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LONG LIVE THE GOLDEN SUMMER: ARBITRATION, COURTS, & COLAS

2019 ANNUAL LECTURE ON INTERNATIONAL COMMERCIAL ARBITRATION
AMERICAN UNIVERSITY WASHINGTON COLLEGE OF LAW
WASHINGTON, DC

THE HONORABLE L. YVES FORTIER, PC, CC, OQ, QC*

I. INTRODUCTION

I am very honored and humbled to have been chosen as this year's speaker in the field of international commercial arbitration, not least because of the distinction of those who preceded me, a line of legal luminaries who are household names in the world of arbitration.

I willingly acknowledge that, at first sight, my subject matter, *Long Live the Golden Summer: Arbitration, Litigation, and Colas*,[1] may seem a little frivolous compared with, for example, *Commercial Arbitration under the*

* Yves Fortier is a past President of the London Court of International Arbitration and of the Canadian Bar Association. From 1984 to 1989, he was a member of the Permanent Court of Arbitration. From July 1988 until February 1992, he was Canada's Ambassador and Permanent Representative to the United Nations ("UN"). In 1989, he was President of the UN Security Council. From 1992 until 2008, he was Chairman of Norton Rose and then Chairman Emeritus until he began practicing as an independent mediator/arbitrator. From 2012 to 2015, Mr. Fortier was Chairman of the Sanctions Board of the World Bank. In 2013, Mr. Fortier was appointed to Canada's Security and Intelligence Review Committee and sworn in as a member of the Privy Council. In August 2016, he was appointed Chairman of the Enforcement Committee of the European Bank for Reconstruction and Development ("EBRD").

1. I would like to acknowledge and thank my colleague Trevor May for his thorough research and invaluable assistance in the preparation of my lecture.

Scrutiny of Human Rights Courts and Investment Tribunals[2] by my friend, Gabrielle Kaufmann-Kohler, or *Legal Risks for Product Liability*[3] by my friend, Johnny Veeder, among the topics developed by previous lecturers. Nevertheless, I will attempt to entertain and educate you in the next hour about how colas and arbitration have a great deal in common.

As you will no doubt recall, long before the *Game of Thrones*, there was the "Game of Colas": the so-called "Cola Wars" between Pepsi and Coca-Cola.[4] In the over 100 years that the brands have competed head-to-head, Coca-Cola has usually prevailed. Today, Coca-Cola's share of the cola market is almost twice that of Pepsi's.[5]

However, in the mid-1980s, winter was coming for the "Official Soft Drink of Summer."[6] Coca-Cola's market share, while still larger than Pepsi's, was eroding.[7] Pepsi's growth had outpaced Coca-Cola's for over a decade, and "by 1983, Pepsi was outselling Coca-Cola in supermarkets."[8]

In the heat of this battle, Pepsi launched one of the most effective marketing campaigns of all time, to which Coca-Cola would respond with the "marketing blunder of the century."[9] In the "Pepsi Challenge," consumers undertook a double-blind taste test of both colas. The results shocked Coca-Cola lovers: blindfolded participants preferred the taste of Pepsi.[10]

Under threat, Coca-Cola scrambled to fight back. It decided to fight fire

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2. Gabrielle Kaufmann-Kohler, Professor, University of Geneva School of Law, Address at the American University Washington College of Law Annual Lecture on International Commercial Arbitration: Commercial Arbitration under Scrutiny of Human Rights Courts & Investment Tribunals (2011), *in* 29 ARB. INT'L 153, 153 (2013).

3. V.V. Veeder, Queen's Counsel, England and Wales, Arbitrator, Address at the American University Washington College of Law Annual Lecture on International Commercial Arbitration: Arbitrators and Arbitral Institutions: Legal Risks for Product Liability? (2012), *in* 5 AM. U. BUS. L. REV. 335, 335 (2016).

4. Matthew Yglesias, *Sweet Sorrow: Coke Won the Cola Wars Because Great Taste Takes More than a Single Sip*, SLATE (Aug. 9, 2013, 8:15 AM), https://slate.com/business/2013/08/pepsi-paradox-why-people-prefer-coke-even-though-pepsi-wins-in-taste-tests.html.

5. *Id.*

6. *See History of Coca-Cola Advertising Slogans*, THE COCA-COLA COMPANY, https://www.coca-colacompany.com/stories/coke-lore-slogans (last visited Nov. 28, 2020) (branding Coca-Cola the "Official Soft Drink of Summer" in 1989).

7. Yglesias, *supra* note 4.

8. Yglesias, *supra* note 4.

9. *The Story of One of the Most Memorable Marketing Blunders Ever,* THE COCA-COLA COMPANY, https://www.coca-colacompany.com/stories/coke-lore-new-coke (last visited Nov. 28, 2020).

10. Yglesias, *supra* note 4.

with fire. Coca-Cola reformulated its storied recipe to create a sweeter flavor intended to outcompete Pepsi, as well as the original Coca-Cola, in taste tests.[11] The result: "New Coca-Cola," a product designed to beat Pepsi at its own game.

It did not. Following New Coca-Cola's release, 400,000 customers sent a tsunami of complaints to Coca-Cola, and Coca-Cola was even sued by partners in its distribution chain.[12] Aside from this collateral damage, the plan failed even more spectacularly with respect to its entire *raison d'être*: outcompeting Pepsi. During New Coca-Cola's first month on the market, Pepsi had its fastest-ever sales growth.[13]

But why? Coca-Cola had designed a product that outperformed both Pepsi and Coca-Cola in a blind taste test. Shouldn't that product have gone on to dominate the market? It turns out that there is a difference between what people like to taste and what people like to drink. With its taste tests, Pepsi was exploiting a cognitive loophole: in beverage taste tests, people prefer sweeter flavors.[14] The pattern holds for both colas and wine,[15] but that test result does not necessarily mean that people want to drink a sweeter beverage. Pepsi wins when you just take a sip, but people do not buy soft drinks just to take one sip.

Moreover, even though Pepsi was growing faster than Coca-Cola in the 1980s, Coca-Cola still had millions of loyal customers.[16] Millions of loyal customers who did not want Pepsi.[17] Irrespective of taste, Coca-Cola's customers felt betrayed by the company's decision to replace the product that had secured their loyalty in order to win over customers who had never been loyal to the brand.[18]

So why am I, an arbitrator from Montreal, talking about colas at an international commercial arbitration lecture in Washington? I recount the "New Coca-Cola" story to you this evening because it offers a valuable

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11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*

15. *See id.* (contending that blind taste tests showed participants also preferred sweeter wine).

16. *Id.*

17. *See id.* (reporting that Coca-Cola's customers in the 1980s "weren't looking for a new flavor").

18. *See* Becky Little, *How the 'Blood Feud' Between Coke and Pepsi Escalated During the 1980s Cola Wars*, HISTORY CHANNEL, https://www.history.com/news/cola-wars-pepsi-new-coke -failure (last updated Mar. 12, 2020) (detailing the anger Coca-Cola customers felt toward the company when it replaced the formula).

lesson for the arbitration world.

Consider the current state of international arbitration. For decades, international arbitration has developed and improved, achieving success in new markets and on an ever-increasing scale. In 2018, parties registered a record fifty-six cases at the International Centre for Settlement of Investment Disputes ("ICSID"), a new record.[19] The record year before 2018 was 2017, and the record year before 2017 was 2015.[20] Similarly, 2018 was also a record-breaking year for the London Court of International Arbitration ("LCIA")[21] and the International Chamber of Commerce ("ICC") International Court of Arbitration.[22] In 2018, in a wide-ranging survey of practitioners, academics, judges, third-party funders, government officials, expert witnesses, economists, entrepreneurs, and others, ninety-seven percent responded that "international arbitration is their preferred method" of resolving cross-border disputes.[23]

Yet, for decades, we have been told that arbitration must be stopped.[24] Recently, the death chants have intensified. Investor-State Dispute Settlement ("ISDS") "should be dismantled and either discarded or rebuilt from scratch."[25] Gary Born warns us that "winter is coming."[26]

The "White Walkers"[27] in this dispute resolution *Game of Thrones* have

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19. Int'l Ctr. for Settlement of Inv. Disps. [ICSID], *The ICSID Caseload — Statistics*, at 7, Issue 2019-1 (2019), https://icsid.worldbank.org/en/Documents/resources/ICSID%20Web%20Stats%202019-1(English).pdf.

20. *Id.*

21. LONDON COURT OF INT'L ARBITRATION, 2018 ANNUAL CASEWORK REPORT 3 (2018).

22. *See ICC Arbitration Figures Reveal New Record for Awards in 2018*, INT'L CHAMBER OF COMMERCE (Nov. 6, 2019), https://iccwbo.org/media-wall/news-speeches/icc-arbitration-figures-reveal-new-record-cases-awards-2018/ (announcing that 2018 had the second-highest number of ICC cases ever reported).

23. WHITE & CASE, 2018 INTERNATIONAL ARBITRATION SURVEY: THE EVOLUTION OF INTERNATIONAL ARBITRATION 2 (2018), https://www.whitecase.com/sites/whitecase/files/files/download/publications/qmul-international-arbitration-survey-2018-19.pdf.

24. *See* Anthony Depalma, *Nafta's Powerful Little Secret; Obscure Tribunals Settle Disputes, but Go Too Far, Critics Say*, N.Y. TIMES (Mar. 11, 2001), https://www.nytimes.com/2001/03/11/business/nafta-s-powerful-little-secret-obscure-tribunals-settle-disputes-but-go-too-far.html (discussing opponents' arguments against tribunal arbitration).

25. Jaroslav Kudrna & Anna Bilanová, *The New Age of the Megacase*, 13 GLOBAL ARB. REV. 14, 16 (2019).

26. Alison Ross, *Winter Is Coming: Is Arbitration's "Long, Golden Summer" Coming to an End?* 13 GLOBAL ARB. REV. 7, 8 (2019) [hereinafter Ross, *Winter Is Coming*].

27. The "White Walkers" are one of the main antagonists in the television show *Game of Thrones* and represent a persistent threat to the Seven Kingdoms. *Game of*

mobilized, and the "New Coca-Cola" of international dispute resolution has arrived. Most notably, the Comprehensive Economic and Trade Agreement ("CETA") between the European Union ("EU") and Canada contains a proposal for a permanent investment court, the Investment Court System ("ICS"), which would replace traditional ad hoc party appointments with fixed-term institutional ones.[28] The EU has also proposed a similar mechanism for ISDS, more generally, with the Multilateral Investment Court ("MIC").[29] Will the introduction of such alternatives lead to the "Red Wedding"[30] for seasoned arbitrators?

My answer to this existential question is *no*. I predict that arbitration's Golden Summer will endure. The popularity of arbitration is not circumstantial or "seasonal"; rather, it stems from advantages inherent to arbitration as a process for settling disputes. Gary Born is right, there are some people who want to put an "end [to] international arbitration as we know it."[31] But he is also right that we can avoid the demolition of arbitration.[32]

International arbitration has outlasted and will outlast its critics because it functions well. I echo the words of Stephen Jagusch, Q.C., that arbitration has "stood the test of time" and that "[i]t is here to stay."[33] Like Coca-Cola, arbitration is confronted by challengers. Arbitration should not rest idly on its laurels. But as Coca-Cola learned the hard and painful way, our response

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Thrones: Hardhome (HBO television broadcast May 31, 2015) (showing the White Walkers, an army of the undead, for the first time).

28. *See ANNEX to the CETA Joint Committee Proposal for a Council Decision on the Position to be taken on behalf of the European Union as Regards the Adoption of a Decision Setting Out the Administrative and Organisational Matters Regarding the Functioning of the Appellate Tribunal*, at 1–2, COM (2019) 457 final (Nov. 10, 2019) (proposing a fixed nine-year term for Members of the Appellate Tribunal, a decision made pursuant to Article 8.28.7 of the CETA).

29. *See* Possible Reform of Investor-State Dispute Settlement (ISDS): Submission from the European Union and its Member States, Rep. of the UNCITRAL in Preparation for the Thirty-Seventh Session of Working Group III, U.N. Doc. A/CN.9/WG.III/WP.159/Add.1, at 5 (Jan. 24, 2019) (proposing a nine-year non-renewable term for the Appellate Tribunal).

30. The "Red Wedding" is a key turning point in the television show *Game of Thrones* in which several protagonists are murdered, ending their storylines. *Game of Thrones: The Rains of Castamere* (HBO television broadcast June 2, 2013) (portraying a gruesome massacre that occurred in the aftermath of a wedding feast).

31. Ross, *Winter Is Coming*, *supra* note 26, at 8.

32. *Id.* at 11.

33. Alison Ross, *The Winter Denier*, GLOBAL ARB. REV. (Dec. 21, 2017), https://globalarbitrationreview.com/article/1151943/the-winter-denier [hereinafter Ross, *The Winter Denier*].

to challengers should not be to change what makes us successful.

I will review briefly at the outset the most recent iteration of the perpetual debate surrounding international arbitration, including calls for quasi-judicial institutions such as the MIC. I will then argue that the advantages of arbitration over alternatives, such as the MIC, lead inexorably to the conclusion that international arbitration will continue to be the premier method for resolving cross-border disputes. I will then examine the prism of future developments that confirm arbitration's enduring relevance. Finally, I will come to my conclusion that, like Coca-Cola, the arbitration community should continue to do what it has done so well for decades — providing a process that litigants like and want — and not change what we do in order to please people who never wanted us to succeed in the first place.

