2(j)(2) (10). See also Allan H. Weitzman, K.M.McKenna, *Employment Law - Companies are Confounded by The ADA's Lack of Guidance on How To Cope With Employees Who Claim Mental Illness.* THE NATIONAL LAW J., Sept. 25, 1995, at B4.

28. McDonald, supra.

29. Duston, supra, at 97.

30. Jane Doe v. The Boeing, 64 Wash. App. 235, 823 P.2d 1159 (1992), 1992 Wash. App. LEXIS 49, 58 Fair Empl. Prac. Cas. (BNA) 107, 58 Empl. Prac. Dec. (CCH) P41,336.

31. 42 U.S.C. Sec. 12208. See also Weitzman, supra, and McDonald, supra.

32. 42 U.S.C. Sec. 12211(a).

33. 42 U.S.C. Sec. 12211(b)(1).

34. 42 U.S.C. Sec. 12114(a).

35. See EEOC Tech. Assistance Man., n. 10 & Fair Empl.Prac.Manual (BNA) at 405:6988.

36. Fields v. Lyng, 1 A.S. Cases 1381 (I) (Md. 1988).

37. Adams v. Alderson, 723 F. Supp. 1531 (D.D.C. 1989).

38. Collings v. Longview Fibre, 63 F.3d 828, (9th Cir. 1995).

39. A.B.C. v. XYZ Corporation, 282 N.J. Super. 494, 660 A.2d 1199, 1995 N.J. Super. LEXIS 209 at *494.

40. 29 C.F.R. 1630.2(n)(3i-vii) (19). See also Weitzman, supra.

41. Carroza v. Howard County, Md. 1995 WL 8033 (4th Cir. January 10, 1995). See also Jones, Walker, Waechter, Poitevent, Carrere & Denegre L.L.P., *Dealing With Mental Illness, Workplace Stress, and Job Performance Under the ADA.* 4 LA. EMPLOYMENT LAW LETTER *Louisiana Employment Law Letter*, Issue 1, April, 1995.

42. The Florida Bar v. Clement, 662 So. 2d 690, 1995 Fla. LEXIS 1749, 20 Fla. Law. S 553 at *699. Note: Although Clement was under psychiatric care for his bipolar disorder when the incidents in this case occurred, Clement also said he could fool his doctor into believing that he was in control during some of the period in question. This suggests that nothing could prevent repetition of the egregious misconduct that occurred in this case"

43. McDaniel v. AlliedSignal Inc., supra and Conlon, supra.

44. An arbitration award upheld by Judge Lawrence P. Zatkoff, Eastern Dist. Mich. See also McBrien, Marcia M., *"Homicidal" Thoughts Are Not Work Misconduct.* MICHIGAN LAWYERS WEEKLY, January 15, 1996, at 1.

45. 29 C.F.R. 1630(r).

46. Id.

47. Skoler, Abbott, & Presser, *Violence On The Job.* 5 MASS. EMPLOYMENT LAW LETTER, Issue 8, Nov., 1994.

48. See Steven H. Winterbauer, *Is Disability-related Absenteeism a Lawful Basis For Discharge Under The ADA?* 21 EMPLOYEE RELATIONS LAW J., No. 3, at 51, Dec. 22, 1995.

49. Leatherwood v. Houston Post Company, 59 F.3d 533, 1995 U.S. App. LEXIS 20421.

50. Id at 537.

51. State of Oklahoma ex rel. Oklahoma Bar Association v. Busch, SCBD 4068, Supreme Court of Oklahoma, 1996 Okla. LEXIS 39, March 12, 1996.

52. In the Matter of Thomas F. Moran v. Mark Chassin, as Commissioner of Health of the State of New York, et al., Supreme Court of N.Y., App. Div., Third Dept., 1996 N.Y. App. Div. LEXIS 2040 at *5.

SIGNIFICANT PROCEDURAL AND SUBSTANTIVE CHANGES IN SECURITIES LAWS UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT

by

Arthur M. Magaldi*

The decade of the 1990's has been a time when an unprecedented number of people have invested in the stock markets. Through 401-K plans, mutual funds, IRA accounts, pension funds, and decisions made by individual investors, money has flowed into securities in huge amounts. Trading volume on the New York Stock Exchange, NASDAQ, and the American Stock Exchange has reached hitherto unrealized heights. It is now common to see trading volume of 300-400 million shares per day on the New York Stock Exchange. NASDAQ volume frequently exceeds that of the New York Stock Exchange. On May 23, 1996, e.g., over 725 million shares were traded on NASDAQ alone.

While stock prices have generally risen and market averages have reached historic highs during the 1990's, this period has been a time marked by trading volatility and wide price swings. In terms of stock prices, good news is often generously rewarded while bad news, e.g., disappointing earnings, brings severe punishment. With increased interest and participation in the stock markets, high trading volume, and broad and volatile price swings has come a large increase in lawsuits alleging violations of the securities laws. A high percentage of these lawsuits alleged some sort of securities fraud. Regrettably, a substantial number of the lawsuits alleging fraud in securities transactions have been found to be abusive and meritless.

The Private Securities Litigation Reform Act of 1995[1] ("The Act") became law on December 22, 1995, when Congress overrode the veto of President Clinton. The act significantly amends the Securities Act of 1933 (the "1993 Act") and the Securities Exchange Act of 1934 (the "1934 Act"). This new legislation makes important substantive and procedural changes to the basic laws which regulate the securities industry. The laws governing private securities litigation, especially class actions, have been reformed by the Act. This paper will focus on the new rules, substantive and procedural, governing private litigation under the Act.

A main objective of the Private Securities Litigation Reform Act is to limit strike suits. A "strike suit" may be defined as a "shareholder derivative action begun with hope

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of winning large attorney fees or private settlements, and with no intention of benefiting the corporation based on a claim that the defendant committed fraud. In the 1990's, strike suits became a particular problem in volatile technology companies where disappointments in earnings frequently caused big downward moves in the price of the shares. Many of these lawsuits were perceived to have been abusive in nature and brought with the hope of extracting high settlements including the payment of legal fees. According to one commentator, the legislation will provide much-needed relief to public corporations, "clamp(ing) down on the parasitic 'strike suit' cottage industry--shareholder class actions routinely filed by enterprising plaintiff's lawyers who see fraud whenever stock prices decline in the hope of reaching a settlement."[3]

Safe Harbor Provisions

The Act amends and dramatically changes both the 1933 Act and the 1934 Act with regard to liability for false and misleading statements for forward-looking statements. The Act creates a safe harbor from liability in private actions, i.e., those not begun by the government, for a forward-looking statement which is false or misleading provided the forward-looking statement, written or oral, is "identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement."[4] This should allow corporations to issue earnings projections and make statements concerning projected corporate developments with less fear of being subjected to lawsuits in the event the earnings or developments do not materialize.

The safe harbor provisions of the Act expand the safe harbor protections which were available under SEC Rule 175. Under Rule 175, safe harbor protection applied to forward-looking statements but only if those statements were included in documents filed with the SEC. Accordingly, the protection of Rule 175 was relatively narrow and left unprotected large areas of vulnerability, e.g., press conferences, interviews, and situations where verbal discussions or announcements take place. The Act's provision for the safe harbor has much in common with the "Bespeaks Caution Doctrine," developed and applied by some, but not all, of the federal courts. "The essence of the Bespeaks Caution Doctrine is that forward-looking statements when accompanied by adequate cautionary language are not actionable as securities fraud."[5]

Among others, corporations, corporate spokespersons, and underwriters should be aided by the safe harbor provision. "The SEC wants to encourage companies to talk about what they anticipate happening in the near future but without the strengthened safe-harbor provision, companies were open to what is called 'fraud by hindsight,' or earnings failing to rise as predicted in company literature being interpreted as corporate fraud."[6] Under the law as it now stands, the likelihood is that the chief financial officer or another appropriate officer will routinely identify and disclose the business factors that might cause the forecasts not to materialize.

The safe harbor provision is further strengthened by another protection in the Act which provides that no liability will attach in any event to forward-looking statements unless the statement or projection is made with actual knowledge that the statement was false or misleading.[7] The Act expressly sets forth that to impose liability for a forward-looking statement, if the statement was made by a natural person that person had to have actual knowledge that the statement was false or misleading.[8] If the statement was made by a business entity, proof is required that the statement was made by or with the approval of an executive officer of that entity and the officer had actual knowledge that the statement was false of misleading.[9] This provision of the legislation would protect even against a charge of constructive fraud, i.e., fraud based on proof that the speaker's statements showed a reckless disregard for truth, accuracy, and completeness. Similarly, forward-looking statements or projections in which the speaker was grossly negligent in making the statement or projection would be protected. As the law now stands, if the plaintiff alleges fraud, it will be necessary to prove that the defendant acted with the intent to deceive or defraud.

The availability of the safe harbor for forward-looking statements provides substantial protection, but it should be noted that this protection does not apply to registration statements for initial public offerings filed with the Securities Exchange Commission (the "SEC").[10] In addition, the safe harbor provisions may be used only by "reporting companies," i.e., those required to report to the SEC by the 1934 Act.

To ensure that a jury adheres to the requirement of liability based on a finding that the speaker had actual knowledge that the statement was false or misleading, a defendant may demand that interrogatories by submitted to the jury on that point.[11] Similarly, in a case decided by the Court, the judge must issue a specific finding that the defendant acted with such knowledge.[12]

Those issuing forward-looking statements are further protected by a provision in the statute which provides that there is no duty to update forward-looking statements.[13] Should events unfold which cause the projection not to be true, therefore, the Act imposes no obligation to correct the projections or to keep them current.

Limitations on Discovery

One tactic of unscrupulous plaintiffs bringing strike suits has been to initiate a lawsuit alleging fraud, but without specifying in the pleadings the offensive conduct. Then, the plaintiff would seek extensive discovery proceedings by which the plaintiff would attempt to uncover specific conduct sufficient to support an award for fraud or simply make the proceedings so onerous and expensive that a defendant company would be forced to settle the matter. The Act attempts to bar "fishing expeditions" of this type by requiring that in a lawsuit in which recovery will be based on a state of mind, typically fraud, the complaint must specify the statement(s) which form the basis of the complaint and why the statements were false or misleading.[14] The plaintiff must plead facts raising a strong inference that the defendant acted with the required state of mind. Upon a motion to dismiss the complaint for failure to allege facts sufficient to raise a strong inference of a

culpable state of mind by the defendant, all discovery proceedings must be stayed by the Court pending the determination of the motion.[15] In this way, lawsuits lacking substance may be dismissed at an early stage of the proceeding freeing corporate officers from the burden- some task of defending against unfounded charges. This, of course, results in great savings to corporations and avoids the corporation having to make the choice of defending or settling a meritless claim.

To further strengthen this provision, sanctions must be imposed by the Court for instituting actions deemed by the Court to be lacking substance because they are found to be frivolous in nature.[16]

The legislation makes clear that frivolous and "abusive" litigation is to be punished. The Act requires that the court make findings indicating whether there has been a violation of Rule 11 of the Federal Rules of Civil Procedure. Rule 11 aims at the prohibition of abusive and obviously groundless actions. At the outset of the lawsuit, the court may require an undertaking from plaintiffs and/or plaintiffs' attorneys for costs that may be awarded to the defendant. Upon a finding of a violation of Rule 11, the court must impose sanctions. It would seem that at a minimum a plaintiff found to be in violation of Rule 11 would be required to pay the defendant's attorneys' fees and court costs. Where the court has taken the precaution of having the plaintiff and/or its counsel post an undertaking, the funds would then be readily available.

Class Action Reforms

Class action lawsuits pose particularly difficult problems for corporate defendants since the liability for damages may be many times greater than in the case of a single plaintiff. In some cases, a plaintiff who had invested and lost a modest sum, inspired by counsel anxious to allege securities fraud, would institute an action and have the case certified as a class action.

All plaintiff class action lawsuits are affected by changes made by the Act. To lessen the chances of parties bringing abusive lawsuits and gaining control of a class action, the "most adequate plaintiff," also called the lead plaintiff, is presumed to be the party who has the largest financial interest in the matter,[17] e.g., an institutional investor. The lead plaintiff has the right to retain the counsel to represent the class. A plaintiff with a small amount at stake who initiates the action and the counsel selected by that plaintiff may therefore be replaced by the court and a different lead plaintiff and its counsel installed.

The lead plaintiff and its counsel generally have the greatest impact on the course of the litigation, but limitations have been imposed by the Act on the power of the lead plaintiff to settle actions. The lead plaintiff does not have the sole discretion to reach settlements for the class. Any proposed settlement must be published along with a brief explanation as to the reasons for support or opposition to the settlement by the lead plaintiff.[18] This affords other members of the class the opportunity to make its position known.

To discourage lawsuits aimed at obtaining unreasonably large attorneys' fees rather than true redress for aggrieved plaintiffs, attorneys' fees are limited to a reasonable percentage of the damages and interest recovered for the class.[19] In addition, it must be certified in the pleadings that the plaintiff did not purchase the shares in order to participate in the action and that the plaintiff will not accept any payment for serving as a representative party for the class beyond a pro rata share of any recovery.[20]

The requirement that the court appoint the most adequate plaintiff to represent the class and the opportunity of that plaintiff to select counsel, the limitation of attorneys' fees to a reasonable percentage of damages and interest recovered by the class, the prohibition against lead plaintiff receiving anything more than a pro rata share of the recovery should alleviate the twin problems of "professional" securities fraud plaintiffs and "lawyer-driven' lawsuits in which certain attorneys routinely represented plaintiffs who had a relatively modest financial interest in the lawsuits.

Changed Responsibilities and Liabilities of Accountants

The Act expands the responsibility of accountants, but also places strict limitations on their liability.[21] Concerning expanded responsibility, accountants must use procedures that: provide reasonable assurance of detecting illegal acts; identify related party transactions; evaluate whether there is substantial doubt about the ability of the issuer to continue as a going concern during the ensuing fiscal year. If the accountant determines that an illegal act has been committed, unless the illegality is inconsequential, the accountant must inform management of the issuer and its audit committee.[22] In the event the issuer does not have an audit committee, the issuer's board of directors must be notified.

If the accountant determines that the issuer has not taken appropriate remedial action after being notified of the illegal act that the accountant reported and the failure to take remedial action will cause the auditor to depart from issuing a standard report or resign from the audit engagement, the accountant must notify the SEC and furnish it with a copy of the report which had been made to the audit committee and/or board of directors of the issuer.[23] In this way, the company is given an opportunity to take remedial action upon receiving notice that some illegal act or course of conduct has taken place. If, however, in the opinion of the auditor, the company does not take appropriate action, then the SEC must be informed.[24]

While the accountant's responsibilities are somewhat expanded, the liability of auditors for damages may be greatly reduced by the provisions of the Act. The previous joint and several liability of the accountant and other liable parties, generally the corporation and its officers, is replaced by proportionate liability.[25] The accountant is no longer liable for the entire judgment unless the trier of the facts specifically determines that the accountant knowingly committed a violation of the securities laws. In those cases

based on negligence, e.g., the liability of the accountant will be limited to the portion of the loss caused by the accountant. The Act provides, " ... a covered person against whom a final judgment is entered in a private action shall be liable solely for the portion of the judgment that corresponds to the percentage of responsibility of that covered person." [26] An accountant who caused 10 percent of the loss, e.g., would be responsible for 10 percent of the damages.

Establishing proportionate liability essentially precludes the possibility that an accountant who acted in good faith will be responsible for paying the entire judgment. This consideration would be particularly important in a situation where liability is imposed and the co-defendant corporation becomes insolvent. Before this change in the law, where a financially sound accounting firm was held liable along with a financially troubled corporate defendant which became insolvent, the result generally was that the accounting firm paid the entire judgment. Referring to the change to proportionate liability, an article in the Wall Street Journal stated:

> The change could save the firms staggering sums in the event of a major calamity such as the savings-and-loan crisis, which forced the Big Six accounting firms to pay more than $1.6 billion in damages and settlements to investors. And it will reduce their payouts for judgments in other, more routine cases.[27]

It should be noted, however, that there is a deviation from the rule of strict proportionality of responsibility where the principal defendant, the corporation, is insolvent. In such a case, the accountant may be responsible for an additional amount equal to not more than an additional 50 percent more of the amount that the accountant would otherwise be required to pay.[28]

To ensure that the provision of the law establishing pro-portionate liability is followed, the Court must instruct the jury to answer interrogatories establishing the percentage of responsibility of each defendant and determining whether the defendant accountant knowingly committed a violation of the securities laws. Where the judge decides the case without a jury, the judge must make a similar finding determining percentage of responsibility and whether the violation of the securities laws by the accountant was a knowing violation of law.[29]

Conclusion

As the title of the Act indicates, the Act is designed to reform the rules for private securities litigation. The changes, both substantive and procedural, should dramatically restrict the number of lawsuits based on fraud. The safe harbor provisions for forward-looking statements - "meaningful cautionary statements" and the requirement of proof of actual intent to defraud - will make it extremely difficult to recover for predictive statements made by corporations.

The procedural changes imposed by the Act - the limitations on discovery, the requirement of pleading specifically the alleged fraudulent statements, the changes concerning the lead plaintiff and other modifications of the class action rules, the requirement of sanctions for the institution of abusive litigation - strongly support the substantive changes and should curtail the strike suits against which much of the legislation is aimed.

The Act also expands the responsibilities of accountants to report illegal activities, but also provides protections for accountants. The provision that accountants will be liable only for the percentage of the loss caused by their conduct absent a finding that they knowingly violated the securities laws will significantly curtail their liability.

As always, court cases will interpret the legislation. There should be, however, no doubt that the Act will have a profound effect on the private securities litigation landscape.

ENDNOTES

1. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67.

2. Black's Law Dictionary 1423 (6th Ed.).

3. *Good Veto . . . Bad Veto: President Clinton Caves to Trial Lawyers, But Congress Saves the Day*, Pitt. Post-Gazette, Dec. 29, 1995, at A12.

4. Pub. L. No. 104-67 § 102.

5. Jeanne A. Calderon and Rachel S. Kowal, *Safe Harbor Rules for Forward-Looking Financial Date*, J. of Financial Statement Analysis 60,63 (Spring 1993). For an excellent analysis of SEC Rule 175 and "Bespeaks Caution Doctrine," see id.

6. Anne Eisele, *Litigation Bill Override Hailed: But Not By All*, New Technology Week, Jan. 2, 1996.

7. Pub. L. No. 104-67 § 102.

8. *Id.*

9. *Id.*

10. *Id.*

11. Pub. L. No. 104-67 § 101.

12. *Id.*

13. Pub. L. No. 104-67 § 102.

14. Pub L. No. 104-67 § 101.

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. Pub. L. No. 104-67 § 301.

22. *Id.*

23. *Id.*

24. *Id.*

25. Pub. L. No. 104-67 § 201.

26. *Id.*

27. Jeffrey Taylor, *Congress Sends Business a Christmas Gift: Veto Is Overridden on Bill Curbing Securities Lawsuits*, Wall St. J., Dec. 26, 1995, at A2.

28. Pub. L. No. 104-67 § 201.

29. *Id.*

Treacherous Waters for White Water Rafters: Outfitters' Exculpatory Contracts and White Water Responsibility Acts

by

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Introduction

White water rafting has become a popular form of risk taking adventure travel. Estimates are that two million Americans participate in the sport but there are no figures on the number of fatalities.[1] While many people safely enjoy guided rafting trips, many find their experiences more dangerous than anticipated. Because some participants have suffered injuries or death, lawsuits have been brought in some states.[2]

This article will discuss three important cases involving white water rafting accidents: *Saenz v. Whitewater Voyages, Inc.*[3] which outfitters regard as significant [4], and two West Virginia cases: *Krazer v. Mountain River Tours, Inc.*[5] and *Murphy v. North American River Runners.*[6] This article will also examine states' *White Water Responsibility Acts.*

In *Saenz v. Whitewater Voyages, Inc.*, Saenz was a healthy 28 year old man who had been recruited to join a three day rafting trip from June 20-22, 1988 on the Middle Fork of the American River in California.[7] Before beginning the trip, all participants including *Saenz* completed and signed "*Release and Assumption of the Risk Agreement*" which stated:

> I am aware that certain risks and dangers may occur on any river with Whitewater. These risks include, but are not limited to, hazards of injury to person and property, while traveling in rafts on rivers, accidents or illness in remote places without medical facilities and the forces of nature...
>
> I hereby assume all of the above risks and, except in cases of gross negligence, will hold Whitewater...harmless from any or all liability, actions, causes of action, debts, claims, and demands of every kind and nature whatsoever, which I now have, or which may arise out of, or in connection with, my trip or participation in any activities with Whitewater..."[8]

The agreement also stated it operated as a release and assumption of the risk for his heirs.