II. THREATS OF WINTER FOR INTERNATIONAL ARBITRATION

The debate about the merits of arbitration is not new. International arbitration has long been the object of hostility and hyperbole. The World Bank's own ICSID has often been a lightning rod for criticism. Detractors have accused the institution of bias in favor of corporations and lamented its prohibitive costs and lack of an appeal mechanism.[34] When Bolivia became the first member state to leave ICSID in 2007, Bolivian President Evo Morales claimed that "[t]he governments of Latin America . . . never win the cases. The multinationals always win."[35]

Surprisingly, even some arbitration insiders, such as Jan Paulsson and Albert Jan van den Berg, have recently joined the chorus of critics unfamiliar with the world of international arbitration. George Kahale, an otherwise outstanding, very successful litigator and a veteran of many high profile arbitrations, is now calling for ISDS's eradication.[36] Mr. Kahale claims that ISDS "lack[s] . . . the normal safeguards of a serious legal system," making it "the Wild Wild West of international practice."[37] Despite the consistently verified fact that states win more investment cases than they lose, Kahale insists on the old canard that the system is biased against states.[38] He now encourages states to "actively explore the termination of ISDS provisions," and even claims that "ending or limiting a system . . . as dangerous as ISDS

34. *See* Silvia Karina Fiezzoni, *The Challenge of UNASUR Member Countries to Replace ICSID Arbitration*, 2 BEIJING L. REV. 134, 134–36, 142 (2011).

35. Naomi Klein, *Latin America's Shock Resistance*, THE NATION (Nov. 8, 2007), https://www.thenation.com/article/archive/latin-americas-shock-resistance/.

36. Kudrna & Bilanová, *supra* note 25, at 14.

37. *Id.*

38. *Id.*

is a good thing, even if it is done for the wrong reasons."[39]

While Mr. Kahale proposes no alternative to ISDS,[40] other critics envision a MIC, with permanent members and an appellate mechanism.[41] This proposal is not new either; proposals for introducing appeals to ISDS have floated around without much follow-through for many years.[42] Now the proponents of such changes seem more serious. Most notably, the EU has seized on this proposal in its confused quest to kneecap an institution that has benefitted its member states for decades.

In its submission to the United Nations Commission on International Trade Law ("UNCITRAL") Working Group III, the EU stressed three main categories of "concerns" with investor-state dispute settlement: "(i) concerns pertaining to the lack of consistency, coherence, predictability, and correctness of arbitral decisions by ICSID tribunals . . . (ii) concerns pertaining to arbitrators, and decision makers . . . [and] (iii) concerns pertaining to cost and duration of ISDS cases."[43] The EU considers these concerns "systemic" and "intertwined."[44] In its view, they can only be alleviated by replacing ad hoc arbitral appointments with a standing court mechanism.[45] The EU went as far as declaring, in 2018, that "[f]or the EU ISDS is dead."[46]

This standing court institution would be designed antithetically to ad hoc international arbitration. It would resemble the promised but yet-to-be-delivered CETA multilateral investment tribunal and appellate mechanism.[47]

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39. *Id.* at 16.

40. *See id.* at 15–16 (reporting that Kahale believes that any solution would exacerbate the issues).

41. *See, e.g.*, MARC BUNGENBERG & AUGUST REINISCH, FROM BILATERAL ARBITRAL TRIBUNALS AND INVESTMENT COURTS TO A MULTILATERAL INVESTMENT COURT: OPTIONS REGARDING THE INSTITUTIONALIZATION OF INVESTOR-STATE DISPUTE RESOLUTION 197–98 (2d ed. 2019).

42. Agnieszka Zarowna, *Veeder and van den Berg on the Future of Investment Arbitration*, GLOBAL ARB. REV. (Apr. 11, 2019), https://globalarbitrationreview.com/article/1190127/veeder-and-van-den-berg-on-the-future-of-investment-arbitration.

43. Possible Reform of Investor-State Dispute Settlement (ISDS): Submission from the European Union and its Member States, *supra* note 29, at 2–3.

44. *Id.* at 4.

45. *Id.*

46. *A New EU Trade Agreement with Japan – Factsheet*, at 6 (July 2018), https://trade.ec.europa.eu/doclib/docs/2017/july/tradoc_155684.pdf ("A new system — called the Investment Court System, with judges appointed by the two parties to the FTA and public oversight — is the EU's agreed approach that it is pursuing from now on in its trade agreements. This is also the case with Japan.").

47. *See* Comprehensive Economic and Trade Agreement (CETA), Can.-Eur., art. 8.29, Oct. 28, 2016, 2017 O.J. (L 11).

The EU proposes a permanent body comprised of two levels: a first instance Tribunal and an Appellate Tribunal.[48] These tribunals would be staffed with full-time adjudicators held to strict ethical and diversity requirements.[49] In sum, the EU envisions an institution that would replace arbitration.

Gary Born has observed these developments with concern and sounded the alarm. Born tells us that, like the Seven Kingdoms in *Game of Thrones*, arbitration has enjoyed a "long, golden summer."[50] He writes that "[b]eyond the walls and bustling marketplaces" of our kingdom, however, "lies a terrifying 'other world,' where people are 'predatory, not productive; preoccupied with taking, not trading.'"[51] The people of this other world, he claims dramatically, "will tear down those walls, destroy everything that has been created and usher in a 'long, brutal winter.'"[52]

Gary Born's *Winter Is Coming* paper aptly captures the severity of the threat posed by recent criticisms of arbitration and proposals to abolish it.[53] Where the analogy is imperfect, however, is that the forces conspiring against arbitration are not simply strangers "beyond the walls" of our world. George Kahale, for one, lives and practices among us and he is an outstanding advocate. In other words — like in the horror classic *When a Stranger Calls* — the call is coming from inside the house.

Fortunately, many distinguished members of the arbitration community have recently reacted vigorously to this contestation of what I refer to as "classic arbitration." Campbell McLachlan, a renowned arbitrator from New Zealand, spoke last month of the assault on international adjudication in his keynote Lalive Lecture.[54] Campbell McLachlan referred to the "growing opposition" to "investment arbitration and . . . termination of bilateral investment treaties" as evidence of a more general "trend towards withdrawal from international adjudication."[55]

Focusing more specifically on the debate and controversy surrounding the new proposed international investment court, my friend the Honorable

48. Possible Reform of Investor-State Dispute Settlement (ISDS): Submission from the European Union and its Member States, *supra* note 29, at 4.

49. *Id.* at 5.

50. Ross, *Winter Is Coming*, *supra* note 26, at 8.

51. *Id.*

52. *Id.*

53. *Id.* at 8–10 (articulating threats to arbitration).

54. Augustin Barrier & Lea Murphy, *McLachlan: The Assault on International Adjudication*, GLOBAL ARB. REV. (Sept. 11, 2019), https://globalarbitrationreview.com/article/1196684/mclachlan-the-assault-on-international-adjudication.

55. *Id.*

Charles Brower has repeatedly denounced its many follies.[56] Charles Brower has strongly criticized not just the new proposal for the Court, but the entire overreaction against arbitration itself, in what he has famously coined as the "Demolition Derby."[57] He has noted that "[t]he 'Demolition Derby' targeting ISDS is flourishing, doubtless confident of victory thanks to the UNCITRAL Commission's welcoming attitude toward the EU's relentless campaign to sell to the world its Investment Court System."[58]

I agree with Charles Brower and with Gary Born that "winter need not come."[59] I place my confidence in arbitration's inherent strengths, which will outlast any intemperate season. The backlash against investor-state arbitration is at least partially attributable to those who participate in arbitration but fail to proclaim its benefits.[60] To "ensure [our own] survival," Born calls on us to "stress" the "five Es" of arbitration: "efficiency, expedition, expertise, evenhandedness, and enforceability."[61] I agree. Even well-intentioned attempts to correct perceived flaws with arbitration jeopardize these proven benefits.

III. INTERNATIONAL ARBITRATION: CONTINUING THE GOLDEN SUMMER

Arbitration has many well-known advantages. They need to be mentioned briefly even if we are all familiar with them. Arbitration is a consent-based mechanism where parties appoint a decision maker or decision makers to determine a binding resolution of their dispute. This classic formula has operated successfully for thousands of years. The Ancient Mesopotamians, Greeks, Romans, groups in Africa and India, and even merchants in Europe, of all places, all used some forms of arbitration.[62] Such diverse usage endures today. For instance, sheiks in Iraq continue to serve as arbitrators

56. *See generally* Charles N. Brower & Jawad Ahmad, *From the Two-Headed Nightingale to the Fifteen-Headed Hydra: The Many Follies of the Proposed International Investment Court*, 41 FORDHAM INT'L L. J. 791 (2018) (criticizing the CETA proposal for an international investment court).

57. *See* Charles N. Brower & Jawad Ahmad, *Why the "Demolition Derby" That Seeks to Destroy Investor-State Arbitration?*, 91 S. CALIF. L. REV. 1139, 1141 (2018) (defining and detailing the "Demolition Derby").

58. *Id.* at 1184.

59. Ross, *Winter Is Coming*, *supra* note 26, at 11.

60. *See* Zarowna, *supra* note 42 (citing "misperception" as one of the reasons for pushback to ISDS).

61. Ross, *Winter Is Coming*, *supra* note 26, at 10.

62. *See* GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION 8–9 (2nd ed. 2014) (documenting the use of international arbitration by ancient civilizations); *see also* L. Yves Fortier, *Delimiting the Spheres of Judicial and Arbitral Power: "Beware, My Lord, of Jealousy"* 80 CAN. B. REV. 143, 145–46 (2001).

among feuding tribes.[63] Such widespread and longstanding use speaks to arbitration's intrinsic appeal: it takes the dispute out of the hands of those locked in disagreement and refers to neutral, respected decision makers the resolution of their conflict once and for all.

As a corollary of its basis in consent, the parties will choose their arbitrators, men or women versed in the issues underlying the dispute, and will agree on the procedure to be followed. Barring public policy concerns, the parties decide what is arbitrable. Then, they can opt for a complex, multifaceted dispute, or simply seek clarification of a single contractual provision. When the award is issued, the dispute is resolved definitely, except for very limited grounds for annulment or denial of recognition and enforcement. By virtue of the New York Convention, arbitral awards can be enforced in the vast majority of countries around the world.[64]

These fundamental characteristics, which are at the heart of arbitration, have been scapegoated for perceived problems with arbitration. Most notably, critics submit that ad hoc party appointees may be biased.[65] Resolving disputes definitely, without an appellate process, may force parties to live with flawed decisions.[66] Such criticisms mistake advantages for disadvantages. These characteristics are the hallmarks of arbitration that make the process successful; they are not flaws that need correction.

I will review them briefly in turn. I commence with the appointment of arbitrators by the disputing parties which has been singled out for a variety of grievances. The EU's submission to UNCITRAL Working Group III credits party selection of arbitrators for arbitrator bias, procedural delays, and gender disparity. This is of course the principal difference between arbitration and litigation. Each party to an arbitration selects as one of his adjudicators, a person he or she knows is well versed in the many facets of the dispute. It is a feature of arbitration that presents parties with certain trade-offs that would not necessarily disappear with a standing court of arbitrators.

Proponents of a standing body claim that it would improve ISDS's perceived lack of impartiality. Their reasoning, in my view, is somewhat suspect and myopic. A standing body would supposedly "insulate decision

63. *See Rent-a-Sheikh*, ECONOMIST, June 1, 2019, at 44.

64. *Contracting States*, N.Y. ARB. CONVENTION, http://www.newyorkconvention.org/countries (last visited Nov. 28, 2020).

65. *See* Possible Reform of Investor-State Dispute Settlement (ISDS): Submission from the European Union and its Member States, *supra* note 29, at 9–11 (acknowledging concerns about the ad hoc party-appointment system).

66. *Cf. id.* at 9–10 (discussing the relevance of the appeal process for ensuring accuracy).

makers from 'powerful private interest'" and eliminate the pressure to deliver awards that will encourage parties to reappoint them.[67] Whether a standing body of arbitrators is more independent than arbitrators appointed by the parties depends on one's perspective.

It might be more accurate to say that such a body would reduce perceived, but statistically unverified, pro-investor bias. I ask, would the trade-off become a pro-state bias? As Gabrielle Kaufmann-Kohler and Michele Potestà wrote, if states make appointments to an institution, "[t]here may be an inherent risk that only or mainly 'pro-State' individuals [will] be selected, especially if they were to be paid by the States alone."[68] I agree.

Are we prepared to deny disputing parties the right, associated with arbitration from time immemorial, to select decision makers with the expertise, experience, and overall DNA they consider essential for the fair resolution of their dispute and substitute women and men of a quasi-judicial institution endowed with general, as opposed to specific, qualifications? I do not think so. And let us not forget the role of the neutral chairperson appointed either by the parties themselves or by an arbitral institution. The Chair, [who generally projects immense gravitas], will, in my experience, often succeed in convincing his or her two party-appointed colleagues to join in a unanimous decision. And, if I may add, based on my experience in the noble profession of arbitration, after a few sessions as chair with my two party-appointed colleagues, I often forget which one was appointed by which party.

In other words, the system, as it exists today, works. Eliminating the appointment by parties of their adjudicators is not a guarantee that the system would be improved. And let us not forget that judges whose term would need to be fixed may also, with time, be seen to be biased. While the proposed code of conduct might be helpful to quell allegations of bias, the prohibition against double-hatting might well cause even more damage. By prohibiting judges from also acting as counsel, the development and training of the next arbitration generation, as well as the diversity within the arbitration community, risks being seriously hampered.

The EU also posits that significant delays and unreasonable costs are

67. *See* GABRIELLE KAUFMANN-KOHLER & MICHELE POTESTÀ, CIDS – GENEVA CENTER FOR INTERNATIONAL DISPUTE SETTLEMENT, CAN THE MAURITIUS CONVENTION SERVE AS A MODEL FOR THE REFORM OF INVESTOR-STATE ARBITRATION IN CONNECTION WITH THE INTRODUCTION OF A PERMANENT INVESTMENT TRIBUNAL OR AN APPEAL MECHANISM? 18 (2016), http://www.uncitral.org/pdf/english/commissionsessions/unc/unc-49/CIDS_Research_Paper_-_Can_the_Mauritius_Convention_serve_as_a_model.pdf.

68. *Id.* at 20.

associated with arbitration. It refers in particular, in this connection, to the many challenges levied against arbitrators in recent years which, of necessity, led to a suspension of the proceedings.[69]

The subject of my conference tonight is not "[a]rbitrator challenges, are they justified or not?" This could be the topic of an interesting conference or a lively panel discussion at some other time. But I do say: why criticize a party to an arbitration for ensuring that every one of his or her adjudicators is free from conflicts? Yes, there are some challenges that are driven by strategy rather than genuine concern about the independence of an arbitrator. But those ill-conceived challenges are few and far between and can be dealt with in cost awards.

Before I leave the impact of challenges on procedural delays in arbitration, I note an intriguing suggestion by Gary Born, who has proposed imposing a duty to investigate on parties.[70] Such a duty could put the onus on parties to search for challengeable conflicts or alleged indicators of bias early in the arbitration. This investigation by the parties themselves, combined with a waiver of the right to challenge when challenges are not raised in a timely manner, could be implemented on a temporary basis by one of our arbitral institutions.

What matters most is the integrity of the arbitral process. I submit that some delay is a small price to pay in order to ensure party autonomy, recognized expertise, and confirmed impartiality. Would a quasi-judicial tribunal juggling dozens, and eventually hundreds, of cases be more efficient than an arbitral panel constituted in order to decide a well-defined dispute? I doubt it. One only needs to look at the national courts in Canada or the United States to see how clogged court systems can get. I do not have a crystal ball, but I venture to say that permanent judges sitting comfortably on a bench, appointed for a fixed term without any input from the parties, would eventually become less efficient and more likely to issue decisions within timelines far more significant than those which, on average, arbitral tribunals do.

For me, delays experienced in arbitration due to challenges and the time taken to complete the constitution of tribunals are not as problematic as the EU and other critics of the present proven system make them out to be. All the more so when, on a balance sheet, they are compared to party autonomy to answer the central question: who is more qualified to adjudicate my case? Eliminating that paramount feature of classic arbitration in order to save a

69. Possible Reform of Investor-State Dispute Settlement (ISDS): Submission from the European Union and its Member States, *supra* note 29, at 11–12.

70. *See* BORN, *supra* note 62, at 1919.

few months of what is, by definition, a lengthy process is not a proportionate and reasonable way to address the perceived problem.

Another criticism levied against arbitration and party appointments is the alleged gender gap among arbitrators. Let me be clear. I start from the premise that although the gender gap has abated today, it has not disappeared but, there is significant and encouraging progress. The glass ceiling has been broken and a number of very competent women now sit as arbitrators. Furthermore, there are many highly qualified women lawyers climbing the ladder who will eventually qualify as very competent arbitrators. While there is still much to be done to remedy the "diversity deficit" in investment arbitration,[71] I note the significant recent initiatives which promote equal representation in arbitration, such as the Pledge.[72] Similar initiatives need to be encouraged.

Allow me nevertheless to debunk briefly the EU proposal that a standing tribunal could have built-in "selection criteria" that would ensure gender balance.[73] This proposal underlines a simple fact: if a standing tribunal with gender parity replaces ad hoc tribunals with party-appointed arbitrators, the gender gap in ISDS will be eliminated, at least in the disputes that end up before that tribunal.

Such a reform, however, while it could increase the *percentage* of women arbitrators, would do so at the expense of decreasing the overall *number* of women arbitrators. A standing tribunal with permanent appointees would centralize the market for arbitrators and thereby reduce the total number of arbitrators needed to administer the ever-increasing universe of arbitrations. This would limit the number of opportunities for women to serve as arbitrators. Gender parity is an essential objective, but the EU's proposed innovation would limit, rather than increase, more opportunities for more women.

I recognize of course that there are more advantages to gender parity than simply the number of women who can be appointed as arbitrators. It may well be that having fewer women arbitrators but having some women with

71. *See generally* Andrea Kay Bjorklund, *The Diversity Deficit in Investment Arbitration*, EUR. J. INT'L L.: EJIL: TALK! (Apr. 4, 2019), https://www.ejiltalk.org/the-diversity-deficit-in-investment-arbitration/ (noting the majority of the influential arbitrators are from either North America or Europe and that only two are women).

72. EQUAL REPRESENTATION IN ARBITRATION, http://www.arbitrationpledge.com/ (last visited Nov. 28, 2020) (explaining that signatories involved in international arbitration pledge to improve the profile and representation of women in arbitration by appointing women as arbitrators).

73. *See* Possible Reform of Investor-State Dispute Settlement (ISDS): Submission from the European Union and its Member States, *supra* note 29, at 11.

permanent appointments on a standing tribunal may be preferable to a higher absolute number of women serving as arbitrators. One of the challenges of addressing the gender gap in arbitration is weighing these possibilities against each other. The EU proposal fails to engage with these considerations.[74]

I now turn to what I consider to be the most egregious example of the strident criticism of arbitration portraying a weakness that is truly a strength. I refer to the fact that there is no appeal from the award or decision of an arbitral tribunal. We can all agree that, whatever its advantages, appeals of arbitral decisions would prolong the dispute, which the parties have submitted to arbitration.

The main argument in favor of allowing appeals in arbitration is that appeals would improve the consistency of awards. ISDS observers have raised concerns regarding "divergent interpretations of substantive standards, divergent interpretations relating to jurisdiction and admissibility, and procedural inconsistency" in awards.[75] Compounding these shortcomings is what has been referred to as ISDS's "[l]ack of appropriate control mechanisms" that could "reverse incorrect decisions and . . . sanction incompetent arbitrators."[76] Allowing appeals would establish a "second level of adjudication," where mistakes could be reviewed and standard interpretations could be upheld.[77]

I will accept, for the sake of argument, that appeals could improve consistency and cure manifestly incorrect decisions, although I have serious doubts that such improvements will happen. Whether an appellate process will result in awards which are more consistent will depend in large measure on whether appellate tribunals will follow precedent.[78] Will they introduce the *stare decisis* principle? Absent a unanimous decision on this front, it is

74. *See* Bjorklund, *supra* note 71 (explaining the arbitration system could require that all arbitrator appointments source from a roster made up of diverse individuals and could create an appellate body that is inherently diverse from the appointment of the members).

75. Comm'n on Int'l Trade Law, Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of Its Thirty-Sixth Session, U.N. Doc. A/CN.9/964, at 6 (2018) (noting that one factor for a difference in arbitral awards is that the rules of treaty interpretation require a tribunal to consider more than the plain meaning of the text and allow the tribunal to hear arguments with extrinsic evidence).

76. KAUFMANN-KOHLER & POTESTÀ, *supra* note 67, at 14.

77. *Id.* at 18.

78. *See id.* at 17 (explaining that a new appellate procedure would establish a per se level of consistency in the tribunals' decisions)*; see also id.* at 47 (stating that it would be more practical to limit the "*stare decisis* effect" to the specific international investment arbitration dispute).

unclear how consistency will improve.

In the arbitration system it should not be assumed that inconsistency between awards is necessarily problematic. It is a truism that different results may stem from the arbitrators' different backgrounds, experiences, or expertise. Factual matrices may be different. We all know that every dispute is unique. In my long experience as a trial lawyer and as an arbitrator, I can truly say that I have never seen two cases which were, in every respect, identical. In other words, what may be seen as a mistake today may be found tomorrow to be justified as a valid distinction that fits the unique factual matrix of a case.

Moreover, in a system of party-appointed arbitrators, divergent outcomes could result from the distinct inputs of arbitral awards, which suggests that differences between decisions reflect tailoring to unique disputes and not simply mistakes. And, let us remember that what constitutes a "mistake" in an arbitral context is very subjective. Who is to say that an appellate division which issues binding precedents will always get it right? As we all know, appellate courts are not immune from criticism for issuing blatantly incorrect rulings.[79]

I submit that appeals are undesirable in the arbitral context because they undermine the finality of the award and they increase costs and delays. From time immemorial, parties who have resorted to arbitration look for finality. In the investor-state context, this is inscribed in Article 53 of the ICSID Convention, which prohibits appeals of ICSID awards.[80] If appeals are allowed, I predict that there would be a tsunami of appeals by the losing parties. To convince oneself of this prediction, one needs only to focus on the number of annulment proceedings in the ICSID system.[81]

And then, I call in aid of my submission the well-known, age-old philosophical principle that "what is sauce for the goose is sauce for the gander." What about the additional delays and increased costs which will certainly be associated with appeals of arbitral awards, particularly if these appeals include issues of law and fact *de novo.*

Arbitration is a dispute resolution process for settling disputes definitively.

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79. *See*, *e.g.*, Andrea Sachs, *The Worst Supreme Court Decisions Since 1960*, TIME (Oct. 6, 2015), http://time.com/4056051/worst-supreme-court-decisions/ (detailing several accounts of criticism from law school professors on monumental U.S. Supreme Court decisions like *Roe v. Wade*, *Bush v. Gore*, and *Citizens United v. Federal Election Commission*).

80. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, art. 53, Mar. 5, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 (entered into force Oct. 14, 1966).

81. KAUFMANN-KOHLER & POTESTÀ, *supra* note 67, at 46–47.

Finality is not a bug of the system, but rather, in my estimation, one of its most attractive features. It is and should remain one of the hallmarks of arbitration. In the meantime, while critics of ISDS, often uninformed about the system, continue to vituperate and propose to do away with party-appointed arbitrators in favor of a standing body of judges, arbitration, "classic arbitration" as I call it, continues to prosper.

As I noted earlier, arbitral institutions such as the ICC, the LCIA, the American Arbitration Association, ICSID, and the Permanent Court of Arbitration are recording exponential growth in the number of arbitrations they facilitate and developing markets in Asia, such as Hong Kong and Singapore, and are asserting themselves as enthusiastic proponents of the Golden Summer. Yes, arbitration is truly booming in Asia. Hong Kong and Singapore are becoming the new London and Paris.

As some of arbitration's longstanding beneficiaries quarrel over how well it has served them, new players have rushed to embrace arbitration's advantages.[82] Developing markets in Asia present auspicious opportunities for the arbitration community, and turmoil in other parts of the world legitimizes the need for impartial international dispute resolution.

I will now review briefly how Hong Kong and Singapore have bolstered arbitration in Asia, the opportunities presented by China's entrance into the wider arbitration community, and how increasingly unstable domestic politics make arbitration more relevant and necessary than ever. Hong Kong has hosted arbitrations since 1985.[83] The Hong Kong International Arbitration Centre ("HKIAC") received 521 new cases in 2018 and the disputing parties came from thirty-nine jurisdictions.[84] More than forty percent of them had no connection to Hong Kong; 5.2 percent of them had no connection to Asia.[85]

Singapore, in recent years, has made a state-assisted, concerted effort to assert itself as a world-renowned capital for international dispute resolution. It has a world-class arbitration center and a growing caseload. While the Singapore International Arbitration Centre ("SIAC") has been in operation

82. *See* Ross, *Winter Is Coming*, *supra* note 26, at 10 (discussing how countries like Singapore and China are making strides in the "establishment of new international commercial courts").

83. *At a Glance*, H.K. INT'L ARB. CTR., https://www.hkiac.org/about-us (last visited Nov. 28, 2020).

84. *Statistics*, H.K. INT'L ARB. CTR., https://www.hkiac.org/about-us/statistics (last visited Nov. 28, 2020).

85. H.K. INT'L ARBITRATION CTR., ANNUAL REPORT: 2017 REFLECTIONS 9 (2017) https://www.hkiac.org/sites/default/files/annual_report/2017%20HKIAC%20Annual%20Report%203469-5010-8172%20v.1.pdf.

since 1991, its caseload has seen exponential growth in the twenty-first century.[86] The SIAC handled ninety cases in 2006.[87] Ten years later, it handled 343.[88] Singapore has been named as the ICC's top arbitral seat in Asia eight times in recent years.[89]

Singapore offers disputing parties a comprehensive regime for dispute resolution. In addition to the SIAC, Singapore is home to an equivalent institution for mediation: the Singapore International Mediation Centre.[90] In 2015, Singapore established a separate division of its High Court for international commercial disputes, the Singapore International Commercial Court ("SICC").[91] The latest addition to Singapore's panoply of dispute resolution options is the ICC's new case management office in Maxwell Chambers.[92] Notably, these institutions do not compete against one another.[93] As the SICC has explained:

> The SICC serves as a companion rather than a competitor to arbitration as it seeks to provide parties in transnational business with one more option among a suite of viable alternatives to resolve transnational commercial disputes. It enhances Singapore's share of the global legal services pie without compromising Singapore's success as a seat of international arbitration as well as the international recognition and acclaim enjoyed by the Singapore International Arbitration Centre (SIAC).[94]

Statistics suggest a mutually supportive relationship between Singapore's various institutions. Since the SICC's establishment, the SIAC's caseload has grown at a most impressive rate. In both 2017 and 2018, SIAC was the

86. *About Us*, SING. INT'L ARB. CTR., https://www.siac.org.sg/2014-11-03-13-33-43/about-us (last visited Nov. 28, 2020).

87. *Statistics*, SING. INT'L ARB. CTR., http://siac.org.sg/2014-11-03-13-33-43/facts-figures/statistics (last visited Nov. 28, 2020).