Before the trip began, employees of the outfitter, Whitewater Voyages Inc., gave a safety talk which included what to do when thrown from the raft, how to get out from under it in a capsize, how to swim in the rapids, and a general discourse on the dangers of white water rafting. A guide also offered a sober reminder that "white water rafting is not a Disneyland ride" and told the participants that, "you can get hurt and even die."[9] The guides also assisted all participants with adjustments to their life jackets and required that helmets be worn on all Class IV rapids.[10]

On the first day of the trip, Saenz' crew encountered two Class III and a Class IV rapid "Tunnel Chute", which was considered "to be the most difficult and dangerous rapid of the three day trip."[11] Before embarking on the latter, "all passengers were given the opportunity to scout the rough water in advance and the option of walking around it on the trail instead or running the rapid."[12] One guide, Butterfield, instructed the participants on how to enter the eddy so as not to become trapped and informed the group that the previous year a woman had been injured when she fell out of the boat and had gotten crushed against the wall of "Tunnel Chute."[13]

During the second day, Saenz experienced several Class III and Class IV rapids and a portage around an unrunnable stretch of river. He also had an opportunity to guide the raft during calm water. Although Saenz fell out of the raft at the bottom of "Menage a Trois", a Class IV rapid, he was pulled back in the boat after thirty seconds, suffering no injury.[14]

Before starting out on the third day, Thomas, a guide, taught Saenz how to swim a rapid by using small ripple rapids near camp as a practice site. He then reviewed the last Class IV rapid called "Murderer's Bar," but stated that running this rapid was optional. Butterfield reiterated that any participant could "go back with the vans" and not complete the trip.[15]

Everyone but Saenz scouted the rapid. He complained that he was tired, had sore legs and "wanted to get last rapid over with."[16] Thomas, nevertheless, spent five minutes with him explaining the configuration of the treacherous "Murderer's Bar," including how the boats would approach it, and how the crew should maneuver. Thomas emphasized to Saenz the dangers of the rapids, particularly the hazards posed by a large rock and an eddy to the right of the rapid. In addition, Thomas reminded Saenz about how to swim if he were thrown out of the raft. Thomas twice asked Saenz if he wanted to run the rapid. Both times Saenz responded, "Let's get it over with. Let's do it."[17]

After these admonitions, the party set out to encounter "Murderer's Bar" where Saenz fell out of the raft and drowned. Saenz' heirs sued Whitewater Voyages, Inc. For wrongful death. The trial court entered summary judgment for the latter but the Court of Appeals held that Saenz expressly assumed the risks attendant to white water rafting and that this fact relieved the company of its duty of care to him. The court further noted that express assumption of the risk occurred when Saenz, expressly consented to relieve Whitewater Voyages, Inc. of an obligation of conduct toward him and to take his change of injury from a known risk. Thus, Whitewater was under no duty to Saenz and could not be charged with negligence.[18]

The appeals court declared that Saenz signed a release, which was an express assumption of the risk, stating that he was aware of the risks and dangers that could occur on the river trip including the hazards of personal injury. The document also exonerated the outfitter and its employees from any claim arising out of the trip.

The court also stated that, although the release did not specifically mention it as a risk, death by drowning is a danger inherent in white water rafting apparent to anyone who embarks on such a trip.[19]

Furthermore, the court also pointed out that Whitewater Voyages was a private company and that there was no public policy in California opposing "private voluntary transactions to which, one party for a consideration, agrees to shoulder a risk which the law would have otherwise have placed upon the other party.[20] The court also declared that any contract that frees its drafter from any liability from his or her own future negligence "must clearly and explicitly express that this is the intent of the parties." The court declared that it applied the rule of strict construction when reading such agreements which requires that such contracts should not contain lengthy, convoluted sentences nor oversimplified language. A release will be invalid if a key word appears in the title but not in the text or if it is too lengthy or too general.[21] The court said:

> It suffices that a release be clear and unambiguous and explicit and it expresses an agreement not to hold the released party liable for negligence.[22]

While conceding that the Whitewater release was not perfect, its plain language did state that Saenz was aware of the risks and dangers that could occur on a river trip and it expressed Saenz' consent to assume the risks of personal injury, accident and illness. In fact, everything short of gross negligence was covered by the document. Clearly, Whitewater Voyager and its agents did not perform negligently. Saenz was outfitted with a life jacket and provided with an initial orientation by the guides. Helmets were required when Class IV rapids were encountered. Advance scouting of difficult rapids was mandatory.

Moreover, prior to encountering the "Murderer's Bar" rapid in which he drowned, Saenz was advised that he did not have to participate. Five minutes were spent explaining the hazards to him and what the crew would need to do to negotiate the rapid. The guide, moreover, emphasized to Saenz the peculiar dangers of the large rock and the eddy. Since the outfitter took the appropriate steps to inform the deceased of the hazards before and during the trip, it could not be held liable.

Echoing the <u>Saenz</u> case was the decision in *Krazer v. Mountain River Tours, Inc.* which upheld a similar release.[23] In June, 1985, Dorothy Krazek, traveled from her home in Pennsylvania to West Virginia to take a white water rafting trip on the New River, conducted by Mountain River Tours, Inc.[24] She paid a fee and signed a document *RAFT TRIP RELEASE AND ASSUMPTION OF THE RISK*. The agreement provided:

I am aware that during the raft trip in which I am participating under the arrangement of Mountain River Tours, Inc. And its agents and employees and associates certain substantial risks and dangers may occur including, but not limited to, hazards of traveling on a rubber raft in rough river conditions, hiking in rough terrain, accidents, or illnesses in remote places without medical facilities, forces of nature and travel by automobile, bus or other conveyance.

In consideration of a part payment for the right to participate in such river trips or other activities and service and food if any arranged for me by Mountain River Tours, Inc., the agents, employee and associates, I have and do hereby assume all of the above risks and release and will hold harmless from any and all liability actions, causes of actions, debts, claim and demands of every kind and nature whatsoever which I now have, or which may arise out of or in connection with my trip or participation in any other activity.

The terms hereof shall serve as a release, indemnification and assumption of the risk for my heirs, executors, administrators and for all members of my family, including any minors accompanying me.[25]

During the rafting trip, Krazek's group encountered a severe hail storm. Mountain River's guide, one Thompson, ordered rafters into the river to protect them from the hail. While in the river, Krazek was swept away in the current, thrown against the rocks, and injured. She filed a diversity action against Mountain River Tours in United States District Court alleging that Thompson's negligence resulted in her injury. She also argued that the release and the indemnification agreement she signed were not effective because they did not specifically waive her right to bring a negligence action.[26]

The court stated that "as general rule of contract law, contracts which release a party from liability resulting from his own negligence are looked upon with disfavor and are strictly construed against the release."[27]

Krazek had argued that any intent to release a party from his/her own negligence must be clearly expressed and, in fact, requires that the parties specifically uses the words 'negligent' or 'negligent act', citing two cases which applied standards similar to West Virginia's.[28] While those courts held that the releases signed by the users of those recreational facilities were insufficient to protect the businesses from their negligent acts, the court found those situations distinguishable from Krazek's.

O'Connell v. Walt Disney World involved a minor who was injured during a horse stampede at the Florida resort.[29] Prior to the child's boarding the ride, his father signed a release which, by its terms, freed the company only from liability for injuries arising out of dangers inherent in horseback riding. O'Connell's father signed a release which stated the following:

"I consent to the renting of a horse from Walt Disney World Co. by Frankie, a minor and to his or her assumption of the risk inherent in horseback riding. I agree personally and on his or her behalf to waive any claims or cause of action which he/she or I may have or hereafter have against Walt Disney Co., arising out of any injuries he/she may sustain as a result of that horseback riding and I will hold Walt Disney World Co. harmless against any and all claims from such injuries."

The Florida Court of Appeals held that the release did not bar a negligence claim because there was no language indicating an intent to release or indemnify Disney World for its own negligence. Such an intent would have had to have been stated in "clear and unequivocal terms" in order to exonerate Disney.

In *Rosen v. LTV Recreational Development*,[30] the injured plaintiff had purchased a season pass to a ski resort and by doing so agreed to be bound by its rules and regulations. One of the regulations was:

"I understand that skiing is a hazardous sport and that hazardous obstructions, some marked and some unmarked, exist on any ski area. I accept the existence of such dangers and that injuries may result from the numerous falls and collisions which are common in the sport of skiing including the charge of injury resulting from the negligence and carelessness of the part of fellow skiers."[31]

The court held that this statement did not bar Rosen's negligence action against the ski resort because there was no express consent to free the ski area from its negligence. The only negligence covered in the statement was injuries resulting from that of fellow skiers. All Rosen did was acknowledge that such hazards were inherent in skiing.[32]

The release Krazek signed was far broader than those signed in *O'Connell* and *Rosen* because it covered *negligence* as well as the dangers inherent in white water rafting. The second paragraph, clearly stated that Krazek waived her right to bring *any* action of any kind. In response to another of Krazek's arguments, the court said that it was not necessary that the "magic" words "negligence" or "negligent acts" be included in such an agreement.[33]

While the plaintiffs in the above cases fared poorly, in *Murphy v. North American River Runners,* the outcome was different. In August, 1987, Kathleen L. Murphy went white water rafting on a tour operated by North American River Runners, Inc., a licensed commercial white water outfitter. The trip also took place on the New River. The guide operating the raft in which Murphy was riding attempted to rescue another raft that had become stuck among rocks in the rapids. While trying to dislodge the other raft *by deliberately bumping it*, Murphy was thrown about in the raft, seriously injuring a knee and an ankle.[34]

Before embarking on the trip, Murphy had signed a release but she brought a personal injury against North American claiming that its guide "negligently, carelessly and recklessly caused her injuries." Murphy also argued that the release she signed was void and contrary to public policy

because commercial outfitters are regulated by law and thus cannot require customers to sign such a release.

Raft Trip Release Assumption of the Risk and Permission:

...during the raft trip in which I am participating under the arrangements of North American River runners, Inc., a corporation, or West Virginia River Adventures, Inc. a corporation, their agents and employees, certain risk and dangers exist or may occur including but not limited to, hazards of traveling on a rubber raft in rough river conditions, using paddles or oars and other raft equipment, hiking in rough terrain, being injured by animals, reptiles, or others becoming ill in remote places without medical facilities available and being subject to forces of nature,...

In consideration of the right to participate in such river trip, including transportation, meals and other activities and services arranged for me by North American River Runners, Inc. Or West Virginia River Adventures Inc., or both their agents, and employees.

I UNDERSTAND AND HEREBY AGREE TO ASSUME ALL OF THE ABOVE RISKS WHICH MAY BE ENCOUNTERED ON SAID RAFT TRIP, INCLUDING ACTIVITIES PRELIMINARY AND SUBSEQUENT THERETO.

I do hereby agree to hold North American River Runners, Inc. and West Virginia River Adventures, Inc. Their agents and employees harmless from any and all liability actions, causes of actions claims, expenses, and damages on account of injury to my personal property, even injury resulting in damages which I now have or which may arise in the future in connection with my trip or participation in any other associated activities.

I expressly agree that this release as an indemnity agreement is intended to be as broad and inclusive as permitted by the law of the State of West Virginia and that if a portion thereof is held invalid, it is argued that the balance shall, notwithstanding continue in full legal force and effect. This release contains the entire agreement between the parties hereto and the terms of this release are contractual and not a mere recital.

I hereby state that
I HAVE CAREFULLY READ THE FOREGOING RELEASE AND KNOW THE CONTENTS THEREOF AND SIGN THIS RELEASE AS MY OWN FREE ACT.

This is a legally binding document which I have read and understood.[35]

Murphy opposed North American's motion for summary judgment by filing an affidavit from an experienced white water rafting guide who stated that there were ways to rescue a stuck raft without making the dangerous maneuvers that resulted in harm to Murphy and others.

Murphy also raised the issue that she was never informed that a rescue operation would be attempted if necessary during a rafting trip or that it would involve the bumping of crafts.

Murphy claimed in her affidavit that she did not understand that the release applied to intentional acts. She said that she believed that the document applied only to ordinary negligence in the form of piloting mistakes associated with a "normal" trip down the river.[36] Despite these arguments, the trial court granted North American summary judgment.

In overturning the lower court, the appeals court cited the *Restatement (Second) of Torts*, "Generally in absence of applicable safety statutes, a plaintiff, who expressly and under the circumstances clearly agrees to accept risk of harm arising from the defendant's negligence of reckless conduct, may not recover for such harm unless the agreement is invalid or contrary to public policy."[37] If such an express agreement is freely and fairly made between parties in equal bargaining position and there is no public interest at risk a release will generally be upheld.[38]

The court noted however, that in order for an agreement to assume a risk to be effective, it must appear that participant has given assent to the terms of the agreement and that this is especially important in a situation when the release was prepared by one of the parties. In such a situation, the Court said, "it must appear that the terms were in fact brought home to, and understood by (the participant)...[39]

More importantly, the court declared that for an agreement to assume the risk to be effective, its terms must apply to the particular activity which caused the harm. The court refused to construe the general claim in this release which exonerated North American from liability for "negligence" to include: "intentional or reckless misconduct" or gross negligence.[40]

Citing Krazek, the court noted, that a release is not defective even though its language does not explicitly use the term "negligence" or "negligent act or omissions."[41] But the court distinguished *Krazek* from the Murphy case because the former did not deal with the issue of reckless conduct by the outfitter.

Murphy also addressed another issue that did not exist in *Krazek*, the validity of a waiver of a tort claim because of a breach of a statutory safety standard. On March 12, 1987, prior to Murphy's trip, the West Virginia legislature passed the *White Water Responsibility Act*.[42] The purpose of the law was to define those areas for which commercial white water outfitters are liable for loss, damage or injury. The legislators conceded that it is impossible for outfitters to eliminate the "inherent risks" in such activities.[43]

The law imposes certain duties upon commercial white water outfitters and guides, while immunizing them from tort liability to participants in white water rafting trips for harm resulting from the risks inherent in such expeditions, which are essentially impossible to eliminate even if the outfitter takes all possible safety measures.[44] The court also noted that the law requires

commercial white water guides to conform to the standard of care expected of members of the profession.

The court thus concluded the release that purported to exempt North American from liability to Murphy for its guide's failure to conform to the standard of care expected of members of the profession was unenforceable.[45] It found that there was a reasonable alternative to the type of rescue operation that the guide used which would have posed no risk of harm to Murphy's raft and so judgment for the defendant should not have been granted. The court simply did not believe that the legislature intended to free commercial white water outfitters and guides from liability for intentional reckless misconduct or gross negligence.[46]

THE WHITE WATER RESPONSIBILITY ACT

The West Virginia legislature passed the *White Water Responsibility Act* in response to concerns voiced by outfitters about being held liable for injuries sustained by passengers on white water rafting trips. The legislature noted that the tourist trade is of "vital importance" to the state participated in "every year in rapidly increasing numbers by both residents and nonresidents." It also stated in the "legislative purpose" that the commercial white water outfitters and guides "significantly contribute to the economy" of the state.[47]

The law defines not only the areas of responsibility for outfitters and guides but also the duties of participants. In fact, the emphasis in the statute is on the *duties of the passengers*, who are charged with the responsibility to act as "reasonably prudent persons when engaging in recreational activities offered by the outfitters."[48] The legislation then lists the rules for passengers: They may not participate on a river expedition while under the influence of alcohol, drugs, or even non-alcoholic beer. The passenger must advise the trip leader or guide of any known health problems or medical disabilities and any medications prescribed to treat these health problems during a rafting trip. A passenger may not engage in harmful conduct or willfully or negligently engage in any conduct or injury which causes injury to person or property or perform any act which interferes with safe operation of the trip. A participant must also use the safety equipment provided by the outfitter and follow the trip leader of guide's instructions with regard to safety. A passenger also cannot fail to notify a guide or leader of personal injuries that occur during the expedition and must leave personal identification if such injury or illness occurs.[49]

The list of duties required of participants is far longer than those of outfitters. In fact, the section of the law entitled "Liability of *Commercial White Water Outfitters and Commercial White Water Guides*" imposes relatively few responsibilities on businesses that operate these expeditions.

The section states that it recognizes white water expeditions as hazardous *regardless of all feasible safety measures* which can be taken. (Emphasis supplied) the Act further states:

> No licensed commercial white water outfitter or guide in the course of his employment is liable to a participant for damages or injuries to such participant unless such damage or injury was directly caused by the failure of commercial white water outfitter or guides to comply with the duties placed on him by Article Two 20-2-1 et seq.[50]

Clearly the legislation is designed to shield the commercial operations that conduct white water excursions from liability, but it did not bar liability in the Murphy case.

There are those who believe that the passage of laws like West Virginia's are in fact detrimental to businesses who engage in white water rafting. While West Virginia obtains economic benefits from persons who visit the state to engage in recreational activities like rafting, the state has a law which purports to deny recovery to injured participants. Colorado,[51] Maine,[52] and Pennsylvania [53] have passed similar laws.

What effect will these laws have on the responsibilities of outfitters? If the Murphy case is any guide, relatively little, if the outfitter or its agents do not operate using the safest possible procedures at all times. Outfitters should not be lulled into a false sense of security believing that this legislation will shield them from liability. But there are several procedures that outfitters can follow to minimize their exposure to liability.

Reservation forms should ask participants about any medical conditions, allergies or medications that might compromise their ability to participate safely on the trip. Outfitters should take care to document maintenance procedures for rafts and other equipment so that it will be easier to counter a claim based on faulty equipment.[54] Outfitters should also keep a daily activity log of each rafting trip including such information as who led the trip, the weather conditions, and what first aid was given. This log can be used as an aid to reconstructing the events surrounding an accident should the outfitter be sued.[55]

Perhaps the most important feature of an outfitter's preparation for a rafting trip is the safety lecture. Outfitters should prepare an exhaustive lecture covering the inherent dangers of the activity: including the temperature of the water and the risks of hypothermia as well as other conditions that may occur on the trip. It is vital to include explicit instructions on how to behave if one falls from the raft. It is also essential to inform participants of the level of physical involvement required and to learn if anyone has any medical or physical conditions that will impair their ability to participate.[56]

The safety talk will normally be delivered by those who will guide the raft trip so it is essential that those hired to guide the trip are competent and well trained. One of the most common claims in lawsuits is that the guide's negligence caused the injury. Obviously, an experienced guide who is licensed and trained with an organized, complete orientation lecture is the best protection against liability.[57]

A comprehensive orientation, experienced guides, well-maintained equipment, and a well-written release are effective tools in minimizing accidents and the lawsuits that inevitably follow. But outfitters cannot assume that these steps are enough.

Outfitters must have in place procedures for emergencies including evacuation routes, location of telephones, designation of which staff member will be responsible for first aid, securing rescue, etc. It is also essential for outfitters to see that the accident victim and witnesses are interviewed.[58]

While these basic steps should be followed to insure as safe a trip as possible, another procedure for the outfitter to follow is to employ spotters along the rafting route. These employees would be trained in rescue operations and stationed at the most critical points along the river with equipment at the ready to make a rescue if needed. Such a program would however add to the expense of these operations and would be passed along to the customers, which might put the cost of such ventures beyond the reach of many participants. Even the presence of such "rescuers" would not necessarily eliminate every injury or fatality.

Finally, the outfitter should require that each participant read and sign or on behalf of a minor child, a comprehensive release which explicitly describes the risks inherent in white water rafting.

What is the effect of exculpatory provisions in white water rafting agreements? As the Krazek case proved, such waivers can be upheld even where negligence has been proven. The *Murphy* case illustrates that even a comprehensive waiver, along with the statutory protection of outfitters, will not exonerate a commercial operation from liability when gross negligence is proven.

What is the value of the waiver to the commercial outfitter? The release form that participants sign is cautionary in nature. Invariably such forms contain the phrase "inherent hazards" in describing these adventure trips to impress on would-be participants that danger is a built-in aspect of the sport.[59] Outfitters want participants to know that white water rafting trips are not comparable to an amusement park ride and that the condition of the river and the rocks encountered cannot be controlled even by use of the best equipment and the most highly-trained guides. If the raft turns over, a limb may be broken or a life may be lost. Those are the inherent risks of such ventures.

The only opportunity for recovery a participant may have is if the outfitter has knowingly used faulty equipment, hired untrained guides, or as in Murphy's case when an imprudent rescue operation is undertaken.

While statistics reveal that the degree of danger in guided river raft trips to relatively low,[60] there is an undeniable element of risk. Passengers must know that they assume these risks and cannot ordinarily successfully sue the white water rafting company. If the latter uses narrowly drawn releases and provides a safety-minded orientation prior to the trip along with careful instruction for participants along the way, passengers will have a difficult time in winning a case.

The only way for a participant to be absolutely safe is to avoid the rough waters of the river and the shoals of exculpatory contracts.

ENDNOTES

1. Betsy Wade, "How Much Risk Do Adventure Seekers Assume?" Travel Section, *The New York Times*, 1990, at 4.
2. Amy Engeler, "On A Rafting Trip, Running Into Trouble," Travel Section, *New York Times*, July 31, 1994 at 31.
3. 326 Cal. App. 758, 276 Cal. Rptr. 672 (Cal. App. 1Dist. 1990).
4. Betsy Wade, "Waivers: More Than a Warning," Travel Section, *The New York Times*, August 22, 1993 at 3 (herein after "Waivers: More than a Warning").
5. 884 F. 2d 163 (4th Cir. 1989).
6. 412 S.E. 2d 504 (W. VA. 1991).
7. *Saenz v. Whitewater Voyages, Inc.*, 326 Cal. App. 758, 276 Cal. Rptr. 672.
8. *Id.* at *Id.*
9. 674.
10. White water rapids are classified according to their complexity Class I through Class V. The larger the number the more difficult the rapids.
11. 276 Cal. Rptr. 672 at 673.
12. Id.
13. Id.
14. Id.
15. Id. at 674.
16. Id. at 675.
17. Id.
18. Id. at 673.
19. Id.
20. Id. at 676.

21. Id.

22. Id.

23. 884 F. 2d 163, (4th Cir. 1989).

24. Id. at 164.

25. Id. at 165.

26. Id. at 165.

27. Id.

28. Id.

29. 413 So. 2d 444 (Fla. App. 1982).

30. 569 F. 2d 1117 (10th Cir. 1978).

31. 884 F. 2d 163 at 166.

32. Id.

33. Id.

34. 412 S. E 2d 504, at 508.

35. Id.

36. Id.

37. Id. at 509 quoting 496 (B) 1963, 1964 (express assumption of the risk).

38. Restatement (Second) of Torts 496 B comment b.

39. 412 S. E 2d 504 at 510.

40. Id.

41. Id.

42. West Va. Code 20-3B-1. 20-3B-5 (1987).

43. 20-3B-1.

44. 20-3B-3.

45. 412 S. E 2d 504 at 512.

46. Id. at fn 10.

47. 20-3B-1.

48. 20-3B-4.

49. Id.

50. 20-3B-5.

51. C.R.S.A. 33-32-101.

52. M.R.S.A. 7361 (1989).

53. 71 P.S. 510-4.