88. *Id.*

89. *ICC Court Case Management Team Begins Operations in Singapore*, INT'L CHAMBER OF COMMERCE (Apr. 23, 2018), https://iccwbo.org/media-wall/news-speeches/icc-court-case-management-team-begins-operations-singapore/.

90. Lucy Reed, *International Dispute Resolution Courts: Retreat or Advance?*, 4 MCGILL J. DISP. RESOL. 129, 140 (2017–2018).

91. *Id.* at 132.

92. INT'L CHAMBER OF COMMERCE, *supra* note 89.

93. *See* Reed, *supra* note 90, at 140 (discussing the establishment of the SICC in Singapore); *see also Establishment of the SICC*, SING. INT'L COM. CT., https://www.sicc.gov.sg/about-the-sicc/establishment-of-the-sicc (last updated May 2, 2019) [hereinafter SICC, *Establishment*] (stating the SICC is more of a "companion" than "competitor" to arbitration).

94. SICC, *Establishment*, *supra* note 93.

venue for more than 400 new cases.[95] There were 271 new cases in 2015.[96] In 2018, the disputing parties came from sixty-five different jurisdictions, and so on. [97] Yes, "classic arbitration" continues to enjoy the Golden Summer.[98]

This coexistence of fora and methodologies is characteristic of arbitration and an element in its success. Arbitration does not have, and has never aspired to have, a monopoly of resolving disputes. It is and has always been available as a proven option for parties who seek to avail themselves of arbitration's recognized advantages. Disputes can be complex, and the parties' needs are multi-dimensional. A range of dispute resolution options ensures that diverse issues and parties are served appropriately. As statistics for Hong Kong and Singapore demonstrate, many parties continue to prefer arbitration, even when other options are available.

And, what about China? Will it become a new frontier? Some indicia suggest that it is poised to become increasingly involved in the arbitration bandwagon. In 2017, the China International Economic and Trade Arbitration Commission ("CIETAC") published new rules for investor-state arbitration.[99] The alternative venues for arbitrations subject to these rules are the CIETAC Investment Dispute Settlement Centre ("IDSC") in Beijing, or, if the parties expressly agree, in Hong Kong ("CIETAC HK").[100] This is an encouraging development.

China's openness to arbitration is connected to its massive One Belt One Road ("OBOR") initiative which has generated, and will continue to generate, a significant number of arbitral proceedings.[101] The OBOR Arbitration Centre created by the Wuhan Arbitration Commission has already heard several disputes arising from OBOR projects.[102]

China has announced that it intends to set up an international court for

95. SING. INT'L ARBITRATION CTR., ANNUAL REPORT 2018 14 (2018); SING. INT'L ARBITRATION CTR., ANNUAL REPORT 2017 11 (2017).

96. ANNUAL REPORT 2018, *supra* note 95, at 15; ANNUAL REPORT 2017, *supra* note 95, at 13.

97. ANNUAL REPORT 2018, *supra* note 95, at 17.

98. *See* SING. INT'L ARBITRATION CTR., ANNUAL REPORT 2015 14 (2015) (tabulating the number of new cases per nationality in 2015).

99. Keith M. Brandt & Michael K.H. Kan, *China*, 9 INT'L ARBITRATION REV. 121, 123 (2018).

100. *Id.* at 124.

101. *See How China Will Change the International Arbitration Field*, COLUM. L. SCH. (Feb. 27, 2018), https://www.law.columbia.edu/news/archive/how-china-will-change-international-arbitration-field [hereinafter *How China Will Change*].

102. *See* Brandt & Kan, *supra* note 99, at 124.

OBOR disputes.[103] While the Court has not yet materialized, the gigantic infrastructure facets of the OBOR project will certainly engender disputes which would be amenable to arbitration.[104] How will non-Chinese parties react to a court overseen by the Chinese state?[105] I predict that arbitration will be preferred to a Chinese court. But, either way, China's emergence as a fledging participant in investor-state dispute resolution is another encouraging development for the international arbitration community.

Before I conclude, allow me to touch briefly on recent geopolitical developments which, I submit, are either arbitration neutral or arbitration boosting. It is trite to note that some governments are becoming increasingly hostile to foreign trade. Tariffs, as you know well in this country, have been increasingly used as economic weapons of mass destruction. Perhaps counterintuitively, however, these ominous developments point to the continued relevance on, and need for, arbitration. As some governments are overtaken by political parties and leaders guided by autarkic policy agendas, the prospect of litigating in domestic courts is becoming less appealing.[106]

I note that many domestic political developments, such as Brexit in the United Kingdom, or the continuing trade dispute between the United States and China, that impact relations between countries and give ulcers to the business community, do not have any effect on arbitration. Despite the negative impact, Brexit, whether it is hard or soft, will almost certainly have an impact on London as a financial center, and it is clear that it is unlikely to impact London as one of the most popular venues for arbitrations. Brexit will not change the United Kingdom's commitment to the New York Convention, the 1996 English Arbitration Act, or English common law that is arbitration-friendly.[107] Nor has it fundamentally altered "the conditions that make London central to arbitration," such as the English language and the city's wealth of legal talent.[108] After a hard or a soft Brexit, London may well benefit from a greater perception of neutrality in disputes involving member states of the EU. The European Court of Justice ("ECJ") decisions

103. *Id.* at 121.

104. *How China Will Change*, *supra* note 101.

105. *See* Brandt & Kan, *supra* note 99, at 125 (noting international participants' concerns with the validity of a court operating under Chinese jurisdiction).

106. *How China Will Change*, *supra* note 101.

107. Joe Liu, *Keep Calm and Arbitrate? The Impact of Political Events on International Arbitration*, WOLTERS KLUWER: KLUWER ARBITRATION BLOG (Oct. 11, 2017), http://arbitrationblog.kluwerarbitration.com/2017/10/11/keep-calm-arbitrate-impact-political-events-international-arbitration/.

108. *How China Will Change*, *supra* note 101.

criticizing arbitration may well drown in the English Channel.[109]

Undoubtedly, however, governments seeking to undermine arbitration can do so particularly with respect to investor-state arbitration. President Trump has taken, early in his tenure, decisions that have impacted negatively the recourse to arbitration. I refer, notably, to the United States' withdrawal from the Trans-Pacific Partnership and repeal of the investor-dispute settlement provisions in the North American Free Trade Agreement ("NAFTA") in its renegotiated version, the new United States-Mexico-Canada Agreement ("USMCA").[110] But the United States remains a pro-arbitration jurisdiction, where disputing parties have an embarrassment of riches which facilitate domestic and international arbitration, and where arbitral awards are easily enforced.[111]

IV. CONCLUSION

Yes, arbitration has been challenged in recent years. Intra-EU investor-state arbitration with *Slovak Republic v. Achmea B.V.*,[112] and other decisions have been boxed against the ropes, but intra-European commercial arbitration is flourishing. To my knowledge, all objections to jurisdictions

109. *See* Liu, *supra* note 107; *see also* Opinion 2/15, EU-Singapore Free Trade Agreement, 2017 EUR-Lex CELEX 62015CV0002(01) (May 16, 2017) (stating that ISDS is a shared competence, with the CETA being declared a mixed agreement to be ratified by the EU and its Member States); Opinion 1/17, EU-Canada CET Agreement, 2019 EUR-Lex CELEX 62017CV0001(02) (Apr. 30, 2019) (confirming the compatibility of EU law and the Investor Court System, to be established as part of the CETA); Case C-284/16, Slovak Republic v. Achmea B.V., 2018 E.C.R. 158 (ruling that the arbitration clause in the 1991 Netherlands-Slovakia bilateral investment treaty is incompatible with EU law due to the adverse effect on the EU's autonomy); Joined Cases T-694/15, T-694/15 & T-704/15, Micula v. Comm'n, 2019 E.C.R. 423 (ruling that the European Commission is precluded from applying EU State aid rules to pre-accession periods).

110. *See How China Will Change*, *supra* note 101.

111. *See*, *e.g.*, *The US Supreme Court Confirms the United States is a Pro-Arbitration Jurisdiction*, DENTONS (Jan. 28, 2019), https://www.dentons.com/en/insights/alerts/2019/january/28/the-us-supreme-court-confirms-the-united-states-is-a-pro-arbitration-jurisdiction (explaining how the United States is a pro-arbitration state because the arbitration clause "delegates the decision of arbitrability to the arbitrators" and not the courts); *see also* Eric Tuchmann, *In an Unruly World, International Arbitration Offers a Safe Haven for Business Disputes*, CORP. COUNS. BUS. J. (Sept. 6, 2018), https://ccbjournal.com/articles/unruly-world-international-arbitration-offers-safe-haven-business-disputes (detailing the benefits of arbitration in resolving conflicts in international businesses transactions, particularly with rising geopolitical volatility and uncertainty).

112. Slovak Republic v. Achmea B.V., 2018 E.C.R. 158 (holding that bilateral investment treaties between EU member states, such as the 1991 Netherlands-Slovakia BIT, were potentially incompatible with EU law because they permitted investors and EU member states to establish alternative dispute resolution mechanisms).

relying on *Achmea* have been rejected. As Eric Tuchmann wrote recently, "[i]n an unruly world, international arbitration offers a safe haven for business disputes."[113] The Golden Summer is going to continue and prosper. Those of us who are dedicated members of this noble profession — because, yes, arbitration is a profession — need to stand up and proclaim loudly and clearly its benefits and advantages.

Brexit, President Trump, and decisions of the ECJ are unlikely to seriously stifle arbitration. Any perception that certain jurisdictions are unfriendly to foreign businesses will simply encourage those businesses to take their capital elsewhere or to avoid domestic courts and seek out neutral fora where they can settle disputes with the assistance of impartial and skilled facilitators.

Global capitalism is dynamic and relentless. International trade and investment will continue to flourish despite attempts to restrain it.[114] Businesses and entrepreneurs will find the best places to invest, a calculation that includes the ability to protect their investment. Arbitration has long been the safe haven for businesses confronted with international disputes, and I predict that its supporters will continue to seek out the advantages it offers over litigation.[115]

Arbitration's success is not circumstantial. Its popularity has grown despite the criticism it faces because it is a proven and effective method for settling complex disputes that do not lend themselves well to adjudication in domestic courts. Arbitration is successful precisely because it is not like litigation. Given its track record for success, as well as increasing uncertainties and risks on our fragile planet, arbitration's Golden Summer should continue. To ensure the continued future success of arbitration, we need not engage in reforms that could compromise its classic and characteristic strengths. As you may have guessed by now, I come to my conclusion by returning to my opening foray in colas.

Trying to make arbitration more like litigation is tantamount to making Coca-Cola taste like Pepsi. Some people will always prefer Pepsi to Coca-Cola, and that is just fine. People who prefer Pepsi can buy Pepsi. Pepsi is a successful product, and Pepsi is a very successful company. Pepsi, in some ways, is a more successful company than Coca-Cola.[116] However, Pepsi is

113. Tuchmann, *supra* note 111.

114. Liu, *supra* note 107.

115. Tuchmann, *supra* note 111.

116. Paul R. La Monica, *Pepsi Beats Coke Thanks to Junk Food*, CNN BUSINESS (Sept. 29, 2016, 10:31 AM), https://money.cnn.com/2016/09/29/investing/pepsi-coke-earnings-stock/index.html.

a more successful business because it does more than sell beverages; it owns Frito-Lay, which is responsible for forty percent of its profits.[117] Coca-Cola doesn't sell chips. Coca-Cola sells beverages; in particular, Coca-Cola sells soft drinks. The most popular soft drink in the world is Coca-Cola.[118] The second most popular is Diet Coca-Cola.[119] Pepsi may be better than Coca-Cola at certain things, but no one is better at making and selling cola than Coca-Cola.

Like Coca-Cola, the arbitration community should not try to replicate its competitors' products. People who want to go to court can go to court. The people whom the arbitration community serves do not want to go to court. As Gary Born has pointed out, as my friend Charles Brower has said forcefully, and as I have stressed tonight, for millennia, many people have preferred arbitration to litigation.[120] Disputing parties prefer arbitration not because it is almost like litigation, but because arbitration is different from litigation and all the better for that difference. Litigation may be preferable to arbitration for certain litigants. But arbitration should not sacrifice what it does well in order to replicate features of litigation that do not make sense in the world of arbitration.

People who want arbitration to be like litigation do not want arbitration. People who like arbitration do not want it to be like litigation. So why would we, members of the worldwide arbitration community, impose changes on the people who like what we do, for the sake of people who will never like what we do? Like Coca-Cola, we have happy and loyal customers who like our product. Let us not sell them imitation Pepsi in Coca-Cola bottles.

To the "New Coca-Cola" proponents of international dispute resolution, I say: you may be able to persuade some people that they prefer a product with a different flavor based on a mere taste test. But novelty grows old and soon tastes stale. After a while, people will not want a product that is trying to be something else. They will want the qualities and advantages that brought them to arbitration in the first place.

Coca-Cola won the Cola Wars because it stopped trying to be Pepsi. Through its "New Coca-Cola" misadventure, Coca-Cola learned what its real strengths were. Wisely, it went back to playing to those strengths instead of its competitor's. Arbitration will win the dispute resolution *Game of Thrones* if it does the same. Like Coca-Cola, when it comes to cross-border dispute

117. *Id.*

118. *See* Yglesias, *supra* note 4 (inferring Coca-Cola's dominant market position reflects its popularity among consumers).

119. *Id.*

120. Ross, *Winter Is Coming*, *supra* note 26.

resolution, "You Can't Beat the Real Thing."[121]

121. *See* THE COCA-COLA COMPANY, *supra* note 6 (1990 slogan).