54. Risk Management Manual, Worldwide Outfitter and Guide Association, 1992, at 7-8 and 17-18. Courtesy Worldwide Outfitter and Guides Association, Trade Association and Industry Advocate. Information provided by William Leverette; Affiliation of Risk Managers for Organized Recreation, and East coast Branch Office of Worldwide Outfitter and Guide Association. The Association is a non-profit Utah corporation operating as a Risk Retention "Purchasing Group" under the Risk Retention Act of 1986, P.L. 97-45.

55. Id at 19-20.

56. Id at 21-22.

57. Id at 15-16.

58. Id at 27-30.

59. "Waivers: More Than a Warning," supra note 4.

60. David Brown, Executive Director of America Outdoors of Knoxville, Tennessee, a trade association of over three hundred members, says that the risk of death is 1 in 300,000 to 1 in 900,000. For example, one million persons have rafted the Ocee River in Tennessee since 1977 with only one fatality. The Ocee is a moderate Class III river with a few Class IV or "difficult rapids." By contrast, the National Ski Patrol Associations places injuries at 4.5 for each 1,000 skiers. Id. 60. Betsy Wade, "How Much Risk Do Adventure Seekers Assume?" Travel Section, *The New York Times*, 1990, at 4.

60. Amy Engeler, "On A Rafting Trip, Running Into Trouble," Travel Section, *New York Times*, July 31, 1994 at 31.

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60. 276 Cal. Rptr. 672 at 673.

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60. Id. at 673.

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60. Id. at 676.

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60. Id.

60. 884 F. 2d 163, (4th Cir. 1989).

60. Id. at 164.

60. Id. at 165.

60. Id. at 165.

60. *Id.*

60. *Id.*

60. 413 So. 2d 444 (Fla. App. 1982).

60. 569 F. 2d 1117 (10th Cir. 1978).

60. 884 F. 2d 163 at 166.

60. *Id.*

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60. *Id.*

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60. *Id.* at 509 quoting 496 (B) 1963, 1964 (express assumption of the risk).

60. Restatement (Second) of Torts 496 B comment b.

60. 412 S. E 2d 504 at 510.

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60. 20-3B-1.

60. 20-3B-3.

60. 412 S. E 2d 504 at 512.

60. *Id.* at fn 10.

60. 20-3B-1.

60. 20-3B-4.

60. *Id.*

60. 20-3B-5.

60. C.R.S.A. 33-32-101.

60. M.R.S.A. 7361 (1989).

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60. Risk Management Manual, Worldwide Outfitter and Guide Association, 1992, at 7-8 and 17-18. Courtesy Worldwide Outfitter and Guides Association, Trade Association and Industry Advocate. Information provided by William Leverette; Affiliation of Risk Managers for Organized Recreation, and East coast Branch Office of Worldwide Outfitter and Guide Association. The Association is a non-profit Utah corporation operating as a Risk Retention "Purchasing Group" under the *Risk Retention Act of 1986*, P.L. 97-45.

60. *Id* at 19-20.

60. *Id* at 21-22.

60. *Id* at 15-16.

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THE LIFE INSURANCE TRUST: A "NO-BRAINER" FOR SAVING ESTATE TAXES *

by

Martin H. Zern**

Introduction

Life insurance is a unique asset. In essence, it is a contractual arrangement whereunder an insurer pays a stipulated amount to a named beneficiary upon the insured's death in exchange for premium payments while the insured is alive. It is unique in that its value (face amount) is born only upon someone's death. Before that event, the policy may have no value, as in the case of term insurance, or some value, as in the case of whole life (permanent) insurance. The value of permanent insurance while a person is alive is commonly referred to as its cash surrender value or more accurately its interpolated terminal reserve value.[1] Regardless of what value, if any, a life insurance policy has while the insured is alive, when he[2] dies, the policy immediately is worth whatever is set forth on its face. No other asset increases in value from one moment to the next, life to death, so much as life insurance does. Fortunately, the amount received under a life insurance contract, whether in a single sum or otherwise, generally is excluded from income taxation if it is paid by reason of the death of the insured.[3] This exclusion also means that there is no income tax on the internal buildup of income while the insured is alive. Unfortunately, however, there is no automatic exclusion of the proceeds of a life insurance policy from federal estate taxation. Quite to the contrary, without proper planning, the proceeds of life insurance are includible in the gross estate of the insured and consequently could be subject to the federal estate tax.[4] Moreover, the estate tax rates are significantly higher than the income tax rates, effectively beginning at 37% and topping out at 55% where and to the extent the taxable base exceeds $3,000,000.[5] If a state (such as New York) imposes an estate tax that is higher than the statutory credit allowed in computing the federal estate tax, the overall rate is even higher.[6] However, as those somewhat familiar with estate taxation are aware, no federal
estate tax is due unless the taxable base exceeds $600,000.[7] Inclusion of life insurance proceeds could bring an estate over this threshold, or increase the amount already subject

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to the estate tax.

For many estates, particularly those with a high percentage of illiquid assets (e.g., family business, real estate, securities that it is desirable not to sell), the federal estate tax is a big problem due to the fact that the tax is generally due within nine months after the date of the decedent's death.[8] Although the executor is primarily responsible for payment of the tax, if it is not paid when due for whatever reason, there is transferee liability imposed upon the person who receives property which has been included in the gross estate.[9] Insurance is often the means by which the estate, or those beneficiaries who may be subject to transferee liability, acquire the means to pay the tax. If the reason for carrying insurance is to pay estate taxes, permanent insurance should be chosen since term insurance gets increasingly expensive as one gets older and may not be available after a certain age. If the insurance is held by an irrevocable trust, as discussed later in this paper, the trust will typically give the trustee administrative powers to purchase property from the estate and to make loans to it, which the trustee could do if there is an estate liquidity problem.

Estate Inclusion

For estate tax purposes, the amount receivable under a life insurance policy upon the death of the insured (the decedent) is includible in the decedent's gross estate if the amount is receivable by his executor or, if receivable by other beneficiaries, where the decedent held any of the "incidents of ownership" in the policy.

Receivable by the Executor

Life insurance proceeds paid with respect to the death of a person are includible in his gross estate if receivable by the executor or administrator of his estate, or if the proceeds are payable to his estate. Moreover, it is not necessary for the estate to be specifically named the beneficiary. For instance, if the proceeds are payable to another beneficiary who is legally bound under the policy to pay taxes, debts or other obligations of the estate, then the amount of insurance proceeds required to be used to discharge such obligations is includible in the gross estate. Similarly, if the insurance was purchased by the decedent as collateral security for a loan, the proceeds are includible in his gross estate even though received by the lender.[10]

Incidents of Ownership

Regardless of who the "other beneficiaries" may be, the amount receivable by any beneficiary, where the face of the policy is paid because of the decedent's death, is includible in the decedent's gross estate if the decedent held at death any of the incidents of ownership in the policy, exercisable either alone or with the approval of any other person.[11]

The term "incidents of ownership" is not limited to technical ownership in the legal sense. Fundamentally, the term relates to the insured's control over the economic benefits of the policy. Accordingly, it includes, among other things, the powers to:

(a) Change the beneficiary.
(b) Surrender or cancel the policy.
(c) Assign the policy or revoke an assignment.
(d) Pledge the policy for a loan.
(e) Determine a settlement option.
(f) Obtain a loan against the cash surrender value.[12]

A decedent may also have "incidents of ownership" in a policy on his life owned by a corporation if the decedent was the sole or controlling stockholder. This rule would be applicable where any part of the proceeds of a policy are not payable to the corporation (e.g., the proceeds are payable to the decedent's son) and thus would not be taken into account in valuing the decedent's stock in the corporation.[13] The term "incidents of ownership" also includes a reversionary interest where the value of the reversionary interest exceeds 5% of the value of the policy immediately before the decedent's death.[14]

Further, a decedent may hold "incidents of ownership" with respect to a policy on his life held in trust if, under the policy, the decedent (either alone or with another or others) had the power (as trustee or otherwise) to change (a) the beneficial ownership in the policy or its proceeds, or (b) the time or manner of enjoyment thereof, even though the decedent had no beneficial interest in the trust.[15]

It is important to recognize that in addition to having "incidents of ownership," the decedent must be the insured in order for the proceeds of life insurance to be includible in his gross estate. For example, if a husband owns a policy on his wife's life (or on the life of any other person), the amount includible in his estate if he is first to die will be only the cash surrender value of the policy, if any.

Impact

If insurance is included in the gross estate, it will be subject to estate tax and the beneficiaries consequently will get that much less. So, any worthwhile estate plan should provide for the insurance not to be included in the gross estate. **Example:** A, the insured, dies with a taxable base[16] apart from insurance of $1,000,000. Insurance payable by reason of his death is $200,000. The federal estate tax with the insurance included in A's gross estate is $235,000 and without is $153,000. By excluding the insurance from the gross estate, the full amount of the insurance is available to pay the estate tax without it in turn being subject to the estate tax. Thus, the objects of the decedent's bounty wind up with an additional $82,000.

Effect of the Marital Deduction

If the deceased owner/insured is married, the unlimited marital deduction will eliminate the insurance proceeds from taxation in his estate if his spouse is the beneficiary.[17] However, this will result in the insurance proceeds being included in the estate of the surviving spouse, if not consumed or given away during her lifetime.[18] Even if an amount equal to the insurance proceeds is consumed or given away, this will simply mean that other assets of an equivalent amount which would have been expended if there were no insurance will not be expended. Thus, with insurance included in the survivor's estate, an estate tax might be imposed where otherwise there would be none, or an estate already subject to tax will be that much greater.

Lifetime Exemption

It must be recognized, of course, that the surviving spouse will not be subject to estate tax unless her taxable estate, including the insurance proceeds, exceeds $600,000.[19] There are many possibilities. For example, she[20] may, before her husband's death, already have net assets in her own name exceeding $600,000; she may have nothing in her name, or perhaps have net assets valued under $600,000, and the insurance proceeds alone, or together with whatever else was left to her, will bring her taxable estate to over $600,000; or, she may have some or no assets and the insurance proceeds, and whatever else was left to her, will not bring her taxable estate to over $600,000. Even if her assets after her husband's death (including the insurance) wind up under $600,000, appreciation and reinvested income during her lifetime may bring her over the $600,000 benchmark.

Whether she will need the insurance money to live on will depend upon her standard of living, the needs of her family and the liquidity of what she winds up with. For example, if after her husband's death, she winds up with the family home worth $450,000 (free and clear) and $250,000 of liquid assets, including insurance proceeds, she may need the $250,000 and may consume all or most of it while alive. On the other hand, she may have a good paying job and not consume the $250,000, intending to leave it as a fund for her children. Thus, disregarding potential appreciation or decline in value after her husband's death, she would wind up with an estate of $700,000 ($450,000 + $250,000) which would result in estate tax to be paid. Another possibility is that she might die prematurely before getting a chance to expend the insurance money where it was expected that she would do so. These are by no means all the possible scenarios. There is, for instance, the capability of making annual gifts within the annual $10,000 per donee gift tax exclusion to deplete her estate.[21] However, the point is made that the insurance left to her will add to her assets and either could cause her to be subject to the federal estate tax where she otherwise would have been below the $600,000 threshold at her death, or will increase the estate tax that she would owe where, without the insurance, she was already over the threshold. Even if she dies owning less than $600,000 and not owing any federal estate tax, she might nevertheless owe increased state estate taxes because of the insurance.[22]

Therefore, unless we are dealing with relatively small amounts, it is generally not a good idea to have insurance proceeds payable outright to the surviving spouse where there is a good chance that she will be subject to estate taxation. Even where it is expected the survivor will consume the insurance proceeds, or deplete the estate to under $600,000 utilizing the $10,000 gift tax exclusion, an early fortuitous death may interpose.

As between a husband and a wife, it may be noted that it makes no difference for estate tax purposes whether the insurance policy is owned by the insured spouse or the other spouse where the other spouse is the beneficiary. If, for instance, a wife owns a policy on her husband's life and she is the beneficiary, she will collect the proceeds upon his death and nothing will be included in his estate since he is not the owner. If he is the owner and she the beneficiary, the proceeds includible in his gross estate will be offset by the marital deduction.

It should be recognized that the marital deduction will eliminate the estate tax in the estate of the insured only if the surviving spouse who is the beneficiary survives the insured. If not, the proceeds will be includible in the estate of the insured, assuming he has "incidents of ownership."

Cross-ownership

In certain cases, both husband and wife may desire to carry significant amounts of insurance on their respective lives naming each other beneficiary, with their children (possibly minors) as secondary beneficiaries. Both spouses may be working and have significant income and possibly assets. Their overall intention is to provide a fund for their children in the event of both of their premature (and possibly simultaneous) deaths, or to make available additional funds to the survivor where one dies before the other. For example, say two professionals, husband and wife, each own a $1,000,000 policy with the other spouse named as beneficiary, and the children as secondary beneficiaries. If the husband dies prematurely, the wife will have added to her assets $1,000,000, and vice versa. (The marital deduction would offset the $1,000,000 included in the estate of the first to die.) If she died shortly thereafter, another $1,000,000 would go into her gross estate, so that she would wind up with $2,000,000. This amount would, of course, be in addition to whatever else was in her gross estate. Although there might be some spend-down if she survived awhile after her husband's death, this would simply mean that other funds would not be expended. Or, if there were a common accident, where the order of death could not be determined, and no will clause containing an assumption as to the order of death, generally $1,000,000 would wind up going into the estate of each spouse.[23] The estate taxes imposed on the insurance would thus erode the amount available for the children, or to be held for their benefit if they are minors.

Second-to-Die Insurance

Where there will be no estate tax on the estate of the first spouse to die because of bypass planning and use of the 100% marital deduction, a type of insurance commonly

called "second-to-die" or "survivorship" insurance is usually preferred, if for no other reason than it is less costly.[24] This type of insurance might be selected where it is expected the surviving spouse will have sufficient assets (after her husband's death) to meet family needs without insurance. The policy would be payable only upon her death with the purpose of financing the estate tax due on her estate, and/or possibly to provide additional funds for children who are still minors, disabled in some manner or otherwise incapable of full self support.[25] Here too, the goal is to exclude the insurance proceeds from the survivor's gross estate.

Having Your Cake and Eating it too

It is possible to eliminate life insurance proceeds from the gross estate of the insured yet have the proceeds utilized as the insured desires. The key is to make sure the insured, at death, does not possess any "incidents of ownership" in the life insurance policy. As discussed hereafter, the techniques for attaining this result are to have the policy owned either by another individual directly or by an irrevocable trust.

Direct Ownership by Another

One approach for eliminating "incidents of ownership" at death is for someone other than the insured to own the policy. A typical scenario is for a child[26] to directly take out the policy on the life of the parent[27] naming himself[28] as the beneficiary. The policy could be a single life policy or a joint-and-survivor policy. Since the parent never owned the policy, it will not be included in his estate, or the estate of the survivor if a joint-and-survivor policy. When the parent dies (or the survivor), the proceeds will be collected by the child without any estate tax being imposed. This plan might be viable, for example, where the child is a mature adult and has an economic interest in the parent such as where there is a family business. Generally, a child cannot take out a policy on the life of a parent unless the parent applies for or consents in writing to the making of the insurance contract.[29]

If a child owns the policy, consideration must be given to how the premiums will be paid. Of course, the child may have sufficient assets of his own to pay the premiums. On the other hand, it may be desirable or necessary for the parent to pay the premiums directly to the insurance company or to give funds to the child to make payment. Either way, the gift of the premium should not be taxable as long as it does not exceed the $10,000 annual gift tax exclusion.[30] On a split gift, the amount could be $20,000.[31] Of, course, funds should be given to the child to pay the premiums only if the child is trustworthy to do so.

Difficulties arise if it is desired to have more than one child own the policy and the parent pays the premium. Because no one child has the capability of exercising ownership rights without the other, it may be construed that no child has a present interest.[32] Thus, the payment of the premium by the parent might not qualify for the annual gift tax exclusion. The seemingly obvious answer to this dilemma is to make gifts to each of the children so that they can pay the premium. In this regard, each gift would qualify for the $10,000 annual exclusion. Here again, however, the issue of trustworthiness is a factor compounded by the fact that there is more than one child to rely on. Also, where there are multiple owners everyone must agree concerning exercise of ownership rights, which could be a problem especially if one of the owners becomes incompetent. Multiple owners may also be treated as owning the policy with survivorship rights, unless clearly spelled out otherwise. Thus, the issue of a deceased owner will be cut off which may not be what was intended. Multiple policies, that is a separate policy to each child, may be a possibility. However, this generally would be more expensive.

Another possibility where there is more than one child is to have only one own the policy and have all as beneficiaries. Apart from the problem of the owner perhaps surreptitiously changing the beneficiaries and excluding his siblings, there could be adverse gift tax consequences when the parent dies. Since the owner has the right to change beneficiaries, his failure to do so might be construed by the IRS to constitute a gift of the proceeds at death to the extent of the share of the other beneficiaries.[33] Consequently, this arrangement should be avoided.

As noted previously, life insurance is excluded from the gross estate of the insured if the spouse of the insured is the owner of the policy.[34] However, where it is desired to keep the proceeds out of the surviving spouse's gross estate for estate tax reasons, the solution is the irrevocable life insurance trust. If the surviving spouse carries insurance on her life, it may be desirable to have such insurance also owned by a trust (or another person individually) in order to keep these further proceeds out of her gross estate.

A disadvantage of direct ownership of the policy by another is the fact that the value of the policy before death of the insured, and the proceeds after death, could be at risk with respect to creditors of the owner/beneficiary, although certain exemptions are usually provided under state law.[35] A further danger is potential claims by a spouse against the owner/beneficiary in the context of a divorce proceeding. Also, individual ownership permits taking a loan against the policy or letting it lapse. This could be done without the consent or knowledge of the insured who is providing the funds to pay the premiums.

Ownership by an Irrevocable Life Insurance Trust - A Better Idea

As is the case with ownership of a life insurance policy by a child, children or a spouse, ownership by an irrevocable life insurance trust will shield life insurance proceeds from estate taxation in the estate of the insured. The irrevocable life insurance trust should always be considered where there are minor children or where the insured does not want children to obtain the funds outright until a "mature" age.[36] It also permits flexibility in managing the insurance proceeds and controlling its disposition. For instance, the insured may not wish his spouse to be the direct beneficiary if there are concerns about her management capability or that she might dissipate the insurance proceeds to the detriment of the children (who possibly may be the children of the insured from a prior marriage). A

trust also can contain "spendthrift"[37] provisions and the trustee may be given authority to "sprinkle" income and principal among multiple beneficiaries. In this context, the problems of direct ownership by multiple beneficiaries, noted above, is avoided. A trustee with management and investment acumen can be selected to oversee the trust.

Moreover, a life insurance trust will keep the proceeds out of the gross estate of a surviving spouse, yet could permit her a certain amount of control over the disposition of the proceeds.[38] As a result, the entire insurance, with no diminution by estate taxes either in the estate of the insured or his spouse, will be available for use by the surviving spouse and/or the children.

An irrevocable life insurance trust is an *inter vivos* trust. In most cases it is an unfunded trust and may be viewed as a standby vehicle awaiting the death of the insured for funding with the insurance proceeds (and possibly with other assets). Ideally, the trustee initiates the policy because of the "three-year" rule, discussed below. The grantor/insured transfers funds to the trust each year in an amount sufficient to pay the premium. Rather than annual transfers, another possibility is for the grantor/insured to initially transfer assets into the trust in an amount sufficient to generate enough income to pay the premium. This latter arrangement, known as a funded trust, is generally undesirable. For one thing, people usually are reluctant to give up control of a significant amount of assets, which would be necessary for the trust to earn the income to pay the premium. Another detriment is that the amount necessary to fund the trust will create a taxable gift requiring payment of a gift tax by the donor or, if any of it is still available, use of his unified credit.[39] Furthermore, an income tax consequence is that, even though a trust is irrevocable, the income generated by the assets in the trust and used to pay premiums is taxable to the grantor.[40]

As explained above, with an unfunded trust, the grantor/insured transfers funds into the trust each year in an amount sufficient for the trustee to pay the premium. Although in substance the grantor/insured is paying the premium, the proceeds will not be included in his estate provided he retains no "incidents of ownership" in the policy. Because the beneficiaries will not receive anything until the grantor/insured dies, the contribution to the trust to pay the premium is a "future interest" insofar as they are concerned.[41] Consequently, the contribution to the trust each year of the premium amount will not, without special language in the trust, qualify for the annual $10,000 per donee gift tax exclusion, which requires a gift of a "present interest."[42] Likewise, a direct payment to the insurance company by the grantor/insured will not qualify for the annual exclusion. As previously noted, a $20,000 annual exclusion per donee is available where a husband and wife make a "split gift" election. Under such an election, the gift is treated as coming ½ from each spouse, resulting in two exclusions, even though it comes from only one.[43]

The Crummey Charade

To obtain the benefit of the annual gift tax exclusion for the contribution to the trust to pay the premium, the trust must contain special language giving the beneficiary(ies) certain withdrawal rights as to the contribution. Such withdrawal rights create a present interest in the beneficiary(ies).[44] In *Crummey v. Commissioner*,[45] Clifford Crummey, who had established an irrevocable trust for his four children, triumphed against the IRS in his contention that each beneficiary's right to possession (to appoint property to himself) of a share of the amount transferred to the trust was equal to actual possession of such share, thus qualifying the amount transferred as a present interest for purposes of the annual gift tax exclusion. The court so held despite the fact that the right to possession was limited in duration and that those beneficiaries who were minors could only assert their right through a guardian. The IRS had not denied an exclusion for the adult beneficiaries. The fact that a guardian may not in fact be appointed was subsequently conceded by the IRS not to be a problem provided there was no impediment under the trust or local law to the appointment of one.[46]

As a result of the *Crummey* decision, the standard irrevocable life insurance trust contains so-called *Crummey* powers. These powers seemingly will qualify an amount transferred to a trust as a present interest for purposes of the annual exclusion even though the power of a beneficiary to withdraw the amount is limited in duration and despite the fact that the beneficiary is a minor and no guardian has been appointed. The power to withdraw, even though short-lived, has been held legally sufficient to create a present interest although arguably it is illusory. The fact of the matter is that the amount transferred to the trust to pay the premium is rarely, if ever, withdrawn by anyone. The reality is that the money is needed to pay the premium. If a beneficiary withdrew the amount, unless paid otherwise, the policy would lapse which would be self defeating to the beneficiary. Moreover, the beneficiary also recognizes that a withdrawal might result in the grantor making no further contributions. In many, if not most, life insurance trusts, the beneficiaries are the grantor's children. One can just imagine a parent's reaction if a child withdrew the money from the trust that the parent just put in to pay the premium. With respect to minor children, the possibility of the money being withdrawn by a guardian is less than minimal. Overall, it is implicit that withdrawal will not be made. It is surprising, therefore, that the courts and the IRS, at least so far, have sanctioned this charade, and that practitioners seemingly have little concern that the apple cart will be overturned.

Multiplying the Exclusion

The $10,000 exclusion is multiplied by each gift of a present interest. Thus, if there are multiple beneficiaries of a trust, the total amount that can be excluded is $10,000 times the number of beneficiaries who have *Crummey* withdrawal powers. For instance, if there are four such beneficiaries, the grantor could annually transfer $40,000 into the trust as a non-taxable gift. Of course, whether such a sum needs to be protected by the exclusion depends upon the amount of the annual insurance premium. (It may be desirable to make gifts to the trust in general and not merely to pay the premium.) In determining

how many $10,000 exclusions are available, it was always clear that you count the number of primary beneficiaries and not those with only a nominal interest, such as a contingent remainderman. This rule was upset a few years ago by the Tax Court in *Estate of Maria Cristofani*.[47] In *Cristofani*, the IRS had allowed exclusions for the two children of the grantor who were primary beneficiaries but disallowed them for the grantor's five grandchildren who had only contingent interests in that they were to receive principal distributions only if their parents (the primary beneficiaries) died before termination of the trust. The somewhat circular argument of the IRS was that since it was unlikely that the grandchildren would get anything, they would normally exercise their withdrawal rights unless there was a prior understanding that they would not do so.[48] However, the court ruled that the test of a *Crummey* power is the "right to demand property" from the trust "not the likelihood" of exercising that power. Thus, the court allowed an annual $10,000 exclusion for all the beneficiaries including the grandchildren, adding up to seven exclusions. It may be noted that the right of the beneficiaries to withdraw existed only for 15 days following the grantor's contribution to the trust. Although the case at first impression appears favorable, at least in the 9th Circuit which sanctioned the result, commentators fear that the case may have brought undue attention to *Crummey* powers in general, and that Congress consequently might enact restrictive legislation on their overall use, not only where there are contingent beneficiaries. [49] It should be recognized, of course, that in many if not most cases, it is not necessary to obtain multiple exclusions since the amount necessary to pay the premium may be below $10,000.

Timely and Adequate Notice

A beneficiary's right of withdrawal under a trust agreement with respect to contributions to the trust to pay premiums must be perfected by notice of such right in order for it to constitute a present interest in the contribution. Generally, the right to withdraw is given for a specific period of time after which it lapses. The time period must be reasonable and begins when notice of the withdrawal right is received by the beneficiary. However, what constitutes a reasonable time is somewhat uncertain. Most practitioners feel that at least 30 days' notice is sufficient and this seems to be the standard, although the courts have sanctioned a lesser time, such as the 15 days in *Cristofani, supra*.[50] There seemingly is no good reason to take a risk and provide for less than 30 days notice in the trust document considering that in most cases withdrawal is highly unlikely regardless of how much time is given. If the premium is due and paid prior to the end of the withdrawal period, at which time the power to withdraw lapses, the right to withdraw may be considered illusory.[51] Consequently, the premium amount should be contributed to the trust sufficiently in advance of its due date to allow for notice of the right to withdraw to be sent and received and the withdrawal time to pass. However, if the policy is one of permanent insurance, as opposed to term, it appears that the cash to pay the premium need not be retained for any period of time and the trustee could thus pay the premium immediately.[52] Under this rationale, the withdrawal rights could be given once a year at a fixed time, for example, 30 days before year end to terminate at year end. However, if the trust is created shortly before year end, the time may be insufficient if the right terminates at year end, but not if it extends into the next year for a reasonable time.[53]

Nevertheless, it would seem to be safer to keep the money around until the withdrawal period lapses.

In addition to giving the beneficiary sufficient time to exercise withdrawal rights, the notice of the right must be adequate.[54] In this regard, the notice clearly should be in writing and delivered to the beneficiary and, if applicable, the beneficiary's guardian. Although the notice may be provided by the grantor, trust documents generally impose this obligation on the trustee. Where notice is given to a guardian, it should state that both the guardian and the minor have the right to withdraw for the specified period. Where the trustee is also the child's guardian, notice would be meaningless and probably is not required.[55] It is also probably not a good idea to rely on a one-time blanket notice in which the beneficiary is advised that each year henceforth he will have the specified withdrawal right, even if the beneficiary waives the right to future notices. In a situation where the trust required annual notices and the beneficiaries waived such right, the IRS ruled that there was no annual exclusion allowed for the gift of money to the trust to pay the premium.[56] Even if a trust provides for a one-time notice, discretion would dictate against it.

The Lapse Problem

Much ado has been made of the so-called "lapsing" problem with respect to *Crummey* powers. Since a beneficiary has withdrawal power only for the period specified in the trust document, it is clear enough that the power will lapse if it is not exercised by the end of such period. A *Crummey* power is considered a "general power of appointment" over the property subject to the power since the holder of the power can appoint the property to himself. A release of a general power of appointment is considered a transfer of such property by the holder of the power to the trust.[57] A lapse of a power is considered the same as a release of the power.[58] It is as if the holder of the *Crummey* power exercised the right of withdrawal, took the money from the trust and transferred it back, irrevocably. If there are other beneficiaries of the trust, the part of the transfer to the trust allocable to them will be considered a gift to them by the holder of the power who allowed it to lapse.[59] Accordingly, each holder who allows a withdrawal power to lapse will be deemed to have made a gift to the other beneficiaries. Furthermore, the part of the lapsed amount that is a gift to the other beneficiaries is a gift of a future interest not qualifying for the annual gift tax exclusion since the gift is not something to which they have immediate rights. However, the actual amount of the gift is generally quite small since a gift of a future interest must be discounted.[60] Consequently, the gift tax implications of a lapsing power to withdraw are generally not of any major concern. Utilization of the $600,000 exemption, if available, would thus be minimal.

Within limits, a special exception permits powers that lapse during lifetime to occur without the lapse resulting in a transfer to the trust with gift tax (and estate tax) implications. The exception permits a lapse during a taxable year not to be treated as a transfer to the trust to the extent that the property, which could have been appointed by exercise of such lapsed power, does not exceed in value, at the time of the lapse, the

greater of (i) $5,000, or (ii) 5% of the value, at the time of the lapse, of the assets out of which the exercise of the lapsed powers could have been satisfied.[61] Since the latter amount would be applicable only to a funded trust (e.g., trust assets would have to exceed $100,000), the $5,000 figure is relevant to unfunded trusts.[62] In other words, there would be a transfer to the trust as a result of the lapse only if and to the extent the right to withdraw that lapsed exceeded $5,000. Generally, insurance trusts with *Crummey* powers permit withdrawal up to the lesser of the value of the property transferred to the trust in the calendar year (i.e., the insurance premium amount) or $10,000 ($20,000 for a split gift). The obvious purpose of such a provision is to assure that the contribution to the trust by the grantor qualifies for the maximum annual exclusion. Accordingly, the lapsing problem only exists if the premium required to be paid exceeds $5,000 times the number of beneficiaries with withdrawal rights. For example, if the contribution to the trust to pay premiums is $20,000, and there are four equal beneficiaries who let their withdrawal rights lapse, there would be no deemed gift by any beneficiary to the trust on the lapse of the power to withdraw since the lapse as to each beneficiary does not exceed $5,000. As to the grantor, the gift of the $20,000 would not be a taxable gift since the amount of the exclusion available is $40,000 ($10,000 x the number of beneficiaries with withdrawal rights). On the other hand, if there were only two beneficiaries who allowed their withdrawal rights to lapse, each would be deemed to have made a transfer to the trust in the amount of $5,000 (the right to withdraw of $10,000 less $5,000) and consequently a future interest gift to the other of $2,500 ($2,500 would be for the beneficiary's own benefit). The grantor still would not have made a taxable gift since the exclusion available is $20,000 (two beneficiaries). Language in a trust limiting withdrawal to the extent of the greater of $5,000 or 5% of trust assets so as not to cause a gift are commonly referred to as "5 & 5" powers. However, such limitation would cause a taxable gift to the grantor (requiring use of his $600,000 exemption, if available) where the required premium exceeds the number of beneficiaries with withdrawal rights times $5,000.

Example: Grantor forms an irrevocable life insurance trust which takes out a policy on Grantor's life. He is to transfer $25,000 each year into the trust, under which his two minor children (Gail, age 12, and Barbara, age 15) are equal beneficiaries, to pay the annual premium. Upon Grantor's death, the life insurance proceeds are to be distributed to the children. However, no distribution is to be made to a child from the trust unless the child has reached age 30, and the trust will continue to this age. If a child predeceases the Grantor or dies before reaching the age she becomes entitled to her share of the life insurance proceeds, her share goes to the other. In order to get the benefit of two annual exclusions, so that there is no taxable gift to the extent of $20,000 (the extra $5,000 is offset by Grantor's $600,000 exemption, if still available), Grantor gives the children *Crummey* powers under which each has the right to withdraw by the end of the year her share of the contribution to the trust up to an amount equal to the $10,000 annual exclusion. Adequate and timely notice of the right to withdraw is given. As is the rule, no withdrawal is made and the right to withdraw lapses. On lapse, each child will be deemed to have made a transfer to the trust of the lapsed amount which, in part, the other child will benefit from *in futuro*. However, the transfer to the trust will be only the excess of the lapsed amount over $5,000. So, rather than each child being deemed to have made a transfer of $10,000 to the trust, the amount of the transfer will be only $5,000 because of the "5 & 5" rule. The part of the transfer to the trust by one child that is a gift to the other will not qualify for the annual exclusion since it is considered a gift of a future interest in that the other child will only benefit from the policy upon the subsequent death of Grantor. More specifically, a transfer to the trust of $5,000 by each child would be deemed a gift to the other child of ½ of the $5,000 or $2,500 since each child has a continuing ½ interest. However, it would appear that since each child is making a gift to the other, the gifts would offset one another. This would be true except for the fact that the children are of different ages and thus the gift from one to the other will be different. The difference will be small, however, since the children are close in age and the gift would have to be discounted actuarially since it is a future interest.[63] Based upon the above numbers, it appears that there would be a gift from the youngest child to the oldest in the amount of only $159.[64] It may be stated, therefore, that permitting withdrawal in excess of the "5 & 5" amount is generally not of any major concern in this type of situation. Although the gift is small, a gift tax return is still required to be filed since the gift is not covered by the annual exclusion.

A Somewhat More Serious Concern

As discussed above, a lapse of a power is considered a transfer of the property subject to the power to the trust. Since a beneficiary who is deemed to have made a transfer of property by allowing the right to withdraw it to lapse has a continuing interest in the trust (i.e., a life estate), the property transferred is pulled back into the beneficiary's estate under IRC § 2036.[65] Consequently, lapsing powers are a more serious estate tax concern. Of special significance where there is a lapse of a power to withdraw in excess of the "5 & 5" *de minimis* amount, is the "cumulation" rule which causes lapsing powers to accumulate for estate tax purposes. Under this quite technical rule, if a right of withdrawal is not exercised in more than a single taxable year, the proportion of the property subject to the power, which is treated as a taxable disposition, will be determined separately for each year. The aggregate of the taxable dispositions that have lapsed each year is to be included in the gross estate of the person who did not exercise the right of withdrawal.[66] Again, the amount treated as lapsed each year will only be the excess over the "5 & 5" amount. Further, if a person holds a power to withdraw at death, the property over which the power exists must be included in the gross estate. However, the "5 & 5" offset does not apply to the lapse of a power caused by the death of the holder.[67]

The cumulation problem usually arises with respect to a lifetime income beneficiary of the trust who holds withdrawal powers (quite often a spouse) and relinquishes them in favor of remaindermen.

Example: Grantor establishes an irrevocable life insurance trust which provides that the income from the life insurance proceeds received on his death (after perhaps some contribution to pay estate taxes) is to be paid to Wife during her lifetime and, at her death, the trust corpus will be distributed equally to their (or perhaps his) three children. The annual premium on the policy (permanent insurance) is $45,000. In order to obtain four

annual exclusions so that $40,000 of the $45,000 premium does not require the payment of gift tax or use of Grantor's lifetime credit/exemption, Wife and children are given *Crummey* withdrawal powers giving each of them the right to withdraw the lesser of their share of the contribution to the trust or $10,000.[68] As is usual, the powers are not exercised and they lapse. Assuming that the *de minimis* amount under the "5 & 5" rule is $5,000, Wife is deemed each year to make a gift of the remainder value of $5,000 to the children because of the lapse. Assuming the Wife is age 60, the first year the remainder value gift is $1,419.[69] Assuming that the cash surrender value of the policy in the first year is $25,000, the percentage of the gift to the trust assets is 5.7%. In the next year, when she is age 61, there is another lapse the gift value of which is $1,482. If the cash surrender value is $60,000 the next year, the percentage is 2.5%. No gift tax exclusions are available under the "future interest" rule. Wife dies before any further contributions are made to the trust, at which time the cash surrender value of the policy is $65,000. Under the cumulation rule, Wife's gross estate would have to include $5,330 ($65,000 x 8.2%). This does not seem to be such a big deal. Taking it a step further, however, suppose Grantor dies with Wife surviving and the trust collects the face amount of the policy which we will assume is $1,000,000. Of course, no further premiums will be payable. Suppose Wife subsequently dies at which time the assets in the trust are worth $1,100,000. It would appear that the amount includible in her estate would be $90,200 (8.2% x $1,100,000). Obviously, if there were lapses in other years before Grantor died, the percentage would build up and that much more would be includible in her estate. The total percentage, however, cannot exceed 100%.[70]

The concept underlying the above result is that Wife has transferred property (the lapsed amount) into a trust over which she has an income interest. Under IRC § 2036, gift transfers with a retained income interest are brought back into the estate at date of death value. However, any amount previously treated as a taxable gift (e.g., the $1,419 and $1,482) would not be counted as adjusted taxable gifts in computing the estate tax, and any gift tax paid would be allowed as a credit against the estate tax.[71]

Hanging Powers and Other Devices

Practitioners have devised several strategies to solve the lapse problem. One solution is the "hanging power." Under this contrivance, the power in excess of the "5 & 5" amount ($5,000 in the above example) does not lapse. The power survives (hangs around) until future years in which, hopefully, it can be absorbed within the "5 & 5" limit. Thus, since there is no lapse, there is no current gift. For example, if it is expected that the policy will become fully paid up after a few years or that policy premiums will drop over time, then the hanging withdrawal powers could lapse at the rate of $5,000 per year (or 5% of trust assets if greater) when no further (or smaller) contributions will be necessary (i.e., when the policy is paid up). Another possibility, is to have the hanging powers lapse at a point in time when the trust assets have built up to a point where 5% of trust assets would be in excess of the $10,000 current withdrawal right required to assure a gift tax exclusion for the current contribution. For example, if the cash surrender value builds up to $200,000, there could be a lapse of $10,000 (5% x $200,000) and thus no new hanging power would be created. Assuming that the next year the cash surrender value of the policy is $240,000, there could be a lapse of 5% or $12,000. This would absorb the $10,000 current premium allocable to the Wife, as in the above example, plus $2,000 of the hanging withdrawal rights.[72]

As time goes on, all of the hanging powers, it is hoped, will be absorbed. The problem is that if the Wife dies before all of her hanging powers are absorbed, she will be deemed to have a general power of appointment to that extent resulting in inclusion in her estate. If the Grantor dies first, there would appear to be no problem since the withdrawal right would then be 5% of the trust corpus ($1,000,000 in the above example). At this level, all hanging withdrawal rights would be absorbed either immediately, or at least should be by the next year.[73]

Another way of preventing a taxable gift and estate tax inclusion is to limit withdrawal rights to the "5 & 5" amount so there is no lapse. This is fine as long as the premium does not exceed $5,000 times the number of beneficiaries with withdrawal rights. Usually, this limitation would be satisfactory for term insurance where the premiums are smaller.

In certain cases, the lapsing problem can be avoided by giving the beneficiary a testamentary limited or general power of appointment over his trust share. This would render any lapse an incomplete gift.[74] Although this would eliminate the gift tax problem, the property subject to the power of withdrawal would be included in the beneficiary's estate.[75] However, this is not a problem if it is expected that the beneficiary will not be subject to estate tax or will wind up with the life insurance proceeds anyway. Accordingly, this might work with respect to the children in the above example.

Finally, the trust could be initially funded with sufficient assets ($200,000) so that 5% would equal $10,000. As previously mentioned, most persons would be hesitant or financially incapable of donating this amount irrevocably and, besides, there would be a taxable gift to the extent in excess of the available gift tax exclusions.

Administrative Considerations

Once the trust is established, the first thing to do is to obtain a federal identification number for the trust which is necessary to open a bank account and to purchase the policy. IRS instructions indicate that this could take four weeks. However, a fairly new procedure permits the number to be obtained by telephone immediately. After the identification number is acquired, a bank account should be established to accept the contribution to the trust for the premium. The premium should be paid out of this account by the trustee in order to insure that the annual exclusion is available (the trust contains the *Crummey* powers). In the event an existing policy is to be transferred to a trust (see discussion below), it will be necessary to get from the issuing company its form(s) to change ownership and beneficiary designation (to the trust). After the forms are returned to the insurance company, one should follow up and get written confirmation from the

company that the necessary changes have been made. The trustee should also make sure the beneficiaries receive timely notice of their right to withdraw when a contribution is made to assure the insured gets exclusions for the contribution. Since the trust will usually have no income while the insured is alive, it will generally not be necessary to file fiduciary income tax returns. Of course, when the insured dies, the trustee has to collect the proceeds and administer the trust over its term.

The Three-Year Recovery Rule

The fundamental goal with respect to life insurance is to keep the proceeds, which are payable at death, out of the insured's estate. Consequently, where the insured already owns a policy, there is a strong incentive to transfer the ownership either outright to an individual or to an irrevocable life insurance trust. In fact, those who are properly advised will do this. However, to prevent transfers in anticipation of death, the Internal Revenue Code mandates that the face amount of the policy be included in the decedent's gross estate if he dies within three years of making the transfer.[76] Consequently, unless the insured can peer into the future and determine that he will be alive in three years, it is better for the policy to be originally acquired by another or by a life insurance trust, rather than the insured gifting an existing policy. Sometimes, it may even pay to cash in an existing policy and have a new policy issued. However, this would be feasible only if the insured is in sufficiently good health to be insurable and the new policy is not too costly. If the insured can't get a new policy, the existing policy should nevertheless be transferred and one would then hope to live the requisite three years. If an existing policy with a cash value is transferred to a trust, the cash value will qualify for the annual exclusion to the extent of the number of trust beneficiaries holding *Crummey* powers. If there are insufficient exclusions to accommodate both the policy value and the premium, the policy should be transferred in a year where the premium has already been paid. The next year, the exclusions could cover the premium.

Conclusion

With estate taxes being as high as they are, there seems to be no good reason for an insured with estate tax exposure to own a life insurance policy. Furthermore, an insurance agent that issues a policy to an insured knowing that (or perhaps not inquiring whether) the insured might have a taxable estate, arguably, is negligent in so issuing the policy. In a recent situation, the author insisted that the agent cancel a new policy issued to the insured and reissue it to a newly established trust. As a general rule, a spouse should not be made the direct beneficiary of a life insurance policy if the spouse might be subject to estate tax, nor in this case should she own insurance on her own life. Care should be taken in drafting the trust so that lapsing powers do not result in unexpected estate and gift tax consequences. Once an insurance trust is established, the trustee should diligently attend to the administrative considerations. Obviously, the rules relative to life insurance trusts are quite technical. Nevertheless, it is quite easy (a "no-brainer," if you will) to avoid the inclusion of life insurance proceeds in one's estate. Simply, the insured should have no "incidents of ownership" in the policy at death.

ENDNOTES

[1] Technically, the value of a permanent life insurance policy is its "interpolated terminal reserve value" plus the proportionate part of the gross premium last paid before the date of the decedent's death which covers the period extending beyond such date. Treas. Reg. § 20-2031-8(a)(2) (as amended in 1974). This usually approximates the cash surrender value. This is usually the value for gift tax purposes provided the insured is reasonably healthy. All references herein to "Treas. Reg. §" are to the Treasury Department Regulations interpreting the Internal Revenue Code of 1986, as amended.

[2] For purposes of this article, the masculine shall be deemed to include the feminine where applicable and vice versa. *See, e.g.*, Section 1 of Title 1 of the United States Code regarding statutory construction which is applicable to the Internal Revenue Code. *Also, see* I.R.C. § 7701(m)(1).

[3] I.R.C. § 101. All references herein to "I.R.C. §" are to the Internal Revenue Code of 1986, as amended. An exception is provided where the policy is transferred for a valuable consideration in which case the transferee can exclude only what he paid for the policy plus subsequent premiums. I.R.C. § 101(a)(2). The exclusion is reinstated in certain cases where the transfer is made to certain entities usually in the context of financing buy-out arrangements. I.R.C. § 101(a)(2)A) and (B).