* * *

WHY CHOOSE LTAS? AN EMPIRICAL STUDY OF OHIO MANUFACTURERS' CONTRACTUAL CHOICES THROUGH A BARGAINING LENS

JULIET P. KOSTRITSKY*

JESSICA ICE**

This Article contributes to recent scholarship regarding Long Term Agreements ("LTAs") by providing empirical evidence that suppliers are more likely to undertake the costs of an LTA if the transaction requires significant capital expenditures or the potential for large sunk costs. Through a survey of a random group of sixty-three Ohio manufacturers, the Article explores why manufacturers with a full range of contractual and non-contractual solutions might choose one set of arrangements over others.[1] It then seeks to link its findings to a broader theory of how parties bargain to solve durable problems under conditions of uncertainty, sunk costs, and opportunism, while minimizing costs. Although only a small portion (seventeen percent) of our sample size indicated that they used LTAs in the majority of their transactions, this group indicated they were more likely to produce customizable goods and have significant capital expenditures. Such a finding is consistent with a model of bargaining in which parties in a transaction seek to achieve their overall goals of wealth maximization while minimizing costs under conditions that include bounded rationality, sunk costs, and

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1. Based on the comments provided by respondents, most survey participants seemed to be suppliers to buyers.

opportunism. If a product is customized for a particular buyer, and the supplier invests sunk costs toward customization, that investment makes it difficult and costly to exit the relationship or resell to others. Where such vulnerabilities exist, the need for protection may justify the costs of LTAs. The non-adoption of LTAs by some suppliers demonstrates that the new organizational form of networked firms, governed by an LTA and straddling markets and hierarchies, has not captured all of manufacturing and reflects a diversity of arrangement.[2] *The non-adoption of LTAs may be one way suppliers respond to the stresses and frictions of the new architecture of supplier relations. Those stresses show that the new organizational paradigm is not static and suffers from the same hazards as an exchange relation. The willingness of suppliers to adopt an LTA when facing large sunk costs shows the continuing importance of sunk costs in institutional decision making and offers an additional reason beyond the need to collaborate under conditions of uncertainty to explain why parties adopt LTAs.*[3] *The other type of risks — opportunism and vulnerability from investing large resources — may be best handled by entering into an LTA because it offers security, including implicit protections needed for the supplier to invest. The switching costs that lock parties into a mutual dependency and protect parties who have invested comes gradually, but without the LTA, the supplier would be reluctant to undertake the initial investment.*

The importance of sunk costs may also explain the choice of buyers to operate under an LTA. Since many of the benefits of LTAs, including information sharing, could be achieved by buyers hierarchically and imposed on suppliers, the explanation for adopting LTAs may lie with the need to collaborate under conditions of uncertainty and the benefits in terms of added value derived from "managerial contracting" practices,[4]

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2. *See* Charles F. Sabel, *A Real-Time Revolution in Routines*, *in* THE FIRM AS A COLLABORATIVE COMMUNITY: RECONSTRUCTING TRUST IN THE KNOWLEDGE ECONOMY 107 (Charles Heckscher & Paul S. Adler eds., 2006) [hereinafter Sabel, *Real-Time Revolution*] (discussing an "organizational revolution" distinct from the Chandlerian revolution of vertically integrated bureaucratic firms). The new ways of organizing follow from new ways of producing goods. JOSH WHITFORD, THE NEW OLD ECONOMY: NETWORKS, INSTITUTIONS, AND THE ORGANIZATIONAL TRANSFORMATION OF AMERICAN MANUFACTURING 16–17 (2005) (discussing the "new production paradigm"). There are other ways that supplier firms might respond to the stresses in the supply chain other than by opting out of an LTA. They might decide to refuse to engage in joint design with an Original Equipment Manufacturer ("OEM") and instead furnish that OEM only with older technology that is already patented. That protects the supplier against the OEM licensing a supplier's intellectual property to others. The strategy might be described as "patent the heck out of it" before working with an OEM. *See also* Interview with [Redacted], in [Redacted]. (Aug. 8, 2018) (confidential source on file with author).

3. Sunk costs may also play a role in the willingness of large buyers, such as OEMs, to adopt LTAs.

4. Lisa Bernstein & Brad Peterson, Managerial Contracting: A Preliminary Study 1 (May 18, 2020) (unpublished manuscript) (on file with author) (defining "managerial provisions" and discussing the significance of such terms to contracting relationships and

but with the need to protect large investments through the security offered by an LTA. Thus, there are two functions of LTAs: (1) how-to provisions to guide and improve production; and (2) provisions offering security of a continuing commitment either through express provisions or implicit protections. This Article suggests that although information-sharing protocols serve to "institutionalize learning,"[5] help parties when there is an "inability" to know how to solve a production problem, and offer more information to informally enforce new types of behavior that are non-compliant, these benefits might occur by means other than an LTA. For example, a quality manual may impose a quality assessment be done by the buyer at the supplier's plant. Alternate means of obtaining the information outside of an LTA raise the question of why LTAs are adopted.

productivity).

5. Matthew C. Jennejohn, *Collaboration, Innovation, and Contract Design*, 14 STAN. J.L. BUS. & FIN. 83, 88 (2008) [hereinafter Jennejohn, *Collaboration*]; *see also* Susan Helper et al., *Pragmatic Collaborations: Advancing Knowledge While Controlling Opportunism*, 9 INDUS. & CORP. CHANGE 443, 468 (2000) (observing that collaborative firms inherently develop routines for evaluating and improving current processes).

I. INTRODUCTION

Recent scholarship identified modern Long Term Agreements ("LTAs"),[6] including information-sharing protocols, as "novel" governance structures for innovative and collaborative ventures.[7] Such scholarship hypothesized that LTAs' information-sharing provisions facilitate informal enforcement and help "endogenize" trust in heterogeneous relationships in the innovation sphere where none previously existed.[8] Other scholarship focused on how contract provisions "institutionalize learning," thereby "fostering innovation"[9] and "establish[ing] processes of interorganizational cooperation."[10] These functions are broadly useful for buyers. Professor Bernstein says that they are "designed to keep the law . . . out."[11] But the LTA fulfills a variety of functions including giving the Original Equipment Manufacturer ("OEM") the option to buy combined with some legal protections such as unilateral termination rights, warranty, and IP protections. How buyers structure these hybrid arrangements depends on how the arrangement of provisions and informal enforcement, facilitated by the information-sharing function, operate to achieve the buyers' varied goals, including maximizing profits. Many of the agreements studied by scholars, such as the OEM agreement, are drafted by the buyer.[12]

In order to answer the comparative question of *why suppliers choose an*

6. These agreements are sometimes referred to as Master Supply Agreements or MSAs.

7. Jennejohn, *Collaboration*, *supra* note 5, at 83.

8. *See* Ronald J. Gilson et al., *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377, 1404 (2010) [hereinafter Gilson et al., *Braiding*] ("[Parties] write contracts in which they manifestly intend to establish a deeply collaborative relation, where little or none existed before, through a combination of formal and informal elements.").

9. Jennejohn, *Collaboration*, *supra* note 5, at 88–89.

10. John P. Esser, *Institutionalizing Industry: The Changing Forms of Contract*, 21 LAW & SOC. INQUIRY 593, 625 (1996).

11. Lisa Bernstein, *Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts*, 7 J. LEGAL ANALYSIS 561, 562 (2015) [hereinafter Bernstein, *Beyond Relational Contracts*]. But many provisions in LTAs deal with warranties and indemnities, provisions that are relevant only when there is resort to legal remedies. Thus, the effort to "keep the law" out remains partial.

12. Omri Ben-Shahar & James J. White, *Boilerplate and Economic Power in Auto Manufacturing Contracts*, 104 MICH. L. REV. 953, 954, 957 (2006).

LTA in only some cases, the research team for this Article decided that instead of studying existing LTAs and hypothesizing what functions they could serve, it would survey a random group of Ohio manufacturers to see what kind of arrangements they used to govern their transactions. Through such a survey, together with qualitative interviews of firms,[13] the research team hoped to learn why, with a full range of contractual and non-contractual solutions, suppliers might choose one set of arrangements over another. Empirical data gathered in this way might support the idea that parties choose their arrangements in a discriminating way to control contractual hazards while minimizing costs.[14]

This Article first outlines the current view of LTAs within innovation scholarship and provides an overview of contractual and organizational choices under the increased de-verticalization of firms. The Article then outlines the current gap in the literature related to understanding LTA usage from the supplier's perspective. To address this gap, the Article outlines its empirical analysis of supplier perspectives through a survey of Ohio manufacturers. Finally, the Article links its findings to a broader theory of how parties bargain to solve durable problems under conditions of uncertainty, sunk costs, and opportunism, while minimizing costs.[15]

Ultimately our research suggests that the choices that parties make about whether to enter into an LTA or not are driven by the same kinds of factors that affect whether parties use modularity, "learning by monitoring," or

13. Our research did not specifically study other arrangements beyond the choice of using an LTA or not using one. There are other non-contractual choices (corporate ones). A buyer could decide not to buy externally from a separate firm but rather to organize the supplier into a separate subsidiary. The buyer might be particularly likely to choose that corporate arrangement if the part needed presented a high risk for the buyer if the part malfunctioned. By cabining the parts supplier into a separate subsidiary, the parent could oversee the operation but could also secure a large insurance policy to cover any risk if the part malfunctioned. The parent would be careful not to exercise control, but only oversight, in order to avoid veil piercing. If the company can organize in that manner and get an insurance policy to cover the risk, there may be no need for an LTA. Because these decisions are made internally, and companies weigh the risks without an LTA against the protection offered by an LTA, it might be hard to study the decision making. However, the same process of cost minimization to control durable problems is at play. In some instances, the choice results in a subsidiary furnishing a part rather than the company securing an external supplier via an LTA.

14. *See* OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE 114 (1996) [hereinafter WILLIAMSON, MECHANISMS]. The drive to control contractual hazards — when sunk costs exist — in a cost-minimizing way was identified by Oliver Williamson as a crucial factor leading to the fundamental transformation of exchange relationships. That drive helps to explain the governance choices parties make, including whether to vertically integrate and how to structure buy transactions with external firms.

15. *See generally* Juliet P. Kostritsky, *A Bargaining Dynamic Transaction Cost Approach to Understanding Framework Contracts*, 68 AM. U. L. REV. 1621 (2019) (discussing durable problems explaining variety of supply chain arrangements).

hedging. The contractual choice will affect the economics of the exchange and the same lens should be used to analyze all of these choices. How to achieve the parties' goals at the least cost, while minimizing contractual hazards, including opportunism,[16] will drive all of these choices. This Article sees LTAs as serving both to streamline production and to constrain opportunism by cementing relationships, offering specific protection in an option to buy at a fixed price, or through implicit protections that arise from LTAs in the form of switching costs.[17] Goals such as routinizing production and preventing mistakes can be achieved through "managerial contracting" provisions such as scorecards. However, those provisions could be imposed unilaterally through quality control manuals imposed by buyers on all suppliers or by an LTA.

II. LTAS WITHIN THE INNOVATION SCHOLARSHIP FRAMEWORK

Innovation scholars[18] explain LTAs as a rational contractual response to situations where it is difficult to reach a completely contingent contract to control production because of high uncertainty over the final product and the need to gain specialized knowledge held by external firms.[19] LTAs differ from the traditional contractual focus and contain many provisions that are not geared toward establishing a basis for a breach.[20] Instead, firms use such "managerial provisions" to provide detailed processes for production that can prevent mistakes and increase quality.[21]

This Article will first examine why many specific provisions exist in LTAs

16. *See* Bernstein & Peterson, *supra* note 4 (manuscript at 39) (explaining new agreements as reflecting a move away from "documents that focused primarily on the prevention of opportunism . . . to documents that devoted considerable attention to governing the contractual relationship . . . .").

17. *See* Gilson et al., *Braiding*, *supra* note 8, at 1383 (discussing "managerial" provisions as a way to control opportunism by suppliers). However, these provisions also have the potential to introduce opportunism by allowing buyers to take information from suppliers to get a lower price.

18. *See, e.g.*, *id.* (describing "contract for innovation"); Jennejohn, *Collaboration*, *supra* note 5, at 87 (detailing innovative contract mechanisms and methods).

19. *See* Gilson et al., *Braiding*, supra note 8, at 1382 (discussing confluence of uncertainty and need for expertise from external firms); *see also* Kostritsky, *supra* note 15, at 1631–32. If the product is certain in the innovation context, other uncertainties, such as uncertainty about a counterparty's behavior and his or her potential for opportunism, remain uncertain throughout all supply chain transactions. What other factors explain why the LTA prevails in some transactions but not others? This Article will offer an explanation based on sunk costs.

20. Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 562.

21. *See* Bernstein & Peterson, *supra* note 4 (manuscript at 3–5) (explaining that "managerial provisions" are enforced not through courts but through non-traditional mechanisms, such as "the threat of termination, the imposition of nonlegal sanctions, like reputational harm or reduced order size, or in some relationships, the buyer's right to withhold part of the price . . . when delivery is late or quality is below specifications").

and describe the benefits of successful production. It will later examine whether there are alternative ways of organizing production to achieve similar benefits and examine how the need to protect sunk costs explains why parties, such as suppliers, enter into LTAs. It will also suggest that the drive to control opportunism and shirking of various types explains a firm's choice to enter into an LTA. However, concerns about opportunism also explain a countertrend in the behavior of suppliers in their resistance to entering into LTAs or to offer less than full cooperation with the LTAs by parties subject to opportunism.