[4] More accurately, the "Unified Transfer Tax" which is applicable to both lifetime gifts and transfers at death.

[5] The "taxable base" under I.R.C. § 2001 is the amount of the taxable estate (gross estate less allowable deductions) plus adjusted taxable gifts made after 1976, other than gifts that might be pulled back into the decedent's estate because of certain retained rights or powers, or when such rights or powers are released by the decedent within three years of the decedent's death. I.R.C. §§ 2035(d), 2036, 2037, 2038. If there are no adjusted taxable gifts, the "taxable base" and the "taxable estate" are the same. For large estates exceeding $10,000,000 the benefit of the lower rates (i.e., below 55%) begins to be phased out by means of a surcharge and is fully phased out at $21,040,000. I.R.C. § 2001(c)(3).

[6] A credit is allowed against the Federal estate tax for death taxes levied by a state or the District of Columbia but limited by a statutory formula. I.R.C. § 2011.

[7] *See* Note 19, *below*, for further discussion.

[8] I.R.C. §§ 6075(a), 6151(a). A lengthy extension of time to pay is permitted where the estate consists largely of a closely-held business including a farm. I.R.C. §§ 6161(a)(2), 6161.

[9] I.R.C. §§ 2002, 6324(a)(2). Certain items may be included in the gross estate and subjected to the estate tax although they are not probate assets under the control of the executor (*e.g.*, jointly held property, property subject to a general power of appointment held by the deceased at death and property previously transferred and pulled back into the estate under I.R.C. §§ 2035-2042).

[10] Treas. Reg. § 20.2042-1(b)(1) (as amended in 1979).

[11] I.R.C. § 2042.

[12] Treas. Reg. § 20.2042-1(c)(2) (as amended in 1979).

[13] Treas. Reg. § 20.2042-1(c)(6) (as amended in 1979).

[14] The term "reversionary interest" includes a possibility that the policy or its proceeds may return to the decedent or his estate, or may be subject to a power of disposition by him. The value of the reversionary interest is determined by using Treasury Department mortality tables. I.R.C. § 2042(2); Treas. Reg. § 20.2042-1(c)(3) (as amended in 1979).

[15] Treas. Reg. § 20.2042-1(c)(4) (as amended in 1979).

[16] *See* Note 5, *supra.*

[17] In computing the taxable estate, an unlimited marital deduction is allowed for the value of property passing from a decedent to a surviving spouse if the property is included in the gross estate. The property must pass outright to the surviving spouse or may go into certain types of trusts in which the spouse or her estate has certain prescribed rights or powers. I.R.C. § 2056

[18] In order for property given away during lifetime not to be included in the gross estate upon death, it must have been a non-taxable gift under the $10,000 annual per donee exclusion. I.R.C. § 2503(b).

[19] The estate tax on a taxable estate (including adjusted taxable gifts, if any) of $600,000 would be $192,800, less the unified credit of $192,800 equals zero tax due. For those states that have an estate tax equal to or greater than the statutory credit allowed against the federal estate tax for local death taxes, the exemption equivalent amount is actually $642,425 rather than $600,000. The estate tax on a taxable estate of $642,425 is $208,497. Subtracting the unified credit of $192,800 and the statutory credit allowed for state death taxes on an estate of $642,425, which would be $15,967, no federal estate tax is due.

[20] For expedience, the surviving spouse is referred to as "she" in this paper since statistics show that on average women significantly outlive men.

[21] *See* Note 1, *supra,* Notes 32 and 41, *below.*

[22] In New York, for example, a taxable estate exceeding $115,000 is subject to estate tax. N.Y. Estate Tax Law § 971(a) (McKinney 1996), for estates of decedents dying after June 9, 1994.

[23] *For example, see* N.Y. Estates, Powers and Trusts Law § 2-1.6 (McKinney 1996).

[24] Basic estate planning carves out a taxable estate for the decedent in the amount of $600,000, the unified credit exemption equivalent (commonly called the by-pass amount since it does not flow into the gross estate of the surviving spouse), with the remainder of the estate going to the surviving spouse in a manner that will qualify for the 100% marital deduction. The tax on the $600,000 will exactly equal the unified credit of $192,800 resulting in no estate tax. Under this type of plan, no estate tax (except possibly state estate or inheritance tax) will be payable on the death of the first to die. Rather, the estate tax consequences are deferred until the death of the survivor.

[25] The author was involved in a situation where the proceeds of second-to-die insurance were made payable to a "supplementary needs" trust to provide for a manic-depressive daughter who was receiving SSI and Medicaid.

[26] For purposes of this article, the singular shall be deemed to include the plural where applicable and vice versa. *See, e.g.*, Section 1 of Title 1 of the United States Code regarding statutory construction and I.R.C. § 7701(m)(1).

[27] *Id.*

[28] *Id.*

[29] *See, e.g.*, N.Y. Insurance Law § 3205(c) (McKinney 1996).

[30] Payment by the parent of the premiums on a life insurance policy owned by the child would be deemed a gift to the child in the amount of the premium paid in the taxable year.

[31] Under I.R.C. § 2513, a donor and his spouse can treat a gift made by him as made one-half by him and one-half by his spouse, provided that both parties consent to such arrangement on a filed federal gift tax form. *See* Treas. Reg. § 25.2513-2 (as amended in 1983) concerning the mechanics of signifying consent.

[32] As discussed in more detail hereafter, only a gift of a "present interest," as contrasted with a "future interest" qualifies for the $10,000 annual gift tax exclusion. I.R.C. § 2503(b).

[33] Goodman v. Commr., 156 F.2d 218, 34 AFTR 1534, 46-1 USTC ¶ 10,275 (2nd Cir., 1946).

[34] Generally, a wife or husband may effectuate insurance upon the person of the other without the other's approval. *See, e.g.*, N.Y. Insurance Law § 3205(c)(1) (McKinney 1996).

[35] Most states provide some type of exemption from creditors with respect to insurance polices. However, the laws vary considerably. *See, e.g.*, N.Y. Insurance Law § 3212 (McKinney 1996).

[36] Many people unknowingly name a spouse as a beneficiary of a life insurance policy with a minor child or children as secondary beneficiary. If the spouse predeceases and no other arrangements are made, through oversight or otherwise, it will be necessary to institute guardianship proceedings. Usually, the guardianship clerk of the court will wind up being co-guardian during minority. The minor children will wind up getting the full insurance proceeds at majority (age 18).

[37] A "spendthrift" provision prevents a beneficiary from transferring his interest in the trust to satisfy the claims of creditors. The effect of a spendthrift provision depends upon state law.

[38] If the trust is carefully drafted, it is possible for the surviving spouse to be the trustee. Discussion of this aspect is beyond the scope of this paper.

[39] Since the amount transferred into the trust would be a future interest, the annual $10,000 exclusion will not be available to offset the funding unless the beneficiaries are given withdrawal rights for this amount as discussed hereafter. *See* Note 41, below.

[40] I.R.C. § 677(a)(3).

[41] Treas. Reg. § 25-2503-3(a) (as amended in 1983).

[42] An unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (such as a life estate or term certain) is a present interest in property. Treas. Reg. § 25.2503-3(b) (as amended in 1983).

[43] *See* Note 31, *supra.*

[44] Revenue Ruling (Rev. Rul.) 80-261, 1980-2 C.B. 279.

[45] 397 F.2d 82 (9th Cir. 1968).

[46] Rev. Rul. 73-405, 1973-2 C.B. 321

[47] 97 T.C. 74 (1991), *acq.* in result, 1992-2 C.B. 1.

[48] *Crummey* powers given to primary beneficiaries have been similarly criticized (i.e. there is an implied prior understanding that the withdrawal rights will not be exercised).

[49] The Internal Revenue Service recently denied annual exclusions for a beneficiary with a vested remainder interest, beneficiaries with discretionary income interests and beneficiaries who had only "naked" *Crummey* powers. The IRS position was that substantively only a few beneficiaries were intended to be benefited, and that there was a pre-arranged understanding that certain beneficiaries would not exercise their withdrawal rights (Tech. Adv. Mem.9628004).

[50] Notice of 30 days was sanctioned in Priv. Ltr. Rul. 9030005.

[51] *See*, Priv. Ltr. Ruls. 8008040, 7947066 and 782649. At the other extreme, the Internal Revenue Service has ruled that four or fewer days is insufficient (Tech. Adv. Mem. 9628004).

[52] Halstead v. Commr., 28 T.C. 1069 (1957), *acq.*, 1958-1 C.B. 5; Treas. Reg. § 25.2503-3(c), Example 6 (as amended in 1983).

[53] Rev. Rul. 83-108, 1983-2 C.B. 167.

[54] Rev. Rul. 81-7, 1981-1 C.B. 474.

[55] Priv. Ltr. Rul. 8008040 .

[56] Tech. Adv. Mem. 9532001.

[57] I.R.C. § 2514(b).

[58] Treas. Reg. § 25.2514-3(c)(4) (as amended in 1986).

[59] Treas. Reg. § 25.2503-2(a) (as amended in 1995).

[60] Unfortunately, the Regulations are not clear on how the value of the future gift is to be determined in varying situations.

[61] I.R.C. § 2041(b)(2).

[62] Although a trust is not initially funded with assets to generate income to pay premiums, it is possible that the cash surrender value might eventually build up to over $100,000, in which case the withdrawal right would exceed $5,000 (unless the withdrawal right excluded the policy itself).

[63] *See* Note 60, *supra.*

[64] The gift may be determined (hold your hats) using the following reasoning: Barbara (age 15) will get the future interest gift age at age 30, or in 15 years. Gail (age 12) will get the future interest gift at age 30, or in 18 years. Using IRS Table B, and an "applicable federal rate" of 8%, the remainder value at 15 years to Barbara is .315242 x $2,500, or $789. The remainder value at 18 years to Gail is .250249 x $2,500, or $626. Also, Barbara would be assured of getting the remainder interest amount only if she reached age 30 and the same would be true for Gail. Using other IRS tables (80CNSMT - Mortality), the chances of Barbara living 15 years and reaching age 30 are 98.2% and the chances of Gail living 18 years and reaching age 30 are 98.1% (the older you are the greater your chance of reaching an older age). Thus, Gail's gift to Barbara is $789 x 98.2%, or $773 and Barbara's gift to Gail is $626 x 98.1%, or $614. In other words, the chances of both surviving to age 30 are very high. Offsetting the future gifts against one another, there is a net gift to Barbara of $159 ($773 - $614). This seems to make some sense since Barbara is older and will get the future interest sooner, and also being older there is somewhat of a greater chance that she will reach age 30. The foregoing computations are, of course, subject to debate.

[65] Under this section, property that is transferred during lifetime in which the transferor retains a life estate is pulled back into the transferor's estate at his death at the value at such time.

[66] Treas. Reg. § 20.2041-3(d)(5) (as amended in 1986).

[67] Treas. Reg. § 20.2041-3(d)(3) (as amended in 1986).

[68] If necessary to obtain another exclusion, a *Crummey* power can be given to the wife of the grantor. In this regard, it should be noted that the contribution to the trust allocable to the wife does not qualify for the marital deduction since it is not a gift of a present interest. Thus, to create a present interest and another exclusion, the wife would have to be given a *Crummey* power.

[69] Using IRS actuarial Table S and assuming an 8% "applicable federal rate" for the month of the lapse the remainder value is .28379. No exclusion is available since it is a gift of a future interest. *See* Rev. Rul. 85-88, 1985-2 C.B. 201.

[70] *See* Note 66, *supra.*

[71] I.R.C. § 2012.

[72] Of course, this plan would not work for term insurance since there is, of course, no value build up.

[73] It appears that a trust may even have a provision requiring consent of the trustee to exercise the hanging power (to assure that there is no actual withdrawal) provided the trustee did not create the power and does not have a substantial adverse interest in the property subject to the power which is adverse to the exercise of the power in favor of the possessor of the power. I.R.C. § 2514(c)(3)(B).

[74] Treas. Reg. § 25.2511-2(b) and (c) (as amended in 1983).

[75] I.R.C. §§ 2036 and 2038.

[76] I.R.C. § 2035.

IMMIGRATION ASPECTS OF NAFTA

by

Roy J. Girasa*

Introduction

The North American Free Trade Agreement (NAFTA), now the subject of intense presidential political debate, was entered into on December 17, 1992, by the signing of the Agreement by the heads of state of the United States, Mexico and Canada.[1] It is an executive agreement rather than a treaty. It became effective a year later, when, Congress passed the North American Free-Trade Agreement Implementation Act which became effective on January 1, 1994.[2] The Act replaced the United States-Canadian Free Trade Agreement of January 2, 1988 which had come into effect of January 1, 1989 and ended on December 31, 1993.[3] The obvious major change was the inclusion of Mexico into the free trade arrangements, although Canada was permitted exclusively to retain certain rights it possessed under CFTA.[4] In the last Presidential campaign, there were intense efforts to curb both legal and illegal immigration and a major presidential contender (Patrick Buchanan) had called for the repeal of the Agreement.[5] The purpose of this paper is to examine the provisions in NAFTA relating to immigration.

NAFTA's immigration provisions are contained in Chapter 16 of the Agreement entitled: "Temporary Entry for Business Persons." The objectives of the Chapter are the facilitation of the temporary entry of nationals of each of the Party states into the other two Party states as well as "to ensure border security," protect the domestic labor force and to assure permanent employment of each of the Parties.[6] Each Party is required to adopt, expeditiously, common criteria to prevent the impairment or delay in goods or services or conduct of investment activities under NAFTA.[7] Accordingly, each Party must grant permission for temporary entry to a qualified business person [defined as "a *citizen* of a Party who is engaged in trade of goods, the provision of services or the conduct of investment activities" (emphasis added)].[8] Exceptions to such grant are provided as to foreign persons who may adversely affect the resolution of an ongoing labor dispute at the location of intended place of employment or who may be involved in the dispute.[9] A person who is refused entry for the reasons stated must be notified by the refusing Party in a writing which sets forth the reasons for such refusal. Also, the fees charged for the immigration document permitting entry must be in accordance with the approximate costs of the services to the government rendering them.[10] Grant of permission to enter one's country does not obligate that state to grant permanent

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permanent residency or citizenship. Not all persons, otherwise eligible, will be permitted into the U.S. There may be health related denial of entry and a number of other exclusionary grounds.[11]

Categories of Business Persons.

There are four categories of business persons in NAFTA: (1) business visitors; (2) traders and investors; (3) intra-company transferees; and (4) professionals.

Business Visitors (Category B-1). Unless coming within the stated exceptions, each state is required to permit temporary entry [12]of a business person for certain designated business activity without the necessity of an employment authorization upon presentation of: (1) proof of citizenship [13] (not merely immigrant or permanent resident status) from one of the three Party states. If the visitor is not a citizen, it would appear that the host Party may readily deny admission without significant proof of the necessity of the business nature of the visit; (2) documentation establishing the purpose of entry and that the individual will be so engaged therein; and (3) evidence that the business activity is international rather than purely domestic in scope so as to establish that the business purpose is not to seek to enter the local labor market.[14] The latter is demonstrated by evidence that the primary source of remuneration for the proposed activity is outside of the host Party and that the principal place of business and place of accrued profits is outside of the host Party.[15]

Although NAFTA specifically sets forth the type of business activities covered by the Agreement, nevertheless, it further permits entry of other business persons who comply with existing host Party requirements for temporary entry. B-1 business visitors visas under the Immigration and Nationality Act of 1990 is a broader category than the enumerated purposes under NAFTA. Each Party is prohibited from requiring petitions, labor certification tests, prior approval procedures or from imposing numerical restrictions for temporary business visitors [exception for Mexicans entering the U.S.][16] The Parties are permitted to require a business person herein to obtain a visa or its equivalent prior to such person's entry into the country of the host Party after consultation with the home state of the visitor.[17] It is the aim of the Agreement to eliminate all such requirements in the future. The prohibition and visa requirement are common for all categories of business visitors.

There are 63 professions listed as business activity referred to above. They include research and design; growth, manufacture and production; marketing; sales, after-sales services; and general services.[18] "Research design" is the conducting of technical, scientific and statistical research for the host Party's enterprise. Under the category of "growth, manufacture and production, " the persons eligible are supervisory harvester owners or managers engaged in purchasing and production for the foreign enterprise. "Marketing" includes trade fairs and promotional personnel for a trade convention and market researchers and analysts conducting such work for the enterprise.

Under "sales," persons eligible are representatives and agents procuring orders or negotiating contracts for the foreign Party's enterprise and persons acting as buyers for the enterprise. "Distribution" includes transportation operators who bring in goods or persons to the host Party's state, customs brokers providing consulting services for the import or export of goods. There are special provisions for Canadian and U.S. customs brokers entering the U.S. or Canada. Both countries permit entry of the brokers for the purpose of performing export related brokerage duties from the host state. "After-sales service" is installation, supervision and repair and maintenance personnel who engage in services relating to warranties and service contracts for equipment or machinery purchased outside the foreign Party's state. "General services" are business professions defined below, management and supervisory personnel, financial services, public relations, tourism, tour bus operators and translators.[19]

Traders (E-1) and Investors (E-2). The second category of business visitors under the Agreement is "Traders and Investors."[20] A "trader" is defined as a business person seeking to carry on a "substantial trade[21] in goods or services" principally between the host Party and the visitor's Party state.[22] An "investor" is one who is involved in a supervisory or executive capacity or has essential skills in the establishment, development, administration of the enterprise or provides advice in the operation of an investment to which the business person or his/her enterprise has committed substantial capital.[23]

The enterprise cannot be merely one giving sufficient income to support the investor and his family alone; rather it must be one which is substantial, i.e., contributes to employment of others and/or has a substantial impact on the local economy.[24] If the enterprise is being formed, the investor must have irrevocably committed the funds to the enterprise.[25] The investment must be active rather than passive (not merely owning stock in the enterprise). The investment must be substantial. The U.S. Department of State, although giving no dollar value, will cause the consular official to weigh various factors, such as the total value of the business enterprise, the amount normally necessary to establish it and the proportionate sum needed to be a major investor (the smaller the enterprise, the greater the investment percentage which will be required).[26]

If the alien is an employee of the trader or investor, the employer must be a person with the nationality of a treaty signatory [a Party to the Agreement] or is an organization which is owned at least 50 percent by persons from a treaty country.[27] The employee must share the nationality of the employer treaty investor. If the employee is an "essential employee," proof will be necessary of his/her expertise, possession of unique skills, time required to obtain the skills, the need for the employee for efficient operation of the enterprise and the duration of the need.[28] The visitor must also comply with existing immigration rules and regulations governing temporary entry.[29]

Each of the Parties is forbidden from requiring labor certification tests or other similar procedures as a condition to temporary entry or from imposing numerical restrictions although it may require procurement of a visa or equivalent prior to entering

the host country.[30] In the event of a strike or labor dispute involving a work stoppage where the alien is or will be employed, temporary entry may be denied if such entry may adversely affect the settlement of the dispute or the employment of a local person in the dispute.[31] The obvious purpose of the requirement is to prevent employment of persons as substitutes for the striking employees.[32]

Contrary to other provisions in NAFTA, Canadian citizens applying under this category will have to apply for a visa at a U.S. consulate, although a passport is not theoretically required but is desirable.[33] Mexican citizens must apply for a visa and possess a passport in other NAFTA business categories.

Intra-Company Transferees (L-1). The third category of business persons who may enter temporarily is one who is sent to the enterprise or its affiliate in to the host Party' state to act in a managerial or executive capacity or who possesses specialized knowledge. Restrictions by the host Party (as in the U.S.) may be made requiring the visitor to establish that s/he was employed for at least one year of the prior three years for the enterprise.[34] An intracompany transferee acting in a "managerial capacity" is a person who manages the organization of a subdivision within the organization, has the authority to hire and fire or has similar authority in personnel matters and exercises discretion over day-to-day operations in his/her activity.[35]

An intracompany transferee who acts in an "executive capacity" is one who directs the management of the organization or a major subdivision therein, sets goals and policies, has broad authority in decision-making and receives only general supervision from higher executives or from the board of Directors.[36] "Specialized knowledge" may be that of the organization's product, service, management, techniques or other advanced knowledge or it may be specialized knowledge of a professional.[37]

In order to acquire access to the United States as an intra-company transferee, it is necessary for the applicant to file a petition which evidences the organization to be a qualifying one, that the alien has met the one year of three years employment requirement and that the alien has met the managerial or other related requirement.[38] The time limitations for remaining within the United States are five years for a person with specialized knowledge and seven years for a person acting in an executive or managerial capacity. To be readmitted, the alien will have to remain outside of the United States for a period of one year (other than brief visits for business or pleasure).[39] The exception to the time limitation is for aliens who are employed in the United States for six months or less during the year or who reside abroad and regularly commute to the United States on a seasonal or intermittent basis.[40]In no event may extensions be granted under this section beyond the stated five years for persons with specialized knowledge and seven years for those acting in a managerial or executive capacity.[41]

The host Party may not require labor certification tests or equivalent as a condition to entry or impose numerical restrictions. [42] Although this section provides that the host Party may require a visa prior to entry, nevertheless, unlike the category of Traders and Investors, the host Party must consult with the visitor's Party state with a view toward the elimination of the requirement.[43] Canadian intra-company transferees may enter by the filing of a petition in duplicate with application for admission at the U.S.-Canadian border or at a U.S. pre-clearance/pre-flight station in Canada. Blanket petitions by the employer may also be pre-filed and granted, thereby facilitating the entry of qualified persons.[44] Spouses and children have comparable admission classification.[45] Mexican transferees are required to procure a visa. As stated previously, in the event of a Secretary of Labor certified work stoppage or strike at the employer's facility, the Mexican or Canadian alien may be denied entry.[46]

Professionals (TN). The last category of business visitors is that of professional workers. "TN" means "Trade NAFTA." The host Party is required to permit entry to a business person at a professional level.[47] The Appendix to the Agreement lists over 63 professions from "General" professions such as accountants, architects, economists, engineers and mathematicians; to "Medical/Allied Professionals", such as dentists, nutritionists and veterinarians; "Scientists" of every type; and "Teachers" in college, seminaries and universities.[48] Each of the professions require proof of minimal educational or alternative requirements (generally, baccalaureate or licenciatura degrees). Other documentation may include membership in professional organizations, evidence of experience from former employers or other such proof.

The essential requirements for TN status is achieved upon presentation of proof of citizenship in a Party state and documentation establishing that the applicant will be engaged in a business at the professional level in the designated professions.[49] Mexico is subject to a 5,500 numerical limitation for entry to the U.S.[50] Any extensions of the limitations must be approved in the form of legislation by Congress. The Agreement does require the Party having a numerical limitation to consult with the other Parties in an endeavor to increase the permissible applicants for entry. Three years after the imposition of the limitation (presumably, after January 1, 1997), the Party imposing the limitation (the U.S. *vis-à-*vis Mexico) must consult with the affected Party with a view towards the elimination of the numerical imposition.[51] The limitation, however, is not to be construed as to prevent a business visitor from applying for admission under some other visa category.

U.S. regulations clearly forbid the self-employment of individuals of the listed professions. The words in NAFTA permitting entry for professionals, "a business person seeking to engage in a business activity at a professional level" is not to be construed as authorizing self-employment.[52] Prior to 1993, Canadian professionals under CFTA were not barred from self-employment. It appears that they will now be denied such employment under the TN category.[53]

There appears to be no express limitation with respect to the time in which a TN professional may stay in the U.S. The regulations state that a Canadian citizen shall be admitted for a period not to one year but "[N]othing shall preclude a citizen of Canada who has previously been in the United States in TN status from applying for admission for

a period of time which extends beyond the date of his or her original term of admission..."[54] A new letter from the employer establishing the necessity for the employee and the payment of the prescribed fee appears all that is required. For Mexican professionals, both the application for extension of time and for extension of the petition must be presented. Like Canadians, the regulations explicitly state that there is no limit on the total time the Mexican citizen may remain in the U.S.[55] The TN professional may switch employers subject to approval of the INS.[56]

Canadian Entry to U.S.[57]

Canadians have an expedited procedure for U.S. entry under NAFTA. The expedited procedure is not available to Mexican business personnel because of the need for procurement of visas before coming to the U.S. At any of the numerous ports of entry into the U.S., a Canadian citizen need only prepare and present the application, pay the appropriate filing fee and receive the I-94 record of admission. Proof of citizenship is required (birth certificate/passport). For a B-1 application, a letter describing in detail the qualifying business purposes will be necessary. For a L-1 application, the said letter should have information about the employer and the employee. If a spouse and/or children are to accompany the petitioner, proof of their Canadian citizenship will also be needed.

A TN application allows a qualifying business person permission to enter the U.S. (within one day) and to receive work authorization and an application for a social security number. Under INS Regulations, 8 CFR section 214.6(e)(3), all that is needed is proof of Canadian citizenship, the filing fee and documentation establishing the engagement of business activities at a professional level and professional qualifications as set forth in NAFTA.[58] The documentation can be in the form of a letter from the prospective employer in the U.S. or Canada, which describes the business activities, anticipated stay, educational requirements, remuneration, as well as exhibition of licenses, diplomas and the like.[59]

Canadian Implementation of NAFTA.[60]

The Canadian provisions relating to NAFTA may be found without formal change in its 1976 Immigration Act. [61]The changes may be found in the modification of its administrative provisions in its Port of Entry and Inland Processing volumes of the Immigration Manual. Both U.S. and Mexican citizens are permitted entry into Canada without visas for designated business purposes without numerical limitations. The permissible business purposes for entry under NAFTA are broader than the treaty's four categories.

There is great similarity of procedure and rights in Canada and the U.S. A major difference is the permissible after-sales service activity in Canada. U.S. and Mexican applicants for such activity must undergo a secondary inspection by Canadian Immigration. He/she must produce the sales warranty or service agreement which establishes the need for after-sales servicing. Other requirements are: (1) that the servicing is to be done only within the warranty period; (2) that the sales agreement clearly provides for servicing; (3) that the servicing is only with respect to installation, repair or periodic maintenance of non-Canadian origin equipment or machinery purchased abroad; (4) that the person performing the servicing have specialized knowledge for the equipment or machinery; and (5) that the person is from a Mexican or U.S. enterprise. No servicing is permitted which is hands-on building or construction work or is servicing of a building.

Mexican Implementation of NAFTA.[62]

To date, the Mexican Government has not issued detailed regulations concerning its required procedures under NAFTA. The two agencies which are directly involved in the grant of permission for business entry are the Secretaria de Gobernacion's Instituto Nacional de Migracion (its U.S. counterpart is the Immigration and Naturalization Service) and the Secretaria de Relaciones Exteriores (U.S. Department of State counterpart). General guidelines were issued and published on May 9, 1994 in the Diario Oficial (like the U.S. Federal Register). The guidelines followed the NAFTA provisions almost verbatim. Business visitors may procure a "Forma Migratoria de Negocios (FMN) visa good for 30 days with respect to the four nonimmigrant NAFTA categories. As any U.S. visitor to Mexico learns in traveling to Mexico, the procedures therein are quite informal unlike the stringent entry procedures at U.S. ports of entry.

Due to the great desire for tourist dollars, the only entry requirement for tourists in general into Mexico is the completion of a Forma Migratoria Turista visa. The visa is extended to all persons entering for recreational, artistic, cultural or sports activities. The visa is good for up to six months and not renewable until the passage of a year. It may not be used to become employed within Mexico or to achieve economic gain. U.S. tourists need only complete a brief form shortly before entry. Certain visitors, such as from Iran and Syria, require pre-approval at local consulates in the respective countries. Mexico also issues transmigrant visas (FM-6) to persons entering Mexico on route to another country. They are good for 30 days and are issued by the appropriate Mexican consulate.

Visitors visas (FM-3) are issued for non-tourist purposes. Examples of such visas are students, business visitors, corporate board members and other visitors. U.S. or Canadian business visitors may apply either for a FM-3 visa or a FMN visa. The former is good for a year and covers one or more entries into Mexico. It is procurable in Mexico at a Mexican consulate or at the National Immigration Institute within Mexico. If the visitor is entering Mexico for a business purpose, the visa may be used for any legal business activity within Mexico including the four NAFTA categories. To procure such a visa, an applicant will ordinarily need a company letter indicating the business purpose for the trip and the details thereof. If the visitor is to become employed by a Mexican company within Mexico, the visa will have to be issued by the National Immigration Institute.

Under NAFTA, the U.S. or Canadian business person may complete the FMN which is good for up to a 30 day period within a one year period. The form is obtainable through any Mexican consulate. It is allegedly good only for multiple entries but the visitor may be restricted to a single entry. The failure of the visitor to leave Mexico after

the 30 day period will subject him/her to a fine and/or deportation. The FM-3 visa may be a better alternative for the business visitor due to its extended length and multiple entry possibilities.

Miscellaneous Provisions.

Accession and withdrawal. The North American Free Trade Agreement does provide for accession by any other country or group thereof. The accession is subject to the terms and conditions imposed by the consenting countries and any Party may refuse to consent to such accession.[63] It is anticipated that other countries of Central and South America will eventually request to become additional parties; in such event, the hemispheric development will be reminiscent of the gradual evolution of the European Union. A Party is permitted to withdraw from the Agreement upon six months notice to the other Parties. In such event, the Agreement continues as to the remaining Parties.[64]

Dispute settlement. Under NAFTA, a Free Trade Commission was established, composed of cabinet-level representatives or their designees of the Parties.[65] The Commission has the responsibility of overall supervision of the implementation of the Agreement as well as the resolution of disputes. It is to convene at least once annually and is to be chaired by each Party successively.[66] A Secretariat is to be established under the Commission with separate sections for each of the Parties. The Secretariat is to assist the Commission, aid in resolving disputes and support committees and groups operating under NAFTA. [67]

The Agreement seeks to coordinate its dispute mechanism with that of GATT. If any dispute arises under both NAFTA and GATT, either forum may be used for its resolution. The exceptions are disputes relating to Article 104 of NAFTA (Relation to Environmental and Conservation Agreements), Chapter Seven, Section B (Sanitary and Phytosanitary Measures) and Chapter Nine (Standards- Related Measures).[68] Where there are disputes, the Parties are to consult with each other. If there is no resolution, a Party may ask for the intervention of the Commission. If the Commission does not resolve the matter, any Party may request that an arbitral panel be convened to make a determination.[69] The Parties are to establish a roster of 30 members who are experts in law, international trade and other matters under the Agreement. For the arbitration, five members are to be appointed to a panel by the Parties. The panel hears the testimony of the witnesses, reviews the evidence presented and renders an initial report. A disputing Party may make comments to the panel respecting its report . The panel then issues its final report.[70]

Customs Union v. Free Trade Area

A customs union, such as the European Union, differs substantially from a free trade area. The latter seeks to eliminate tariffs between member countries so as to permit goods to move freely among them without monetary or other barriers, whereas a customs union also imposes a unified common tariff for goods imported from non-member states. Thus, Germany, Italy, France and the other members of the European Union are one entity for the purpose of trade with other non-European Union states. A customs union, however, may be a much more extensive arrangement. The European Union envisions a near total integration of the member states. In effect, it is designed to eliminate national boundaries as to all economic activities as an eventual prelude to political integration. The Union has a supranational political, legislative and judicial system which may override national promulgations.[71] Thus, the decisions of the European Court of Justice supersede the decisions of the highest court of member states. There is a European Parliament composed of members elected from the various member states, which has rather expanded legislative powers.[72]

Another major difference between a free trade area and, a customs union as envisioned in the European Union is the degree of freedom of movement permitted under the two arrangements. The policies of the European Union is comparable to the freedom of movement of U.S. nationals within the United States. Just as any resident may travel, reside and work in any state without restriction, similarly, a resident in any country within the Union may travel and work in any member country.[73] Under NAFTA, there is limited freedom of movement, restricted only to those business persons provided for under the Agreement. [74]The reason for the discrepancy is largely historical. The countries of Europe have engaged in numerous wars which caused enormous devastation. In an attempt to end European and global conflict, a "United States of Europe" was envisioned Schuman and Monet of France which would unite the warring states into an economic union, thus eliminating the most significant cause of wars.

Under NAFTA, there was no underlying fear of future armed conflict among the three states; rather it was the desire to further enhance the efficiency and growth of the interdependent economies. Instead of a permanent right to move freely, NAFTA provides only for a temporary entry for prescribed business purposes.[75] The U.S. sought to expand the Mexican economy in an endeavor to greatly curtail illegal immigration, particularly into California. The concept is that with the creation of jobs south of the border, the need to leave family to find a job would come to an end. One author noted "the anomaly of NAFTA"s endorsement of free trade and closed border."[76]

Is NAFTA racist?

Clearly, as indicated above, Canadian business visitors are treated differently with less restrictions than their Mexican counterparts. Under NAFTA, Mexican business persons must obtain a B-1 visa from a consulate [or U.S. Embassy] in Mexico. In order to obtain it, they are required to a have a valid Mexican passport which further requires an interview, proof of legitimacy of purpose plus any other documentary or other requirements which the consular official may demand such as ties to Mexico, monies to support oneself in the U.S. and/or invitations from the U.S. company. Proof may be required anew at the U.S. port of entry. Canadians need only show proof of Canadian citizenship, such as a birth certificate for a B-1 classification. No visa or passport is necessary.[77] With respect to the E-1 and E-2 visas for Treaty Traders and Investors, there

is no overt discrimination. Both Mexican and Canadian persons seeking entry must obtain the appropriate visas.

There is discriminatory treatment as to Intra-Company Transferees [L-1 status]. As stated above, Canadian nationals may present his/her application with the employer's petition at the port of entry at the U.S.-Canadian border for expedited entry. A Mexican national must initially present a valid Mexican passport to a U.S. Consulate or Embassy in Mexico in order to obtain an L- nonimmigrant visa. There is generally a delay of almost a month before the Mexican national is able to complete the process. Agains the visa requirements are more strict than the requirements for Canadian nationals.[78]

The Professional (TN) requirement is another example of discriminatory treatment. The only numerical limitations upon the entry of professionals is placed upon Mexican nationals. Appendix 1603.D. 4 limits the number of professionals permitted entry into the U.S. to 5,500 annually. Mexican professionals are also subject to labor attestation requirements and must have prospective employers petition for them for entry. Approval is by no means certain. In addition to the petition to be filed by the employer, it must be substantiated by attestations concerning the nature of the employment and that the salary to be paid will be no less than prevailing wages [in this writer's experience, the requirement is often onerous and somewhat arbitrary]. The approval is for a one year period but is renewable. Canadians need no prior petition or labor certification. To obtain a TN visa, all that is necessary is proof of professional status and an offer of employment by a U.S. employer for the professional. No passport is required.

It would appear that Canadians are clearly favored over their Mexican counterparts. The favoritism, at best, can be ascribed to the fact that to induce Canada to terminate the prior U.S.-Canadian Free Trade Agreement in favor of NAFTA, Canada insisted that it receive treatment no less burdensome then it had under CFTA. Mexico, somewhat desperate, to revive its economy, was agreeable to the less than equal provisions of the agreement. There may be anti-Latino aspects coloring the differences in treatment.[79] Although Congress debated Mexican illegal immigration in deciding whether or not to approve legislation enacting NAFTA, nevertheless, there was a de-linking of the issues of illegal immigration from free trade. It was feared that the joinder of the two issues would de-rail the agreement.[80]

Final Comments.

NAFTA represents a continuing attempt by the United States to have a global economy free of tariffs and other barriers. Somewhat imitating the efforts of GATT [now, the World Trade Organization] and the European Union, NAFTA is the expansion of free trade, which began with the United States-Canada Free Trade Agreement of 1992, and is expected to continue throughout the Western Hemisphere. There is much controversy in the United States as to the effects of the Agreement upon the U.S. labor market. To date there is little evidence of the loss of U.S. jobs, although the balance of trade did change from 1994 to 1995 from a U.S. surplus of $1.6 billion to a deficit of $8.9 billion. The peso collapse has diminished the expectations of supporters of NAFTA. Illegal immigration has continued unabated.[81] Free trade appears to be beneficial for the parties thereof wherever it is instituted. It awaits to be seen what the ultimate results will be with the institution of NAFTA.

ENDNOTES

[1] H.R. Doc. No. 159, 103d Cong., 1st Sess. (1993), 32 I.L. M. 612 (1993).

[2] P.L. 103-183, 107 State. 2057, which Act was signed by the President on December 8, 1993. The President issued an Executive Order, No. 12889, on December 27, 1993, 58 Fed. Reg. 69681 (December 30, 1993).

[3] H.R. Doc. No. 216, 100th Cong., 2nd Sess. (1988), 27 I.L.M. 281 (1988).

[4] The reason apparently is to induce Canada to be a signatory to the Agreement. See Ellen Ginsberg Yost, "Overview of NAFTA," Immigration Practice and Procedure Under the North American Free Trade Agreement, (Washington, D.C.: American Immigration Lawyers Association), ed. Janet H. Cheethan, pp. 1-15 at p.2. In addition to NAFTA, the U.S. has bi-lateral trade agreements with other Central and South American countries. These agreements provide for the issuance of E-1 and/or E-2 visas discussed in the main text. Among the countries with which the U.S. has such agreements are Argentina, Bolivia, Colombia, Costa Rica, Honduras, Panama and Paraguay. For a discussion of business visitor entry visas to the United States, see Catherine L. Haight and Kevin C. Brague, "The International Transfer of Business Personnel into the United States," 2 Sw. J. L. & Trade Am. 545 (Fall, 1995).

[5] S. Doc. 1394, 104th Cong., 1st Sess. (1995).

[6] Article 1601 of the North American Free Trade Agreement (hereinafter referred to as the "Agreement").

[7] Article 1602 of the Agreement.

[8] Article 1608 of the Agreement.

[9] Article 1603 (2) of the Agreement.

[10] Article 1603(3)(4) of the Agreement.

[11] They include controlled substance traffickers [drug dealers], prostitutes, security reasons, terrorists, past immigration violators and other criminal types. INA section 212(a)(2)-(9), 8 U.S.C. section 1181. For a discussion, see: Harry J. Joe, "Temporary Entry of Business Persons to the United States Under the North American Free Trade Agreement," 8 Geo. Immigr. L. J. 391 (Summer, 1994).

[12] "Temporary entry" is defined under Article 1608 as "entry into the territory of a Party by a business person of another party without the intent to establish permanent residence."

[13] Annex 1608 of the Agreement defines "citizen" with respect to Mexico as "a national or a citizen according to the existing [in effect on date of entry of NAFTA] provisions of Articles 30 and 34, respectively of the Mexican Constitution."

[14] Annex 1603(1) of the Agreement entitled "Temporary Entry for Business Persons; Section A-Business Visitors."

[15] Annex 1603(2) of the Agreement. Generally, an oral declaration will suffice as a letter from the employer stating the requested information.

[16] Annex 1603, Section A(4)(b). Appendix 1603.D.4 of the Agreement provides that the U.S. is to approve annually as many as 5,500 petitions of business persons [professionals as defined in Appendix 1603.D.1, i.e., engaging in a business activity at a professional level] from Mexico seeking temporary entry. The number is exclusive of those persons receiving renewal of visas or of spouse or children accompanying the business visitor or persons admitted under other sections of the Immigration and Nationality Act. The restriction is valid for only 10 years or a lesser period if the U.S. has a less restrictive arrangement with any other state which may become a Party to the Agreement.

[17] Annex 1603, Section A(5) of the Agreement.

[18] The "after-sales" category is an expansion of the B-1 visitor category applicable to non-NAFTA business visitors. It permits Mexican and Canadian business persons to come into the U.S. to perform after-sales service for the product sold for the duration of the sales warranty and adds computer software to the product list within this category. See Haight and Brague, op. cit. p.. 548.

[19] Appendix 1603.A.I of the Agreement.

[20] Annex 1603, Section B of the Agreement.

[21] "Trade" refers to "the exchange, purchase or sale of goods and/or services." "Goods" are tangible personalty having intrinsic value while "services" are economic activities other than producing goods which include banking, advertising, engineering, insurance and the like. 8 CFR section 214.2(e)(2).

[22] Id., Section B (1)(a). The Immigration and Naturalization Act, section 101(a)(15)(E) permits an alien to enter the U.S. pursuant to a treaty of commerce [not just NAFTA] together with his spouse and children "solely to carry on substantial trade, including trade in services or trade in technology between the United States and the foreign state of which he is a national..." See, also, Department of State Regulations, section 41.51.

[23] Id., Section B(1)(b). The Department of State Regulations, 22 CFR section 41.51(a)(2)(b) states that the qualified alien "has invested or is actively in the process of investing a substantial amount of capital in a bona fide enterprise from a relatively small amount of capital in a marginal enterprise solely for the purpose of earning a living..."

[24] 9 FAM, note 10 to 22 CFR section 41.51.

[25] See James D. Eiss, "Treaty Traders and Investors-The E Category Under NAFTA,", Immigration Practice and Procedure, op.cit., pp. 38-50 at p. 43, citing 9 FAM, note 7.1-2 to 22 CFR section 41.51.

[26] 9 FAM, note 9.1-9.2 to 22 CFR section 41.51, cited in Eiss, id.

[27] Department of State Regulations, 22 CFR section 41.51(c). It appears, however, that 51 percent may be required inasmuch as the applicant should have a controlling interest in the enterprise in order to have the requisite capability of developing and directing the enterprise.

[28] 9 FAM, notes 13.3 and 13.3-1 to 22 CFR section 41.51.

[29] Id., Section B(1). Under INS Regulations [8 CFR. section 214.2(e)(1)], the alien is permitted entry into the US for an initial period of up to one year with up to a two year extension thereafter. Such trader or investor who wishes to change employers may do so upon written request to and approval of the local district director. Failure to do so would be grounds for cessation of status.

[30] Id., Section B(2)(3).

[31] 8 CFR 214.2(e)(3). See, also, Department of State Regulations 22 CFR section 41.51(f).

[32] The Department of State [Regulations 22 CFR section 41.51] has regulations governing issuance of visas abroad to treaty traders or investors. E-1 visas for Treaty Traders [INA 101(a)(15)(E)(i)] meeting the definition to intend to depart upon ending of E-1 status. Treaty Investor, E-2, [INA section 101(a)(15)(E)(ii)] is one who qualifies under this section and has invested or is actively in the process of investing a substantial amount of capital in bona-fide enterprises in the US (not merely a small amount to earn a living) and will leave when the activity is completed.

[33] 22 CFR section 41.2(m).

[34] Annex 1603 of the Agreement, Section C(1'). See INS Regulations 8 CFR. 214.2(l)(1)(i) which specifically so provides that "an alien who within the preceding three years has been employed abroad for one continuous year by a qualifying organization may be admitted temporarily admitted to the United States to be employed by a parent, branch, affiliate, or subsidiary of that employer in a managerial or executive capacity, or in a position requiring specialized knowledge..."

[35] 8 CFR 214.2(l)(1)(ii)(B).

[36] 8 CFR 214.2(l)(1)(ii)(C).

[37] 8 CFR 214.2(l)(1)(ii)(D).

[38] 8 CFR 214.2(l)(3).

[39] 8 CFR 214.2(l)(12)(i).

[40] 8 CFR 214.2(l)(12)(ii).

[41] 8 CFR 214.2(l)(15).

[42] Annex 1603 of the Agreement, Section C(2).

[43] Id. Section C(3).

[44] 8 CFR 214.2(l)(17)(i)(ii).

[45] 8 CFR 214.2(l)(17)(v).

[46] 8 CFR 214.2(l)(18).

[47] Annex 1603 of the Agreement, Section D.

[48] Appendix 1603. D. 1 of the Agreement.