The LTAs provide many benefits to companies dealing with uncertainty as they may contain protocols to share information and develop routines.[22] These routines, developed in collaborative networks between buyers and suppliers, help to foster an "organizationally rooted trust-as-reliability."[23] This trust develops with the routines and diverges from the early concept of a different type of trust rooted in a willingness of "the parties to a network [to] agree to forego the right to pursue their own interests at the expense of others."[24] Sharing these routines allows buyers and suppliers to "generate novel alignments of interest [with suppliers] that render collaboration more feasible and more necessary."[25] The "input of others" becomes critical when buyers develop or improve products and enhance production.[26] Scholars of the new forms of production and organization have detailed how LTAs can facilitate simultaneous engineering and benchmarking,[27] improve quality in production, "establish a pragmatic learning process between collaborators,"[28] and "institutionalize learning."[29] These sharing protocols and collaboration can generate benefits that extend beyond improving production and can increase joint returns.[30] When weighed against quality

22. WHITFORD, *supra* note 2, at 98.

23. *Id.*

24. *Id.* at 98 (citing Walter Powell, *Neither Market Nor Hierarchy: Network Forms of Organization*, 12 RES. ORGANIZATIONAL BEHAV. 295, 303 (1990)).

25. *Id.* at 28.

26. *Id.* at 28–29.

27. *See* Gary Herrigel, *Emerging Strategies and Forms of Governance in High-Wage Component Manufacturing Regions*, 11 INDUSTRY & INNOVATION 45, 52, 66, 71 (2004) (observing the increasing difficulty and necessity for firms to benchmark and "keep abreast of and compare [their] own capacities to new developments" in the industry and new production economy).

28. Jennejohn, *Collaboration*, *supra* note 5, at 83.

29. *Id.* at 88 (noting that such contracts also result in a convergence of the parties' interests, which underscores a change in the contract away from risk allocation toward "align[ing] parties' divergent interests . . . .").

30. *See* WHITFORD, *supra* note 2, at 29 (quoting Helper et al., *supra* note 5, at 445) ("[O]nce the cooperative exploration of ambiguity begins, the returns to the partners from further joint discoveries are so great that it pays to keep cooperating.").

control through warranty enforcement, these production protocols are thought to be more effective ways "to better quality."[31] Thus, firms use industrial strategies to solve a problem: firms can no longer profitably acquire and maintain the required expertise in-house and need to collaborate to survive.[32] That strategy affects whether firms "make-or-buy" products needed in production.[33] Similarly, the strategy affects how firms are governed: internally by bureaucratic fiat, by contracts of varying types with external firms, or by some other mechanism.[34]

Where innovation requires both investment and collaboration, and investments may be asymmetric, information sharing in an LTA may foster informal enforcement by increasing transparency[35] and observability.[36] Professor Bernstein explains these LTAs as beneficial because "they create a space in which private order can flourish."[37] The iterative exchange of information and performance can deter opportunism and raise switching costs.[38] As each party learns about the other, the costs of finding a substitute

31. Bernstein & Peterson, *supra* note 4 (manuscript at 8) (quoting John L. Pence and P. Saacke, *A Survey of Companies that Demand Supply Quality*, 42 ANNUAL QUALITY CONGRESS (1988)) (discussing American Society for Quality Control study showing benefits of managerial-focused contracts over traditional contracts).

32. *See* Helper et al., *supra* note 5, at 445, 463; *see also* WHITFORD, *supra* note 2, at 98 (discussing the increasingly symbiotic relationship between OEMs and suppliers, enhancing "reliability" and "confidence").

33. *See* Ann P. Bartel et al., *Technological Change and the Make-or-Buy Decision*, 30 J.L. ECON & ORG. 165, 170 (2014) (observing that the fraction of firms that find outsourcing more profitable increases with pace of technological change); *see also* Robert Gibbons, *Firms (and Other Relationships)*, *in* THE TWENTY-FIRST-CENTURY FIRM: CHANGING ECONOMIC ORGANIZATION IN INTERNATIONAL PERSPECTIVE 186, 188 (Paul DiMaggio ed., 2001) (quoting Bruce Kogut et al., *The Make-or-Cooperate Decision in the Context of an Industry Network*, *in* NETWORKS AND ORGANIZATIONS 348–65 (Nitin Nohria & Robert G. Eccles eds., 1992)) (evaluating the "make-or-buy" decision in the context of "whether integration or non-integration facilitates the superior relational contract").

34. *See infra* Section VII.C ("Diversity of Arrangements").

35. *See* Jennejohn, *Collaboration*, *supra* note 5, at 87 (discussing how transparency "largely eliminates opportunism"); *see also* Helper et al., *supra* note 5, at 469–72 (explaining that pragmatic collaborations advance the collective knowledge of the parties and curb opportunism through the sharing of information).

36. Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 584 (observing that contracts, to maintain cooperation, often give parties rights to conduct a root cause analysis and monitor which "condition on information that in their absence would not be observable . . ." thereby allowing for more informal enforcement possibilities).

37. *Id.* at 561 (noting however, presumably private order can flourish without LTAs as parties engage in iterative investments and develop a relationship).

38. Gilson et al., *Braiding*, *supra* note 8, at 1382–84 (citing Ronald J. Gilson et al., *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431, 458–71, 448–51, 435, 486–89 (2009) [hereinafter Gilson et al., *Contracting for Innovation*]). For an earlier discussion of switching costs, see Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC.

supplier or buyer increases for unknown parties. "Switching costs" acts as a deterrent to early termination.[39]

III. SOURCING AND CONTRACTUAL CHOICES IN THE AGE OF DE-VERTICALIZATION: AN EVOLVING LANDSCAPE

In the last several decades, the large integrated firm has de-verticalized.[40] The pressure to cut costs, while keeping up with specialized expertise that is expensive to develop in-house, led large and complex firms to develop various types of arrangements with suppliers to source and organize production.[41] One scholar has described a "multiplicity" of suppliers "sourcing strategies."[42] The diversity of suppliers' arrangements responds to various pressures exerted by large and complex firms as buyers. Suppliers are struggling to respond to unpredictable and varying behavior by such buyers.[43]

A. Collaboration

One arrangement in this de-verticalized economy that has received a great deal of scholarly attention is the pragmatic collaborative arrangement between large buyers and suppliers who participate in "learning by monitoring."[44] To enhance quality and prevent costly errors on the production line, buyers require suppliers to participate in root cause analysis,[45] benchmarking,[46] and other routines to enhance quality.[47]

ASS'N. 55, 64 (1963). Of course, the iterative exchange of information may occur during a relationship between a buyer and supplier without an LTA. The parties can take small steps to accommodate another party and the other party may then respond in a kind of overture and response scenario. An LTA is not needed to accomplish this. Gilson et al., *Braiding*, *supra* note 8, at 1384.

39. Gilson et al., *Braiding*, *supra* note 8, at 1383 n.10 (quoting Gilson et al., *Contracting for Innovation*, *supra* note 38, at 435, 486–89).

40. *See, e.g.*, WHITFORD, *supra* note 2, at 18 (describing a "shift" in the production economy throughout the twenty-first century); Gillian K. Hadfield & Iva Bozovic, *Scaffolding: Using Formal Contracts to Support Informal Relations in Support of Innovation*, 2016 WIS. L. REV. 981, 985 (providing a list of some of the "pervasive uncertaint[ies]" in present-day innovation contacts); Gilson et al., *Contracting for Innovation*, *supra* note 38, at 438 ("[F]ear of hold-ups . . . no longer compels firms to vertically integrate."); Herrigel, *supra* note 27, at 55 (discussing OEMs' concerns in the "current environment of consistent vertical disintegration").

41. *See* Gilson et al., *Contracting for Innovation*, *supra* note 38, at 439–40.

42. Herrigel, *supra* note 27, at 46.

43. *See* WHITFORD, *supra* note 2, at 99.

44. *See* Gilson et al., *Contracting for Innovation*, *supra* note 38, at 435, 448.

45. John Paul MacDuffie, *The Road to Root Cause: Shop-Floor Problem-Solving at Three Auto Assembly Plants*, 43 MGMT. SCI. 479, 486 (1997).

46. *See* Herrigel, *supra* note 27, at 73–74.

47. WHITFORD, *supra* note 2, at 42, 98 (noting one of the key benefits of the routines

Companies who may be dealing with "radical uncertainty" characteristics, such as the biotechnology industry, may share information about a yet unknown product or drug.[48]

Often the parties enter into LTAs with information-sharing protocols and other provisions to encourage collaboration. Buyers and suppliers develop routines that allow buyers to learn from suppliers and coordinate in ways that facilitate collaboration.[49] Collaboration may be necessary for buyers because the cost of research and development for specialized expertise is too great, making collaboration a cheaper way of acquiring the needed expertise. Buyers and suppliers both benefit "from further joint discoveries" through collaboration and information sharing.[50] This collaboration and information sharing between buyers and suppliers constitutes, according to some scholars, a new "organizational revolution"[51] that stands between vertical integration and spot market transactions. Others have described these arrangements as "neither fully transactional nor fully relational."[52]

The sharing of information and new networks can occur in a variety of contexts. For example, information sharing can occur when there is uncertainty about what will be invented, as in the biotechnology industry, or when there is uncertainty about emerging improvements, as in traditional manufacturing industries. The information sharing takes the form of simultaneous engineering, benchmarking, root cause analysis, and routines all designed to improve the quality of the final product through incremental improvements.[53] The decision to share information, in the innovation or industrial sector in a rapidly changing world with intense competition, might suggest that this networked approach with information-sharing protocols is the "key to survival"[54] and that companies will converge on this path and

for information sharing and collaboration ideally leads to "jointly question" the production process and that questioning both disrupts and leads to improvements); Sabel, *Real-Time Revolution*, *supra* note 2, at 107 ("[P]ermanent uprising against habit . . . [a] key to survival in an otherwise unmanageably turbulent world."); *see also* Jennejohn, *Collaboration*, *supra* note 5, at 101; Helper et al., *supra* note 5, at 472 (stating that disruptions can change "static procedures" and thus lead to improvement).

48. *See* WHITFORD, *supra* note 2, at 28.

49. Helper et al., *supra* note 5, at 445 ("[The] pragmatic mechanisms . . . create and maintain the conditions under which two or more firms can sustain collaboration.").

50. *Id.*

51. WHITFORD, *supra* note 2, at 99, 100.

52. Bernstein & Peterson, *supra* note 4 (manuscript at 1).

53. *See* Gilson et al., *Contracting for Innovation*, *supra* note 38, at 449 ("[W]hat we see emerging [is] . . . continuous improvement in product development and engineering."); *see also id.* at 438 ("[F]ear of hold-ups . . . no longer compels firms to vertically integrate.").

54. Sabel, *Real-Time Revolution, supra* note 2, at 107.

become locked into this approach.[55]

B. Modularization

Of course, there are other ways to source production. Some suppliers become large tier mega suppliers who collaborate in the way described above. Sometimes OEM buyers pursue a modularization strategy with large suppliers of "discrete subsystems or functional modules (example in an automobile: front end, cockpit, drive train, common chassis platforms, etc.)."[56] Modularity, by reducing the need for coordination and collaboration,[57] could reduce costs. However, modularization, at least in the automobile industry, has proven to be less successful as a sourcing strategy than originally anticipated.[58] Because automobiles are necessarily integrated with one system affecting another, "to a degree that renders their separate design almost impossible without sacrificing performance,"[59] modularization "along the lines of black-box contract manufacturing is a difficult proposition."[60]

The adoption and then decline of modularization and the partial adoption and failures in networks (particularly the hedging by suppliers in response to opportunistic behavior by OEMs and the institutional blockages that hinder buyers from fully collaborating),[61] demonstrate that organizational choices, are not static. Instead, organizational choices are contextual and driven by the economics of the exchange, including all of the transaction costs. Such organizational choices include whether to operate by a network, whether and how much to collaborate or withhold information, whether to adopt modularization as a sourcing strategy, or whether to resort to a discrete market transaction. The choices about how much knowledge to retain in-

55. However, collaborative networking and the "forced openness of joint design and learning by monitoring" is not necessarily the last stage of organizational development as the collaboration itself is subject to failure for a number of reasons including "factional conflicts" in firms that undermine the collaborative strategies themselves and by opportunism in the form of misusing information. WHITFORD, *supra* note 2, at 99.

56. *Id.* at 61 (quoting Gary Herrigel & Wittke Volker, *Varieties of Vertical Disintegration: The Global Trend Toward Heterogeneous Supply Relations and the Reproduction of Difference in US and German Manufacturing*, *in* NATIONAL BUSINESS SYSTEMS IN THE NEW GLOBAL CONTEXT 47 (Richard Whitley et al. eds., 2004)).

57. Jennejohn, *Collaboration*, *supra* note 5, at 142 (quoting Henry Smith, *Modularity in Contracts: Boilerplate and Information Flow*, 104 MICH. L. REV. 1175, 1177 (2006)).

58. *See* Francois Fourcade & Christophe Midler, *Modularisation in the Auto Industry: Can Manufacturer's Architectural Strategies Meet Supplier's Sustainable Profit Trajectories?*, 4 INT'L J. AUTOMOTIVE TECH. & MGMT. 240, 241 (2004).

59. WHITFORD, *supra* note 2, at 62 (quoting Herrigel, *supra* note 27, at 49).

60. *Id.*

61. *Id.* at 99.

house may respond to a need by buyers to gauge how well the suppliers are performing.[62]

The choice to organize production by sharing routines in a collaborative network or to choose another way of sourcing production, such as modularization, is context-dependent. There is not one organizational solution to the problems that parties face. That same diversity of arrangements extends not only to the type of supply arrangement for sourcing production, but also to the choice of whether to formalize those routines in an LTA or opt-out. These are all rational responses by buyers and suppliers to the particular circumstances in product development and sale, to the risks of failure, to the dangers of opportunism in settings of low or high asset specificity, and to the tradeoffs that each party is making to those risks and returns.