[49] Annex 1603, Section D of the Agreement. The regulations of the Department of State mirror closely the Agreement. It separates Mexicans from Canadians. The latter merely must show evidence of an offer of employment in the U.S. requiring employment for the purpose stated in the Annex and proof of credentials. Mexicans must show approval of a petition from the INS for the classification or confirmation of petition approval or the approval of the aliens' stay in such classification. 22 CFR. section 41.59. See, also., Department of Labor regulations in 20 CFR section 655.700(c)(2).

[50] See INS regulations, 8 CFR section 214.6(d)(7). If the numerical limits are reached, then no further numbers may be assigned for entry for the year. Spouse and children are not counted towards the limitation nor are petitions for extensions or amendments of petitions.

[51] Annex 1603, Section D 7.

[52] INS Regulations, 8 CFR section 214.6(b).

[53] Janet Cheethem, "Application for TN Status Under NAFTA," Immigration Practice and Procedure, op. cit.p. 26.

[54] 8 CFR section 214.6(f),(h)(2)(ii).

[55] 8 CFR section 214.6(h)(1).

[56] 8 CFR section 214.6(i).

[57] This section is based upon William Z. Reich, "Processing of Canadian NAFTA Applications at the Port of Entry," Immigration Practice and Procedure, op. cit., pp. 51-57.

[58] Appendix 1603.D.1 of the Agreement.

[59] 8 CFR, section 214.6(E)(3).

[60] This section is based upon Stanley B. Bush and Asher I. Frankel, "Canada's Implementation of Chapter 16 of NAFTA," Immigration Practice and Procedure Under the North American Free Trade Agreement, ed. Janet H. Cheetham (Washington, D.C.: American Immigration Lawyers Association), 1995, pp. 58-91.

[61] For a summary of the changes, see Bush and Frankel, op. cit..

[62] This section is based upon the research found in Kathleen Campbell Walker and Roberto Fernandez Reyes, "NAFTA Implementation in Mexico," Immigration Practice and Procedure Under the North American Free Trade Agreement, ed. by Janet H. Cheetham supra, pp. 92-106.

[63] Article 2204 of the Agreement.

[64] Article 2205 of the Agreement.

[65] Article 2001 of the Agreement.

[66] Article 2001((3)(5) of the Agreement.

[67] Article 2001(3) of the Agreement.

[68] Article 2005(1)(3)(4) of the Agreement.

[69] Articles 2006 and 2007 of the Agreement.

[70] Articles 2016-2018 of the Agreement.

[71] The European Union began initially by the creation of the European Coal and Steel Community in April, 1951 by six countries, namely, Belgium, France, West Germany, Italy, Luxembourg and the Netherlands. It expanded by the creation of two additional entities, The European Economic Community and the European Atomic Energy Community in the Treaty of Rome signed on March 25, 1957 and which became effective on January 1, 1958. Significant expansion of the Union took place in later years with the addition of Denmark, Ireland and United Kingdom on January 1, 1981, the admission of Greece on January 1, 1981, the entry of Portugal and Spain on January 1, 1986 and the admission of Austria, Sweden and Finland in 1994.

[72] The European Parliament was initially called the Assembly had almost no binding legislative powers. The Single European Act of February 17, 1986 and the Maastricht Treaty [Treaty on European Unity] of February 7, 1992 renamed the Assembly and gave it some legislative capability but not quite the powers of national legislative bodies.

[73] See Articles 7 and 8 of the Maastricht Treaty which confers European Union citizenship upon every national of the member states and explicitly grants the right of freedom of movement throughout the territory. For a more detailed discussion of the comparative aspects of the two types of arrangements, see: Christopher J. Cassise, "The European Union v. The United States Under the NAFTA: A Comparative Analysis of the Free Movement of Persons Within the Regions," 46 Syracuse L. Rev. 1343 (1996).

[74] Obviously, any foreign national having a valid visa may travel quite freely within the U.S. By freedom of movement we are referring to the virtual elimination of any borders for eligible persons for purposes of travel, reside or become employed.

[75] NAFTA, Article 1601.

[76] Kevin R. Johnson, "Fear of an "Alien Nation": Race, Immigration, and Immigrants," 7 Stan. L. & Pol'y Rev. 111 (Summer, 1996), p. 939.

[77] See op. cit. footnote 15. For a detailed discussion of this topic, see: Gerald A. Wunsch, "Why NAFTA"s Immigration Provisions Discriminate Against Mexican Nationals," (5 Ind. Int'l & Comp. L. Rev. 127, Fall, 1994).

[78] Id.

[79] For a discussion of Latinos and immigration see: Kevin R. Johnson, "Civil Rights and Immigration: Challenges for the Latino Community in the Twenty-First Century," 8 La Raza L.J. ((1995). See also Kevin Johnson's article, op.cit., p. 941. The author notes that while Congressional debate focused on Mexican illegal immigration, nothing was said concerning illegal immigration from Canada.

[80] The failure to link the issues was frowned upon by one author, Alan C. Nelson, "NAFTA: Immigration Issues Must be Addressed, 27 U.C. Davis L. Rev. 987, (Summer 1994), p. 988. See also, Kevin Johnson, Id.

[81] Robert Collier, "NAFTA Stumbles Short of Expectations," LatinoLink, http: //www.latinolink.com/nafecon.html. See also, "*ENLACE*: Politica y. Derechos Humanos en las Americas (English translations), at http:/americas.fiu.edu/wola/egenlac.html.

TEACH YOUR PUPILS TO BE STUDENTS OF THE LAW*

by

Peter M. Edelstein**

Introduction

No matter how talented an instructor is, if a student does not have the power to learn, the efforts of the instructor may not be effective. To use an analogy from Law 101, if the terms of an offer are communicated to one without the power to accept, no offer is made.

We do not expect our students to bring to our classrooms a meaningful knowledge of the law about to be taught and it may not be realistic nor fair to expect them to bring a knowledge of the tools and the skills necessary to learn that law.

It is amazing to think that students may somehow progress through twelve years of public school and four or more years of college without adopting or developing an array of practices designed to make their learning a more natural and graceful endeavor. Yet anecdotal evidence seems to indicate that many students do not profitably apply any conventional or consistent approach to their studies. Is there any one of us who has not been confronted by a student wanting to know *what did I do wrong*? or *how can I do better next time*? And you just want to shout, "Don't you know how to study? Don't you know how to take an exam?"

That feeling of frustration generates two inquiries: (i) is it possible for pupils to be taught to become better students? and, (ii) if so, can *we* do it? This article suggests that it is possible to teach students to enhance their abilities to study, learn, and take examinations, and that we, as their instructors, are the ones best situated to help them.

While most colleges and universities have learning and study resources available, many students do not take advantage of those resources because they may not be readily accessible or convenient or because the effort required is perceived as an additional burden. By addressing law-learning skills in our courses, we can take advantage of the students' presence and comfort in our classrooms, we can minimize the perception that we are adding to their workloads, and we can monitor their progress.

Students who know and apply learning skills are likely to achieve better results, are likely to have greater confidence in their studies, and are likely to find solace in merely having

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a set of guidelines to help them. If we focus our energies only on the transmission of the substance of our courses and exclude consideration of the methods by which the information is received and processed, we may be inviting continued frustration.

Based on the belief that by helping our students to become better learners, we can become more effective teachers, this article is intended to enable you to offer to your students an assortment of skills, techniques, and ideas that may assist them in our law courses (and in other courses), now and in the future. The material which follows is divided into three parts: I. Law Learning Skills, II. Guide to Briefing, and III. Exam Techniques. The information is addressed to the students and is designed to illustrate methodologies which will enhance their abilities to understand and learn the law. The suggestions are simple and informal and may be modified to accommodate your particular class environments. Permission is granted to any educator to photocopy or otherwise use or disseminate the material for noncommercial classroom purposes. Attribution would be appreciated. A bibliography is included to offer students additional "study" resources.

I.
Law Learning Skills

Getting good grades in any course, involves more than studying *hard*. Good grades are usually the reward for those who study *right*. While studying is an intensely personal process, and everyone has their own methods and devices, there are some practices that may help you. Even if you consistently get good grades in your other subjects and are comfortable with your methods, if you desire to obtain or maintain better grades in your *law* courses, and to do so without exerting a punishing mental and physical effort, consider the suggestions that follow.

1. *Understanding and remembering.*

- Look at the *background*. The subject of law is more easily understood and its rules, principles, and doctrines more easily remembered if related to their social or historical backgrounds. As the law evolved, in many cases, it responded to social needs or pressures. If you appreciate the environment in which laws were formed or operate, they make more sense and the details can be more readily recalled. Some examples: the existence of "consideration" was (and is) considered evidence of "an intent to be legally bound;" U.C.C. 2-207, the "Battle of the Forms" section, was designed to modernize and expedite the process of making sales agreements, because the common law "mirror image rule" was inhibiting or preventing commerce; the doctrine of "promissory estoppel" offers legal help to a party unfairly damaged by relying on a naked promise and unable to sue for breach of contract. While not every rule, principle or doctrine lends itself to an obvious social or historical analysis, try to understand those that do. You will be rewarded with a better grasp of the rules and easier recall of the details because you can relate them to meaningful applications.

- Look for the *logic*. The law and learning the law should be logical. Attempt to relate the legal points in an orderly fashion to determine a sensible result. The search for logic in the law will also assist in understanding and remembering the rules. For example, in the tort of *negligence*, even if the defendant acted carelessly (defendant had a duty to plaintiff, defendant breached that duty, plaintiff was damaged), if the defendant did not *cause* the damage to the plaintiff, there is no liability for negligence.

- Be *precise*. Knowledge of the definitions of words is fundamental to all meaningful communication. In the study of law, knowledge of the definitions of the various causes of action and related terms is essential because the definitions serve as analytical tools. For example, once you know the definition of "offer," you will be able to seek and identify its elements from a given fact pattern in order to determine if an offer exists. The study of law requires an appreciation of the concept of *precision*. If you learn the definitions exactly, you will learn to think precisely. Thinking precisely makes you comfortable with your knowledge, you will know what you know.

2. *Attend classes regularly*. Attending class is, in itself, an efficient form of studying. The classroom environment makes use of lots of your senses; (remember the five senses: touching, smelling, hearing, seeing, tasting). By using more senses, more sources are available to input the information and your ability to learn is enhanced. In class you *hear* the instructor, you *see* (and *touch*) your notes, you *see* the board, the text and your notes, you *hear* questions, you *hear* answers. And, there are relatively few distractions. Compare the number and quality of these sources to sitting in your room at night trying to read and understand the text. Attending class has additional benefits:

- You will be investing in the portion of your grade attributable to "class participation."

- You will get to know other students who can help you if you missed something in your notes, discuss the subject with you, or be a member of your study group.

- You will impress the instructor.

3. *Take accurate and complete notes.* Your notes reflect more than what your instructor said. They represent what he or she thought was relatively important, things you should know. It is not possible, nor is it good practice for an instructor to try to teach everything. Your instructor has distilled the information into a mass, manageable as to its quantity and desirable as to its quality. You are being sent a message: "The material I review in class is worth knowing." While it may be appropriate to examine students on areas not covered in class (especially if the student is so advised), most instructors will probably feel for reasons of fairness (or ego) that you should be examined on areas that were "taught." In class, think about what the instructor is saying. Attempt to capture the ideas and thoughts rather than struggling to transcribe every word. Your notes should memorialize and represent the essence of the lesson.

- If the instructor illustrates a point on the board, copy the illustration in your notes. His or her use of the board is indicative of special significance.

- Instructors often offer remarks about the substantive material in the form of hints or clues that can assist you with exam preparation. Include in your notes any comments about "exceptions," "general rules," "exam material," "name cases," etc.

- Conspicuously mark or "flag" anything that you did not understand or that needs more work, as a signal to return to that subject.

- Create your own "shorthand" to save time; for example "P," for plaintiff; "D," for defendant; "S. Ct.," for Supreme Court; "K," for contract.

Study your notes; learn them. In most courses, a knowledge and understanding of the notes is the *basic* element of exam preparation.

4. *Use a form for your note-taking.* In law school bookstores, "law school notebooks" are available. A page in a law school notebook, unlike a standard page, is divided into two sections by a vertical margin line: one-third is on the left side and two-thirds are on the right side. The practice is to take notes or brief cases on the right side of the page. Then use the left side of the page to insert explanations, additions, corrections, and other comments when the material is reviewed in class, or to write your own summaries when you review. This method of taking notes is useful and effective. It helps to organize your thoughts as well as your material. Review becomes much easier because all the related material is in one place. This note taking technique can be used successfully in other courses.

5. *Participate in class.* If "class participation" is a component of your grade, you should participate for that reason alone. But there are other reasons:

- You will learn more by participating. You will necessarily have to think just to formulate a question, make a comment, or supply an answer.

- Participating in class is a form of studying. Hearing yourself say something reinforces your knowledge and builds your confidence. You are more likely to remember ideas, rules and concepts that can be associated with your participation or the participation of your classmates.

- Class participation signals to the professor that you are there, that you are interested, that you are making an effort. Do it!

6. *Review class notes regularly.* It is easier to chew, swallow and digest small portions, than to gobble and binge. When possible, review your class notes every day. Try to edit or rewrite them the same day you took them, and as you do so, think about what is described. Daily review of your notes accomplishes several purposes:

- It is a quick, informal form of study, which is relatively easy because the material is still fresh in your mind and limited in size and scope.

- It affords the opportunity to correct or complete them, while you still are aware of the omission or defect;

- It is an excellent form of warm up for the next class; (you will then not arrive in class cold and spend the first few minutes reorienting yourself);

- It establishes a rhythm to your learning routine that becomes a natural part of your life - not an intrusion.

- You will have a head-start when you commence your formal, dedicated, study sessions.

7. *Participate in a study group.* For most people, studying is not an exercise in fun. A study group is the closest thing to injecting an element of fun into your job as a student. Meeting with other students regularly during the semester or several times before an exam to review course material can be

rewarding, especially in the study of law (where differing positions caused the dispute). In any group some participants will have a better understanding of some matters than other participants. Members of the study group, in effect, teach each other. By speaking, arguing, or listening, you are more likely to understand the material. You are more likely to retain the rules, doctrines and concepts because you can associate them with the participation or presentations of members of your group. Your study group participants can fill gaps in your understanding. The exchange of ideas and questions becomes a form of review and self-testing. A few *caveats*: pick your study group members carefully (as in tennis, it helps your game when you play with a better player); don't waste time - eat and drink after the study session; appoint one person as "group leader," to schedule meetings, communicate with members, keep track of progress, note problems, etc.

8. *Plan your study schedule.* If you were about to start a new business you would probably prepare a business plan including financial goals and target dates. Consider a *study plan* an essential part of getting good grades. Your objective is to have the time and opportunity to study and learn the required material. Well in advance of the exam, plan your study schedule. Look at the body of material you have to master, consider the relative difficulty of the various portions of the material. Divide the material into realistic study segments. Using your calendar, plot days and hours to be devoted to the material. Then stick to the schedule.

9. *Organize your stuff.* Gather all study materials in the place you will study regularly: notebook, text, other resources, pencils, paper, etc. Place them where you will not have to get up to reach them. Once you are up, the refrigerator or the phone or the TV beckons. Use your study time efficiently. Do not waste it searching for your materials. Every time you move from your study posture, the efficiency of your study session is reduced.

10. *Start nice and easy; then get tough.*

- Survey the task ahead. Calculate how and when to study each part of the material. You might start by making a quick review of all class notes or by reviewing the Table of Contents of the text. This will provide a feel for the size and scope of the subject matter.

- Distill your notes by preparing an outline, or when appropriate, by using the Table of Contents from the text as your outline. Note the headings, subheadings, listings and itemizations. The outline will offer you perspective; you can see the total to be learned and the relationship of the parts. The outline may also serve as a checklist. For example, in the study of law of Contracts, by making an outline or by looking at the Table of Contents you will determine that "offer," "acceptance," and "consideration" are basic requirements. You then see the tests for enforceability: whether assent was genuine; whether the parties had contractual capacity; whether the bargain was legal; and whether the agreement was in the required form.

- After the quick overview, slow down and methodically learn the material in small, manageable segments. Study one rule, one concept, one doctrine, one area, at a time. Do not move on until you are confident that you understand what you have reviewed.

11. *Empathize with the instructor.* Do not ask, "Do I have to know that?" Instead, try to imagine what the instructor wants or expects you to know. Think about hints or clues the instructor offered. Consider the relative time that was spent in class on the various subjects. Look at the scope and depth of various portions of your notes. Determine what was emphasized. It is not possible to know what will be asked on an exam, but it is possible to anticipate what is likely to appear.

12. *Learning means understanding.* Do not fool yourself. Memorizing a term or being able to recite a rule, doctrine or concept is not sufficient. After you read or after you study a segment, pause and think. Ask yourself frequently as you progress with your studies, *Do I understand? Can I apply this rule (concept or doctrine) to situations other than the one described in the notes or text?* Do not feel comfortable until you can apply what you think you learned. Make up hypothetical questions, work them through to a conclusion. If your text offers problems at the end of each chapter, use them as a form of self-testing.

13. *Use a pencil when reading.* It is a useful practice to make notes directly on your reading materials. The notes will help you focus and recall. A pencil can underline, it can make a *bold* underline, and it can allow you to write comments or explanations. A highlighter cannot readily be used to distinguish gradations of importance, nor can it be used to make marginal notes, interlineations, or to add other information.

14. *Use mnemonic devises.* If you have trouble remembering lists of things that have no logical relationship, use a memory aid such as an acronym. Assign a letter to each item to be remembered and create a code word or phrase you can use to recall the categories. The Statute of Frauds, for example, addresses six unrelated categories of promises that must be in writing to be enforceable. You could choose: "E," for promises made by an executor or administrator to pay the debts of a decedent personally; "A," for promises to pay the debts of

*a*nother (suretyship); "M," for promises given in consideration of ***m***arriage; "R," for promises dealing with the transfer of interests in ***r***eal property; "G," for promises for the sale of ***g***oods having a value of $500 or more; "O," for promises which by their terms cannot be performed within ***o***ne year. Play with the letters to create a word or phrase like, "GO MARE" or "My Elderly Aunt Rose Gets Out." The word or phrase does not have to make sense; just pick something which will trigger your recall. With *all* difficult lists, assign each item a designated letter or word and then make up a code word or phrase.

15. Skim reading assignments first. When confronted with a reading assignment, before you start to read, quickly skim the chapter(s), article, or other material. This will give you an overview of the task ahead. It will give you an idea of how long the assignment will take and how complex it may be. It will also offer you a sense of the main ideas, the terminology, and the relationship of the parts to the whole. After the quick scan, then proceed with a careful and deliberate reading of the material.

16. Schedule study sessions early and often. Frequent, brief, dedicated study sessions are more productive than one major cramming session. There is nothing worse than picking up a thick notebook and heavy text right before the exam; your memory is dim, the task is daunting, and time is running out. Delay only adds to your pressure; you have to be concerned about the available time in addition to learning the subject matter. Plan sessions of moderate length that will not wear you out or bore you. Do not separate the sessions by too much time to avoid having to relearn the material.

17. Seek help from the instructor. The instructor, in most cases, will be able to assist you. He or she probably has helped other students with the same or similar questions. You should not feel reluctant to speak to the instructor. There is no stigma associated with a desire to learn. By seeking help you will be more comfortable with the subject matter and you will have demonstrated to the instructor that you are making an effort to learn the material.

By applying a methodology to learning the law you will find that you *can* master the required material. Merely applying the process will make you more comfortable and thus enhance your ability to learn.

II.
Guide to Briefing

1. Why Brief?

Lawbook authors use selected cases to illustrate the application of the rules described in the editorial portion of the text. The cases usually contain background information about the dispute, a description of how the case came before the appellate court, and the "opinion" of the judge which justifies, explains and amplifies his or her decision of the issues presented. The cases, however, were not written for the purpose of educating students of the law. They represent a documented result of the legal process.

"Briefing" or "abstracting" is the process by which a reported case containing a legal opinion written by a judge is *transformed* into a learning tool for law students and lawyers.

By briefing or abstracting, we convert a judge's opinion into a consistent format containing an abbreviated statement of the facts, a statement of the issue or issues, the decision or decisions, and a summary of the reasons or "holdings." Once in this form, the brief serves several functions: you will learn to analyze a body of facts in order to glean what is relevant to the legal subject you are studying; you will learn to determine from those facts the differing legal positions of the parties; you will learn to artfully formulate the legal questions the judge had to decide, in the form of legal "issues"; you will recognize the judge's decision; you will understand the reasoning and justification the judge used in making the decision; and you will be better able to analyze and compare the relative qualities of different opinions.

2. Form of a Brief.

To maximize the benefits of briefing, use a consistent form:

Caption
Citation

Facts:
____
____
____
____

Issue: Whether ______________________________________?
Decision: Yes/No
Holdings/Reasons: ____________________________________
____
____

3. Components of a Brief.

"Caption." At the top of the page is the Caption. This is a statement of the name or title of the case. For example: *Jones v. Smith.*

"Citation." Under the Caption is the Citation. The Citation is a series of numbers and abbreviations that serve to identify and locate the case in printed (or computer) sources. For example: "123 N.Y. 2d 456 (1990)." The first numbers,

"123", refer to the volume in which the case is found. The next letters indicate the name or title of the volumes containing the case; for example "N.Y.S. 2d" refers to a set of books entitled "New York State Reports, Second Series." The next group of numbers refer to the page number in volume 123 of the New York State Reports, Second Series, on which the case appears. The last numbers, usually in parentheses, indicate the date the case was decided.

"Facts." The "Facts" portion of the brief is a summary of the facts reported by the judge in his or her opinion. Properly briefed facts should include all of the facts of the case relevant to the law you are studying, and should omit the irrelevant facts. For example, if you are studying contract law, references in the case to the weather conditions are probably irrelevant and therefore should not be included in the brief. If, however, you are studying negligence involving an automobile collision, references to the weather may be entirely relevant and should be part of the Facts portion of the brief.