C. Opportunism and Sunk Costs

Empirical work by Professor Josh Whitford shows that the success of these federated collaborations between buyers and suppliers is only "partial."[63] OEM buyers remain "deeply cautious about genuinely relying on supplier firms,"[64] and suppliers react to opportunistic behavior by OEM buyers by hedging and withholding information, thereby reducing joint returns.[65] The choice of whether and how to organize production, whether to vertically integrate, operate by discrete market transactions or to form collaborative information networks and how fully to cooperate within these networks, is affected by transaction costs and the fear of holdup. For example, owners may vertically integrate to solve the holdup problem.[66] A major driver of vertical integration is profit capture. A company vertically integrating decides to capture the profit that the supply company would otherwise accrue to the supplier's shareholders.[67] Vertical integration may also be done to deny competitive access from a supplier to another large OEM. Or a company may decide to produce, and not buy, because of the cost of

62. *Id.* at 62–63 (noting the importance of knowledge retention to "evaluate the performance of suppliers").

63. *See id.* at 100 (disputing Sabel's description of the new collaborative networks as "an inescapable organizational revolution" by noting it "remains altogether partial").

64. *Id.* at 31.

65. *Id.* at 100 (discussing suppliers' strategy of hedging to withhold information and investment in response to "OEM unreliability").

66. WILLIAMSON, MECHANISMS, *supra* note 14, at 16; *see also* Jennejohn, *Collaboration*, *supra* note 5, at 84–85.

67. *See generally* Anne Sraders, *What Is Vertical Integration and What Are the Benefits?*, THE STREET (Aug. 17, 2018), https://www.thestreet.com/markets/what-is-vertical-integration-and-what-are-the-benefits-14671684 (detailing the benefits of vertical integration).

transmitting to suppliers the knowledge of what is needed ("tacit knowledge") makes it easier and cheaper to produce the goods.[68]

The economics of exchange, profit, minimizing frictions, and transaction costs underlie organizational decisions about where the boundaries of the firm should lie. Those same economic considerations drive the coordination mechanisms adopted by OEM buyers to streamline the production process, promote innovation, and expand the reach of informal non-contractual relations. These coordination mechanisms decrease the importance for delineating performance obligations under constant adjustment. The drive to economize on transaction costs will affect other decisions made by suppliers who will be subject to the same profit driver from the economic exchange.

Operating by network and sharing information with a supplier governed by an LTA "creates an information symmetricizing machine in which actors must keep one another abreast of their intentions and capacities."[69] The sharing of information also helps to curb opportunism as it raises switching costs for both parties in the supply chain. A "virtuous circle" may result in which parties learn more about each other's "reliability" and "competence,"[70] which reinforces collaboration. These information-sharing protocols are consistent with "Macaulay's definition of contracts as 'devices for conducting exchanges.'"[71]

The choices of contractual form, decisions about structure, the inclusion of detailed protocols, and cooperation during the relationship may also respond to behavioral proclivities to opportunism of one's collaborating partner and changes in the relationship, such as the misuse of information by the buyer.[72] The context affects how fully one party cooperates and those risks may also affect the decision to opt into or out of an LTA. Breakdowns may also occur due to "factional conflicts"[73] within an organization of buyers that hinder collaboration and increase uncertainty for suppliers. The withholding of information or hedging by the supplier represents a private

68. John Paul MacDuffie & Susan Helper, *Creating Lean Suppliers: Diffusing Lean Production Through the Supply Chain*, 39 CAL. MGMT. REV. 118, 120 (1997) ("Extensive tacit knowledge can develop in the supplier-customer relationship, facilitating coordination of the respective expertise of the parties, particularly with respect to complex value-added tasks such as product development.").

69. Helper et al., *supra* note 5, at 472.

70. WHITFORD, *supra* note 2, at 99, 111.

71. David Campbell, *What Do We Mean by the Non-Use of Contract?*, *in* REVISITING THE CONTRACTS SCHOLARSHIP OF STEWART MACAULAY ON THE EMPIRICAL AND THE LYRICAL 159, 166 (Jean Braucher et al. eds., 2013).

72. WHITFORD, *supra* note 2, at 103.

73. *Id.* at 99.

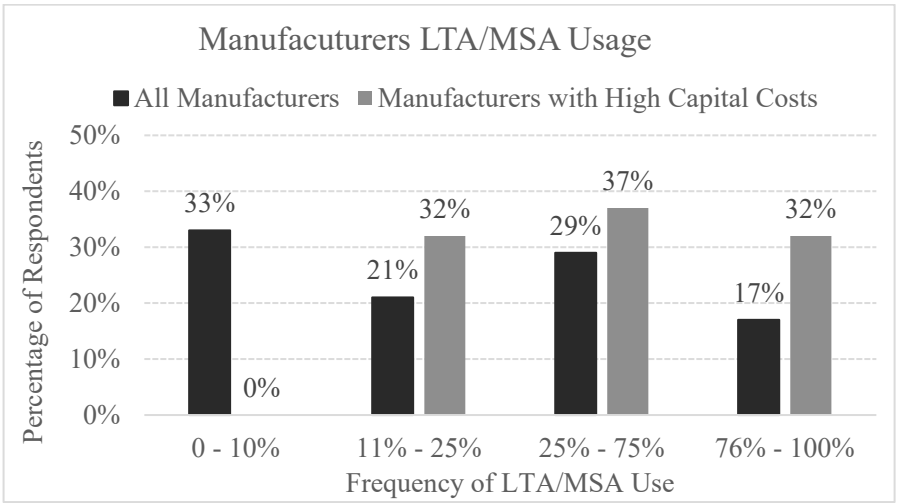
strategy to minimize the costs of opportunism.[74] Instead of opting out of the agreement, the least cost response may be hedging.

The decisions of how to operate and what organizational mode to use, whether it is a network, hierarchy, or market transaction, whether to hedge or not, and what contractual form to rely on (LTA or purchase order) for governing production, are all responses to durable problems that parties face in exchange relationships. One of the institutional choices suppliers make is what type of contract to agree to — whether to enter into an LTA or to opt-out of such an agreement.

The same considerations that affect parties deciding how to structure their organization of the supply chain, whether in a collaborative network or a hierarchy or by market, affect the choice of whether to enter into an LTA. Parties ask how can they increase joint returns and address durable problems while minimizing the frictions that affect exchange relationships. The empirical evidence from our survey demonstrates that the decision to enter into an LTA is affected by the presence of large capital equipment costs, a sunk cost with asset specificity.[75] In all of the networks that have been extensively studied in the automotive and innovation contexts, there are large sunk costs, uncertainty, and a need to de-verticalize to capitalize on the expertise of suppliers. Where such sunk costs are present, the parties cannot simply exit without being at risk for losing sunk costs.[76] The parties devise

74. *See id.* at 100.

75. *See* Kostritsky Ice Survey *infra* Q4 and Q6. As you can see from the chart below, manufacturers indicating in Q4 that they acquire capital equipment at a significant cost in sixy-seven percent or more of their transactions were more likely than the average manufacturer in the sample to indicate that they would use an LTA in most of their transactions.



76. *See* Kostritsky, *supra* note 15, at 1675; *see also* OLIVER E. WILLIAMSON, THE

structures and routines that are embodied in a long term contract to deal with uncertainty about the product and their partner's reliability and competence. Those routines create a "roadmap"[77] or "scaffolding"[78] for guiding production, reducing uncertainty, and lessening the chances of shirking or substandard goods. Those routines also lessen the risk of opportunism by raising switching costs. As parties become embedded in these relationships, that embeddedness substitutes for trust. It cements the relationship, protects the sunk cost investments, and secures other protections, such as guaranteed fixed prices or an option of ordering that protect sunk cost investments.

IV. WHY CHOOSE LTAS?

The decision by buyers and suppliers to enter into an LTA when the parties have sunk costs — a result revealed by the survey — constitutes one mode of protecting those sunk costs. When buyers and suppliers engage in joint projects that require either party to have significant capital expenditures, the parties may benefit from provisions in the LTA that encourage collaboration and efficiency. Empirical work looking at collaborative agreements and networks shows that provisions requiring shared information[79] or cost reductions[80] often arise in an LTA. However, if the sharing protocols deter opportunism and are costly to implement, then why would either the buyer or the supplier decide to enter or avoid a formal LTA and in what circumstances?

In answering that question, it may help to think about all the different ways that knowledge about the other party's reliability and the information needed for error detection could be obtained and with what agreements. There is the further question of how collaboration affects the arrangements. First, in situations with multiple buyers, the supplier could develop a commodity good and operate purchase-order-by-purchase-order while remaining confident that it could exit and sell the commodity to others. Second, in a supply arrangement with limited large buyers and multiple suppliers, a buyer and supplier could exchange goods pursuant to a purchase order and reply. Knowledge about the other party's reliability and competence would emerge

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ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING 53 (1985) [hereinafter WILLIAMSON, ECONOMIC INSTITUTIONS].

77. Bernstein & Peterson, *supra* note 4 (manuscript at 1).

78. Hadfield & Bozovic*, supra* note 40, at 988.

79. *See* Gilson et al., *Braiding, supra* note 8, at 1405 (noting that parties contract to "motivat[e] the iterative exchange of private information"); Gilson et al., *Contracting for Innovation*, *supra* note 38, at 49–50 (referencing the Deere-Stanadyne agreement to show how parties today may enter long-term contracts for the purpose of assessing parties' "capabilities").

80. WHITFORD, *supra* note 2, at 76 (observing that OEMs and suppliers can collaborate to reduce costs over time).

gradually as the buyer continues to buy and the supplier continues to provide goods. No LTA would be required for that knowledge about reliability and competence to develop into trust. Third, in situations with a large buyer and multiple suppliers, a supplier could invest a large amount in capital costs without collaborating with the buyer. In that case the supplier might insist on an LTA to guarantee that the buyer's purchase obligations would defray the cost of the capital equipment. An LTA governs, though there is no collaboration.[81] Fourth, in highly innovative settings with a scarcity of suppliers (i.e. biopharmaceuticals), the parties might engage in a collaborative project and enter into an LTA with sharing protocols.

Thus, the desire to recoup sunk costs and a firm's bargaining power, rather than innovation and uncertainty, is the distinguishing feature that may influence parties to enter into an LTA.[82] That conclusion may be warranted because information obtained through an LTA could also be obtained by other hierarchical management techniques and the trust could be built up incrementally through the exchange of goods. Any buyer could draft a purchase order insisting that a supplier submit to information-sharing protocols. Trust about competence and reliability could build up over time. However, if the buyer, such as an OEM, is investing in a model car and a supplier is investing in a plant that will furnish a door for that model car, the buyer and the supplier both need the security of a long-term commitment.

What does the LTA provide that could not be provided by benchmarking or other routines? For the supplier there may be implicit protections against early termination or even explicit protections of a long-term purchase contract, even if qualified by contingencies such as meeting the competition's pricing. That long-term contract may exist in combination with sharing protocols in which parties collaborate toward quality improvements or innovations. The buyer wants an LTA to guarantee a price and continuing supply, benefits that could not be achieved unilaterally or by "management technique[s]."[83] The buyer may be reluctant to invest in a production facility without the benefit of an LTA guaranteeing price and supply. In each case parties trade off and determine which institution, contract, provisions, or organization will maximize joint benefits by achieving their myriad of goals at the least cost.

Then, having entered a particular structure, the parties continue to make adjustments, such as hedging, in response to new pressures, such as opportunistic use of shared information. The decision about whether to enter a network subject to a formalized LTA is only one of the many choices

81. Interview with [Redacted], in [Redacted]. (June 16, 2017) (confidential source on file with author).

82. *Id.*

83. Jennejohn, *Collaboration*, *supra* note 5, at 87.

parties must make. Parties and suppliers make tradeoffs in order to lessen the risks and costs of unremedied contractual hazards, but also decide on choices about how fully to cooperate and whether to resist or hedge by withholding information or failing to invest.[84]

Where there are no sunk costs or large capital equipment costs by suppliers, suppliers may opt out of LTAs, perhaps deciding that the costs extracted by the buyer in the LTAs outweigh any benefits of such agreements. In particular, one such reason may be the onerous burdens on suppliers to constantly reduce prices in response to buyer demands.[85] Suppliers can simply exit to the market and find another buyer. LTAs may be the least costly alternative for organizing production in the supply chain, particularly when the suppliers seek to reduce uncertainty about the buyer by continuing to deal with the buyer.

V. THE SURVEY APPROACH TO ANALYZING WHY FIRMS USE LTAS

At least some of the benefits of an LTA could be imposed by buyers unilaterally or in a short terms and conditions section of a purchase order.[86] Through such short term agreements, buyers can develop increased knowledge about reliability and competence of suppliers, and benefits such as informal enforcement, monitoring, and increases in switching costs can occur without an LTA. The key question remains: *why parties would enter into an LTA or decide not to do so*? What mechanism or institution will achieve the parties' goals and at what cost? Some industrial strategies, such as the LTAs with learning routines, respond to new pressures on buyers to enhance knowledge and improve quality under increased time pressures. When implementing strategies in particular contexts, including the types of contractual and non-contractual arrangements, parties consider how the institutions selected will respond, not only to knowledge enhancement and competitive pressures on quality and price, but also to problems of opportunism and other durable problems in the supply chain. Switching costs, with the resultant deterrence of opportunism, could be achieved in other less costly ways without a formal LTA.

Current scholarship focusing on "exemplars," or significant LTAs in the innovation field,[87] has identified increased transparency from LTA information-sharing protocols as one reason to contract using an LTA. Ideally, as information is shared in an iterative fashion, pursuant to the LTA, parties' uncertainties about each other are reduced and knowledge is

84. WHITFORD, s*upra* note 2, at 100.

85. *Id.* at 81, 102.