The Facts should be an abbreviated report of the events that gave rise to the lawsuit and which will assist in understanding the decision.

There are two types of facts: "substantive" and "procedural." "Substantive" facts recite the "story;" that is, what generated the dispute between the parties and what their respective legal positions are. "Procedural" facts explain how the case came to be heard before a particular court. For example: the case may have been tried and "A" may have won; then "B", the losing party, may have appealed (to an intermediate appeals court) and this time "B" may have won; then, "A", the losing party may have appealed that decision, (to the court of last resort) and that final case may be the case reported in your text. In most undergraduate law courses the substantive facts are emphasized; however, pre-law students (or serious students) should note the procedural as well as the substantive facts in their briefs.

The cases in your text are usually reports of the highest court of a particular state, because it would not be wise to study cases stating law which could soon be reversed or overturned by a higher court.

"Issue." While there are many ways to pose a question, for consistency, the Issue of a case should be started with the word "Whether." For example: "Whether the objective test is used to determine the intent required to establish an offer?" By always starting with the word "whether" you are forced to frame the Issue to properly focus on a particular point of law and to invite a clear decision. Be careful to note that there may be more than one Issue in a case.

"Decision." If the Issue is framed properly, the Decision is limited to the words "yes" or "no".

"Reasons" or "Holdings." This portion of the brief justifies and explains the decision in light of, and by reference to, the facts and applicable rules of law. It usually is the largest portion of the brief (except in cases in which the facts are lengthy or complicated).

"Rule of the Case." To test the quality of your Issue, and as a finishing touch to the brief, try the following: using the Issue, delete the word "Whether," delete the question mark and invert the question to form a declaratory statement. If the statement sounds like the legal proposition for which the case stands, the Issue is well done. This statement is referred to as the Rule of the Case; write it in your notebook above the caption. It will expedite your review of the cases and help you learn the applicable law.

4. Format of a Brief.

It is customary to write briefs on the right two-thirds of your notebook page, leaving the left one-third blank. When the case is reviewed in class, you can then insert comments, additions or changes in the portion of the page previously left blank.

III.
Exam Techniques

The first and most important rule of exam taking is "be prepared." If you have adequately prepared or even if you have not adequately prepared, the following techniques may help you squeeze out the highest grade possible.

1. Relieve the pressure. As soon as you are comfortable, on scrap paper, "off-load" anything that might be resting in a fragile condition in your memory including any mnemonic cues. This will free your mind to think and reason unburdened of short-term memory enhancing devices.

2. Survey the exam. Look over the entire exam before starting to answer any questions. Doing so will give you an opportunity to relax, as much as you can, and to determine the proper allocation of your time between or among parts of the exam or the various questions, and to mentally prepare for what is to come.

3. Answer the questions you know first. If the exam is an essay exam or contains an essay component, do the easiest ones first. This technique will relieve some of the mental pressure, build your confidence, and allow you to return to the more difficult questions later. Furthermore, you will be assured of getting credit for what you know before time runs out.

4. Look for answers in questions. Do the short-answer questions first (but after you have read the essays). The short-answer questions (particularly

multiple-choice), may contain answers or hints, or may refresh your memory. This information can be used to answer other short-answer or the essay questions.

5. *Guess on short-answer questions.* Generally, you are not penalized more for providing wrong answers than for providing no answers (but check with the instructor). Therefore, if you do not know the correct response to a *short-answer* question - guess. Do not leave any blanks. If you do not give any answer, you cannot receive any credit.

6. *Do not guess or give incorrect information on essay questions.* Essay questions are usually graded by the correctness and quality of the response. Incorrect information furnished as part of your answer will result in loss of credit. Therefore, unlike short-answer questions, do *not* guess. Similarly, do not offer references to case citations, sections of statutes, or names of rules or doctrines, unless you are certain of their accuracy. If in doubt, refer to the name of the case or common title of the statute or describe the rule or doctrine.

7. *Do not invite loss of credit.* Do not signal possibly incorrect answers by "flagging" the question or answer. Graders have been known to overlook a wrong answer. Do not help the grader do his or her job. If you make a mark to remind you to return to a specific question, erase or obliterate it before submitting the exam.

8. *Use definitions.* As you read the essay questions, identify the legal issues and write the definitions of the relevant terms or concepts. Once the definition is on your paper, use it as analytical tool. It will serve as a checklist from which you will be able to discern the elements of the cause of action or legal concept. If each of the elements is present in the facts, you can assume the existence of the cause of action, doctrine or rule. Even if you are confused or uncertain in your analysis of an essay question, by providing the definition(s) involved, you will earn some credit.

9. *Focus on issue identification.* As you read the essay questions, note all the legal issues that may be involved. A single contract question, for example, may contain issues related to offer, acceptance, consideration, illegal bargain, capacity, mistake, statute of frauds, and more. Make the examiner aware that you saw the issues. By noting all the relevant issues, you properly begin the process of legal analysis and, in the event your discussions or decisions are less than perfect, you will be rewarded with some credit for being able to identify the issues. Be careful not to read too quickly, or to read carelessly, or to let an obvious issue capture your entire attention; you will miss issues.

10. *Read the facts methodically.* When reading a law exam question, pause at every word or phrase of legal significance, make a tentative analysis to that point, then proceed. Do not try to read the entire question, remember all the relevant facts, analyze them and then come to the proper conclusions at the end. This methodology will help you to identify the not-so-obvious issues, and assist you in appreciating the relationship of the various issues.

11. Write well. If you know the answers but express them poorly, you may not receive complete credit. Try to write clearly, simply, concisely, and precisely. Check your spelling and grammar. Plan your time so you can proofread before you submit the exam.

12. *Make notes.* When reading the essay questions, make notes on the exam or on scrap paper to highlight important facts, to help you recall your tentative conclusions, and to organize your thoughts. Fact patterns can be long and complex. Trying to retain too much information can be confusing. You may not be able to recall all of your thoughts when you finally compose your answer unless you made notes in the process.

13. *Outline the essays.* Before you start writing the answer to an essay question, draft a brief outline of your proposed response on scrap paper so your final answer is well organized and does not ramble.

14. *Be responsive.* Answer the question that is asked. Read the instructions carefully. Do not lose credit by giving information that is not responsive. Be conscious that in the pressure of the exam environment, it is possible to read a question carelessly, believe you recognize what is being sought, and begin to answer . . . the wrong question.

15. *Be relevant.* Answer the question that is asked with information pertaining to the issues raised. Offering irrelevant information can be a signal to the examiner that you did not see the issue, or if you saw it, did not know the answer. Irrelevant information increases the risk of an incorrect response.

16. *Use "keywords."* If a doctrine, concept, or rule of law has a name or title, use it. This is a quick and easy way of letting the instructor know that you identified the issue. For example, if you are answering a question involving an exchange of promises, use the word "consideration"; if answering a question involving reliance upon an intentional misrepresentation of fact, use the word "fraud." If an explanation is appropriate, state it after identifying the doctrine, concept, or rule of law. Use of the keyword signifies that you recognized the issue, even if you did not know all of the ramifications.

17. *Do not be conclusionary.* Illustrate your reasoning. Explain how you reached your decisions. Since credit is usually awarded on the basis of the quality of your written answer, and not merely the correctness of a particular decision, you should give the grader sufficient information to illustrate that you knew the reasoning supporting your decision. Do not assume that the

instructor knows anything other than what you include in your response. Do not think so fast that you merely put down the conclusion without evidencing your reasoning. If your answers to the essay questions are very short, you may be offering conclusions without proper explanations.

18. Write something. If time is running out on essay questions and you know the answer, put something down, even if it is merely a list of applicable keywords. You will get no credit if there is no answer. If you do *not* know the answer to an essay, put down anything *relevant* that will indicate to the instructor that you knew something about the subject. You may get lucky. Be careful, however, not to offer wrong or irrelevant information.

19. Do not cheat. Do not cheat or give the appearance of cheating. You do not need to cheat. Help is available from the instructor. Get it *before* the exam.

20. Do not hope. When studying (or not studying), don't even think, "My instructor won't ask that..." He or she will.

Conclusion

We should not assume that our students have acquired meaningful law learning or exam skills. By devoting some effort to those subjects, we will have given our students a gift of enduring value. And we will find that we have become more effective instructors. References to law learning skills and exam techniques can be easily incorporated as part of our class presentations. The ratio of effort to reward is so great that we should not ignore the issue nor leave the task to others.

The foregoing suggestions have been accumulated over many years of studying, taking tests, and teaching. Some are the results of the author's experiences, some were gleaned from other sources, and some seem to have evolved into the public domain. Three especially practical and appealing publications are: "How to Study, Suggestions for High School and College Students," Third Edition, Arthur W. Kornhauser, The University of Chicago Press, 1993, (originally published in 1924, and revised many times); "Legal Writing Style," Second Edition, Henry Wiehofen, West Publishing Co., 1980, and "Whip Smart, The Tricks of the Trade for Better Grades," by Lamar Graham, in Rolling Stone Magazine, March 23, 1995. On the Internet, explore Virginia Tech Study Skills Self-Help Information at http://www.vtedu/stdysk/stdyhlp.html.

If you have any law learning, briefing or study suggestions, or exam tips, please share them with the author.

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STRESS IN THE WORKPLACE: A CASE STUDY

by

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and
Diana D. Juettner**

CASE OVERVIEW

Mental-mental job-related stress claims have been debated across the country in the state courts and the state legislatures throughout the late 1980s and 1990s, with experienced practitioners on both sides of the issue taking opposite points of view regarding their compensability. Mental-mental claims are those claims in which mental stress at work causes a mental disability (nervous breakdown caused by emotional stress) without any physical corroboration. New York was one of the first states to resolve mental-mental workplace stress claims. In *Wolfe v. Sibley, Lindsay & Curr. Co.* 36 N.Y. 2d. 505, 330 N.E. 2d 603, 369 N.Y.S. 2d 637 (1975), the New York Court of Appeals for the first time held that the psychological or nervous injury precipitated by psychic trauma is compensable to the same extent as physical injury.

Recently, the state of Iowa has allowed recovery for mental stress claims, after its highest court resisted ruling on mental-mental claims for years. In the landmark case of *Dunlavey v. Economy Fire and Casualty Company* 526 N.W. 2d 845 (Iowa 1995), the Supreme Court for the first time considered the question of whether psychic trauma is a readily identifiable cause of psychological or nervous injury. The Court held that mental disorders, even if not accompanied by physical traumas to the body, constitute an injury under the Iowa workers' compensation statutes, Iowa Code Chapter 85 (1993). In *Dunlavey*, Francis C. Dunlavey filed a petition with the Iowa Industrial Commissioner against his employer, Economy Fire and Casualty Company, claiming that he had suffered psychological injury as a result of work-related stress. Economy Fire and Casualty Company argued that without any

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physical injury Dunlavey had no basis for recovery under Iowa's Compensation statute. This case sharpens the legal focus on mental-mental claims and places itself in the national spotlight in responding to the increase in workplace stress.

BACKGROUND ANALYSIS OF JOB-RELATED STRESS

The *Dunlavey* case is typical of the stressful scenarios occurring more and more frequently in the workplace and is symptomatic of what has been termed the 20th Century Disease. In light of current economic conditions, there are literally thousands of individuals who feel insecure in their jobs and who are unsatisfied with their present or long term career prospects. This economic uncertainty and vanishing job security has produced widespread worker tension. A 1991 study showed that 25% of United States workers suffer from stress related illnesses.

In the late 1980s and 1990s, employees' well being was battered by a set of stressful scenarios: added job responsibilities, job changes, non-recognition for their work, changing work environments, corporate cut backs, and corporate restructuring. The most significant of this result of this widespread worker tension has been the escalation of mental-mental stress claims against employers. These mental-mental stress claims have resulted in a whole new wave of workers' compensation cases. This widespread worker tension caused companies to experience costly litigation, lower productivity, higher medical costs, increased absenteeism, and higher employee turnover.

DUNLAVEY V. ECONOMY FIRE AND CASUALTY COMPANY

Factual and Procedural Background

In *Dunlavey*, the Iowa Supreme Court ruled that workers can recover Workers' Compensation benefits for mental illnesses caused by stress in the workplace. The court concluded "that the term 'personal injuries,' as used in Iowa Code section 85.3(1), includes a mental injury standing alone. Having so determined, it naturally follows that an employee's pure nontraumatic mental injury 'arising out of and in the course of the employment' is compensable under chapter 85 of the Iowa Code."

Dunlavey, a 62 year old claims adjuster, had worked in the insurance industry for approximately 30 years. He was employed by Iowa Kemper Insurance Company from 1977 to 1986 until Kemper merged with Economy Fire and Casualty Company. Prior to the merger, Dunlavey testified that he enjoyed his work as a claims adjuster, received good employment evaluations, denied having had any mental injuries.

Following the merger, Dunlavey's work environment became increasingly more stressful. Initially this stress resulted from uncertainty about his job future and also from increased criticisms from his new supervisors. For example, Dunlavey worked overtime to meet his new responsibilities usually working daily from 6:30 a.m. to 6:30 p.m. and working several hours during the weekend. Nevertheless, his level of performance as evaluated by the new management, was deemed as marginally acceptable.

Furthermore, Dunlavey and a co-worker Howard Anderson, another former Kemper employee, testified that Kemper employees had to perform more work than the employees brought in by Economy Fire and Casualty. Additionally, both men claimed that the stress the Economy managers placed upon them was greater than the stress placed on the Economy employees.

As a result of the levels of stress experienced at work, Dunlavey's wife testified that she noticed that her husband appeared to be depressed, physically exhausted and continuously complaining about the stressful conditions at work. Shortly thereafter, Dunlavey was diagnosed with depression by Dr. James K. Coddington, the family physician. Dr. Coddington cited job stress as a definite causal factor in Dunlavey's illness.

Following this diagnosis, Dunlavey took a leave of absence from work seeking psychiatric treatment for his depression. Simultaneously he sought workers' compensation benefits claiming that his mental illness was caused by work-related stress. At his workers' compensation hearing, the treating psychiatrists unanimously agreed that Dunlavey was afflicted with major depression and that workplace stress was a causative or aggravating factor in the development of his depression.

The Iowa Industrial Commissioner ruled in favor of Dunlavey. Economy filed a petition for judicial review in the Iowa District Court arguing that without any physical injury Dunlavey had no basis for recovery under Iowa's Workers' Compensation statutes. The District Court upheld the Industrial Commissioner's decision, whereupon Economy appealed to Iowa's Supreme Court.

Decision of the Iowa Supreme Court

The Iowa Supreme Court agreed with the District Court and the Industrial Commissioner that an employee can recover for a non-traumatic injury. The Court further held that the term "personal injuries" found in Iowa Code section 85.3(1) includes mental injuries without any accompanying physical injury. Additionally, the court held that the employee must satisfy two requirements. First, the employee must establish factual or medical causation; the employee must prove that he or she has a mental injury which was caused by mental stimuli in the work environment. Second, the employee must meet the legal causation standard; he or she must prove that the mental injury was caused by workplace greater than day to day stresses experienced by other workers employed in the same or similar jobs. As a result, the Iowa Supreme Court set new standards for mental-mental injury claims and it becomes the most recent state to resolve the debate surrounding mental-mental workplace stress.

INSTRUCTIONAL NOTE

Course Area and Pedagogical Objectives

This case is ideally suited for an undergraduate or graduate course in Business Law and/or Employment Law. It may also have application in Business and Society, Human Resource

Management and Business Policy courses. This case can be used to demonstrate the legal implications of workplace stress. In the management context, this case can be used to analyze the management policy approaches and programs associated with job stress related issues. The professor may choose to lead classroom discussion of the legal and managerial issues presented in the case. In addition, the professor may choose to assign this case as a role playing exercise and challenge students playing the roles to resolve their disagreements to avoid litigation.

Sources of Data

Information for this case study is based on the Iowa Supreme Court decision in *Dunlavey v. Economy Fire and Casualty Company*. In addition, it is based on articles from health and stress management journals, popular business journals, and newspaper articles.

Suggested Questions and Analysis

1. What criteria does the Iowa Supreme Court establish in order for employees to be compensated for mental-mental job-related stress claims?

The court in *Dunlavey* held that the employee must satisfy two requirements to recover for mental-mental claims under Iowa's Workers' Compensation statutes. First, the employee must establish factual or medical causation: the employee must prove that he or she has a mental injury which was caused by mental stimuli in the work environment. Second, the employee must meet the legal causation standard: he or she must prove that the mental injury was caused by workplace stress greater than the day to day stresses experienced by other workers employed in the same or similar jobs.

2. Find other jurisdictions that have permitted recovery for a mental injury caused solely by a mental stimulus under the state's workers' compensation laws.

At least 15 state courts have permitted recovery for mental-mental injuries suffered in the workplace under their state's workers' compensation laws. These states include: Arizona, Arkansas, California, Delaware, Hawaii, Illinois, Indiana, Maryland, Mississippi, New Jersey, South Carolina, Tennessee, Texas, Virginia, and Wyoming.

3. What state legislatures have amended their workers' compensation statutes to permit compensability for mental injuries arising solely from a mental stimulus?

During the late 1980s and 1990s the following states have amended their workers' compensations statutes to permit recovery for mental-mental job-related claims: Alaska, Colorado, Louisiana, Massachusetts, Maine, New Mexico, New York, North Dakota, Oregon, Rhode Island, and Wisconsin.

4. What legal alternatives are available to individuals who wish to pursue mental-mental stress claims outside of the workers' compensation area?

While the greater number of job-related stress claims are made under worker compensation claims, in some instances, employees have been able to successfully pursue such claims outside of the workers' compensation area. In some work-related mental stress claims pursued under state discrimination statutes, employers have raised the issue of the "exclusive remedy" provisions of the state workers' compensation laws.

The issue was squarely faced in *Boscaglia v. Michigan Bell Telephone Company*, 420 Mich. 308, 362 N.W. 2d 642 (Mich. 1984), where the claimant brought an action for damages alleging violation of her civil rights and sought recovery for physical and mental or emotional injury. Here, the court held that the exclusive remedy provision of the Workers' Compensation Act did not bar such an action where the employee was alleging a violation of the Fair Employment Practice Act or the Michigan Civil Rights Act.

In addition, New York's highest court exemplified a willingness to compensate employees for mental anguish and humiliation in discrimination cases. The New York Court of Appeals in *Consolidated Edison Company of New York, Inc. v. New York State Division of Human Rights (Pamela Easton)*, 77 N.Y. 2d 411, 570 N.E. 2d 217, 568 N.Y.S. 2d 569 (1991) held that there was substantial evidence supporting the finding of the state commissioners of Human Rights, that Consolidated Edison discriminated against Pamela Easton, a black woman, on the basis of sex and race, by promoting two white males to supervisory positions, both of whom lacked her experience level. In upholding the Commissioner's award of $10,000.00 for hurt, humiliation, and mental anguish suffered, the court noted the effects of discrimination were perceived every day when the complainant reported to white males, petitioners had promoted over her.

5. Which state courts and legislatures deny recovery for mental-mental claims for job related stress?

The states of Alabama, Florida, Georgia, Kansas, Minnesota, Montana, Nebraska, Ohio, Oklahoma, and South Dakota are among the minority and do not permit compensation for mental-mental stress cases under any circumstances. In a South Dakota Supreme Court case, *Lather v. Huron College*, 413 N.W. 2d 369 (S.D. 1987), the issue of mental-mental compensability was considered for the first time. Here, the employee left his position as a college basketball coach because of work-related stress. Subsequently, he was treated for a psychological disorder which ultimately led to his suicide. The court, in denying the claim, held that mental disability caused by a mental stimulus was not compensable.

Similarly some state legislatures have denied workers' compensation for mental injuries unless the mental injury is suffered in connection with a physical injury. For example, workers who suffer heart attacks from job related stress are covered by mental-physical claims. The state legislatures that have denied mental-mental claims are the following: Alabama, Connecticut, Idaho, Kentucky, Montana, New Hampshire, Washington and West Virginia.

6. In light of the *Dunlavey* decision, describe the types of programs companies might employ to cope with work-related stress?

Concerned with escalating human cost that job related stress exacts, employers have instituted various programs designed to identify and prevent, or reduce, the sources of stress that are precipitating mental stress claims and employee burnout. Employees from companies that offer stress reduction programs are 50% less likely to miss work or quit their jobs due to stress. Researchers calculate the average cost of rehabilitating stress disabled employees at $1,925 and, if not rehabilitated, the cost would average $73,273 to cover the disability payments.

While employee assistance programs have been in existence for some time, it is only within the past decade that employers have instituted stress management programs. A review of some of the programs adopted by employers both major corporations and small firms, reveals a wide diversity in their structure, components and focus, ranging from comprehensive holistic stress management programs to modest programs providing employees with time to engage in stress releasing activities.

Some examples of stress management programs are as follows:

- Texas Instruments, Inc. cited as the employer of the year in 1991 by the National Employees' Services and Records Associations, adopted a holistic stress management philosophy which underlies a wide range of programs such as its wellness program Lifetrack which includes health assessments and recommendations for participation in company sponsored wellness programs. Over a three year period, employees participating in the program have shown a 7% improvement in coping with stress.

- AT&T Communications began developing a corporate wellness program known as Total Life Concept which recognizes stress management as an essential component. The program focuses on educating its managers about stress, with emphasis on the recognition of stress factors that can effect workers, and the development of a flexible management style which would mitigate the stressors.

- Small companies are beginning to recognize that on-the-job stress, while varying from company to company, is a fact of life and must be addressed. For example, Pension and Group Services at Kalamazoo, Michigan, an administrator for employee health benefits and health care, responded to employees' requests for programs that would reduce stress by creating a complete physical fitness center. This center developed a program encouraging a holistic approach to stress management. The company has had a positive response with approximately 75% of its 200 employees making use of its programs.

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