86. *See supra* Section IV.

87. *See generally* Gilson et al., *Contracting for Innovation*, *supra* note 38 (analyzing the reasons companies choose to enter specific LTA-exemplar contracts).

enhanced. That knowledge leads to improvement in production and the development of new technologies.[88] However, often it is the suppliers who are being asked to share information, so LTAs may reduce uncertainty only for the buyer.

This Article posits that the LTA is a governance mechanism or a "machinery to 'work things out'"[89] that may not be necessary or cost-effective when there are no idiosyncratic investments. Thus, the form of contract is tied to the functions the parties seek to achieve, including the need to protect investments. That need could affect both buyers and suppliers in the supply chain. This Article supports Oliver Williamson's theories of contracting by providing empirical evidence that parties may undertake the costs of "specialized governance structures" such as LTAs where there is "considerable investment in transaction-specific assets."[90] As Williamson explains, the "specialized structures come at great cost, and the question is whether the costs can be justified."[91]

This Article offers another justification for the LTA that is separate from the "learning by monitoring" pragmatic collaboration that has been explored deeply by other scholars. While the "learning by monitoring"[92] devices and routines in the newer forms of LTAs may be effective tools to deal with problems with performance based on an "insufficient understanding of the problem at hand, or even how to pose it in the first place,"[93] they cannot completely eliminate opportunism in a supply relationship. When the problems faced by parties also include an "unwillingness" and "self-regarding motives,"[94] the LTA offers security to protect parties who invest large resources and might lose that investment or be subject to holdup after making a large investment. A buyer might be reluctant to invest in a model car without the security of long-term sourcing and price assurances.[95] The supplier might be reluctant to invest in building a factory to build doors for

88. WHITFORD, *supra* note 2, at 99 (explaining that "the forced openness of joint design and learning by monitoring creates the conditions for a '*virtuous circle*,'" or a waltz).

89. WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 76, at 60 (coining the term "machinery to 'work things out'").

90. *Id.*

91. *Id.*

92. Gilson et al., *Contracting for Innovation*, *supra* note 38, at 448.

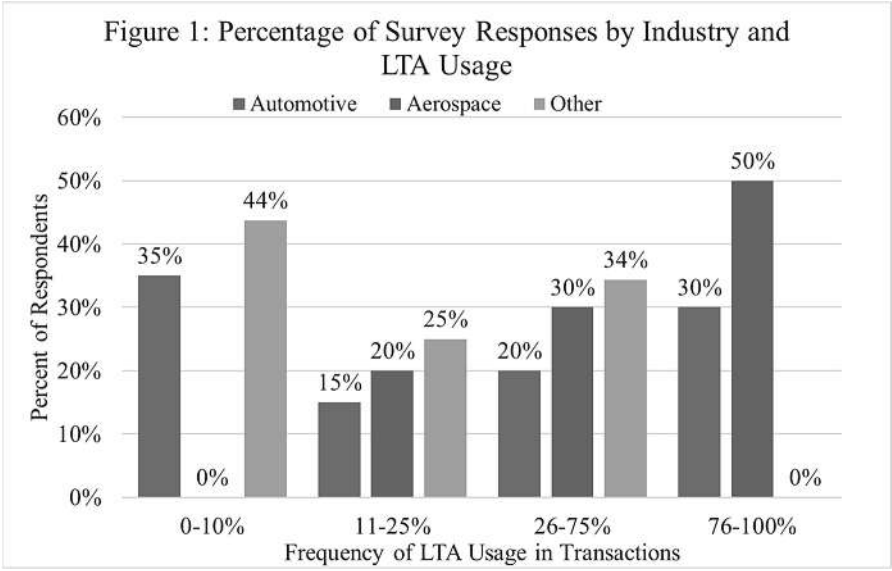
93. Charles F. Sabel, *Learning by Monitoring: The Institutions of Economic Development* 23 (Colum. L Sch. Ctr. Law & Economic Studies, Working Paper No. 102, 1993) [hereinafter Sabel, *Learning by Monitoring*], http://www2.law.columbia.edu/s354abel/papers/Learning%20by%20Monitoring.pdf.

94. *Id.*

95. Interview with [Redacted], in [Redacted]. (Jan. 25, 2019) (confidential source on file with author).

a customer without some security.[96]

Studying existing LTAs and situating them within industrial and production strategies can elicit theories about the functions they serve, but such studies do not shed light on why parties prefer certain arrangements over others. By expanding the range to random manufacturers, the research team hoped to shed light on why and *when parties adopt an LTA or opt out*. Since parties could provide for submitting to collaboration outside an LTA (for example, through provisions of a quality manual[97]), the question arises when and under what circumstances an LTA is a cost-minimizing method of achieving the parties' goals? The prior focus on LTAs themselves, *instead of on the use or non-use of such agreements*, means that important insights about contractual preferences based on factors like industrial variations, sunk costs, or firm size might have been overlooked. For instance, the research team discovered significant differences in LTA usage across industries (see graph below).[98] Simply analyzing differing terms within LTAs across various industries would not have demonstrated industrial variations in usage, because such an analysis would not have gathered information from firms that do not use LTAs.



96. Interview with Susan Helper, Professor of Law, in Cleveland, Ohio. (Feb. 21, 2017); *see also* Kostritsky Ice Survey *infra* Q4 and Q9 (showing the aggregated survey responses).

97. *See* discussion *infra* Section IX.C (explaining that quality manuals dictate purchase orders or terms and conditions).

98. *See supra* Figure 1 (finding that, based on survey responses, aerospace companies are far more likely to use LTAs than other industries).

Therefore, instead of focusing on the terms of high-profile LTAs like the agreement between *Apple and SCI*,[99] or between *Eli Lilly & Emisphere Techs Inc.*,[100] the research team designed a survey to shed light on the types of agreements a random group of Ohio manufacturers used in their transactions, including the choice to use LTAs or other arrangements. Using data from a random sample of manufacturers allowed for empirical comparisons across industries and firm sizes. In most instances, the buyers (often OEMs) draft and dictate the terms in agreements to the suppliers.[101] Thus, simply studying terms of an LTA may not shed light on *supplier thinking.*

Since many of these LTAs are drafted by large OEMs or other buyers, such as aerospace companies, and the information often travels almost exclusively from the supplier to the buyer, the question arises as to when and why LTAs will be either resisted or embraced by suppliers? When and why would an LTA be used and result in overall cost minimization for each party? Since the research team did not survey buyers in that capacity, we offer only tentative answers on buyers based on an analysis of some LTAs and current literature analyzing such agreements. Our results do shed empirical light on the choices by suppliers that suggest that the choice of contractual form is context-dependent, tied to sunk costs, and not a static choice, but one that varies as the pressures on suppliers increase or change. That decision to adopt or opt out of an LTA parallels other decisions suppliers make to "hedge" in order to protect themselves against buyer misuse of information.[102]

In analyzing the myriad of choices of suppliers to enter into an LTA, opt out, render less than full cooperation under the agreement, or protect against the risks of buyers licensing a supplier's intellectual property by only furnishing older technology that is already patented,[103] it helps to situate those choices within a bargaining model. Each party approaches an

99. *Fountain Manufacturing Agreement between Apple Computer, Inc. and SCI Systems, Inc.*, ONECLE INC. (May 31, 1996), https://contracts.onecle.com/apple/scis.mfg.1996.05.31.shtml [hereinafter *Apple-SCI Agreement*]; *see also* Gilson et al., *Contracting for Innovation*, *supra* note 38, at 463 ("SCI was, at the time [of the agreement with Apple], the largest contract manufacturer").

100. *See* Eli Lilly & Co. v. Emisphere Techs., Inc., No. 1:03-cv-1504, 2006 U.S. Dist. LEXIS 23245, at *2 (S.D. Ind. Apr. 25, 2006).

101. *See* Kostritsky Ice Survey *infra* Q8 and Q9 (showing the aggregated survey responses to Q8 and Q9, which in turn demonstrate: (1) the proportion of terms that manufacturers can dictate; and (2) the proportion of manufacturers who reported that the terms are dictated to them).

102. *See* WHITFORD, *supra* note 2, at 51.

103. *See* Kostritsky, *supra* note 15, at 1644–47 (discussing the problems parties face regarding opportunism and the appropriation of intellectual property); *see also* Interview with [Redacted], in [Redacted]. (Aug. 8, 2018) (confidential source on file with author).

exchange with its own private goals (to solve durable problems such as opportunism) and the parties will reach a particular bargain only if the benefits of achieving those goals outweigh the costs. Similarly, firms will constantly look for an arrangement that minimizes their costs while controlling contractual hazards, thereby maximizing value. Once the entire universe of agreements is considered, including factors that incline suppliers to use an LTA or to operate under other documents, it becomes possible to tie the parties' choice of form to a model of bargaining under conditions that include bounded rationality, sunk costs, and opportunism.[104] Under this model, one considers how parties in a transaction seek to achieve their overall goals of wealth maximization while minimizing costs.

VI. SURVEY METHODOLOGY

To evaluate the key question of why suppliers decide to use an LTA, the research team developed a survey of thirty-four questions about topics regarding why firms use LTAs, how often firms use LTAs, when firms engage in information-sharing between the buyers and suppliers, and the enforceability of LTAs and Master Supply Agreements ("MSA").[105] The survey was designed to determine if and when LTAs were used by manufacturers.[106] The manufacturers in the survey predominantly represented suppliers in buyer and supplier arrangements.

To identify survey participants, our research team obtained a list of 1,875 Ohio-based manufacturers from the Mergent Intellect database. The research team identified manufacturers by using the super sector Northern American Industry Classification System ("NAICS") codes related to manufacturing.[107] Data from Mergent Intellect included each manufacturer's

104. *See* Kostritsky, *supra* note 15, at 1656–57.

105. The questions regarding information sharing also touched on collaboration between the manufacturers and the buyers. Recent scholars have tied the information-sharing protocols in LTAs to the benefits of informal enforcement of parties' arrangements. The survey and interview questions were designed to elicit whether information sharing took place in the absence of an LTA and if so, at what levels (i.e., did information sharing occur at the same rate as occurred with an LTA?). Although the information sharing and collaboration questions helped the research team identify companies that might be concerned about intellectual property, the majority of respondents did not indicate that intellectual property or highly innovative collaborations were a major concern.

106. Part of the interest in framing the survey in this manner arose when a General Counsel I interviewed suggested that his company tried to avoid signing LTAs. *See* Interview with [Redacted], in [Redacted]. (Aug. 8, 2018) (confidential source on file with author).

107. See NAICS codes 31 through 33. *See generally* NORTH AMERICAN INDUSTRY CLASSIFICATION SYSTEM, EXEC. OFFICE OF THE PRESIDENT, OFFICE OF MGMT. & BUDGET 33, 143–311 (2017), https://www.census.gov/eos/www/naics/2017NAICS/2017_NAICS_Manual.pdf (classifying industries in the manufacturing sector).

name, phone number, physical address, and industry sub-sector. A paper-based mail survey was sent to the manufacturers obtained on the original list. After the first paper mailing, our team received fifty-eight responses either by mail or online.

The research team scrubbed the list to remove any duplicate companies or companies that had gone out of business, reducing the total number of "potentially active" manufacturers to 1,458. Then, the research team manually searched all "potentially active" manufacturers online to find their email addresses for an online survey. Of the 1,458 "potentially active" manufacturers, the research team found email addresses for 667 manufacturers and deemed them "likely active."[108] An email survey was sent to the 667 "likely active" manufacturers. Sixty-nine manufacturers returned an additional eleven survey responses. Thus, the overall survey response rate was 3.7 percent for all companies in the original database, 4.7 percent for "potentially active" manufacturers, and 10.3 percent for "likely active" manufacturers.

In addition to the survey, the research team conducted several one-on-one interviews with manufacturers to gather more qualitative data on LTA usage. The in-person interviews were especially helpful in understanding how highly innovative companies use (or do not use) LTAs within the context of protecting intellectual property. Table 1 outlines the annual sales revenue of each of the five manufacturers interviewed.

Table 1: Annual Sales Revenue of Interviewed Manufacturers

Company	2017 Annual Sales Revenue in USD
1	$6.3 Billion
2	$12.03 Billion
3	$3.2 Billion
4	$287 Million
5	$20.4 Billion

VII. SURVEY RESULTS

A. LTA Usage

Our survey of Ohio manufactures indicated that the majority of respondents use LTAs infrequently. Only seventeen percent of respondents (eleven of sixty-three manufacturers) indicated that they used LTAs or MSAs in seventy-six percent or more of their transactions (see Table 2). Twenty-four percent of all manufacturers indicated that transactions with

108. A selection of companies without email addresses were contacted by phone but the majority were out of business.

LTAs or MSAs accounted for seventy-six percent or more of their revenues (see Table 3). This tends to indicate that firms use MSAs and LTAs for high-revenue transactions disproportionately.

Table 2: Count of Manufacturers by LTA Usage as a Percentage of Transactions

LTA Usage	Manufacturers
0-10%	21
11-25%	13
26-75%	18
76-100%	11

Table 3: Count of Manufacturers by LTA Usage as a Percentage of Revenues

LTA Usage	Manufacturers
0-25%	24
26-50%	16
51-75%	8
76-100%	15

In addition, sixty-five percent of respondents indicated that they predominately produced customizable goods and twenty-nine percent of respondents indicated that they spent a significant amount of money on capital goods for a specific buyer in most of their transactions. However, when looking only at the subsection of manufacturers that indicated that they used LTAs in most of their transactions,[109] seventy-three percent of manufacturers indicated that they predominately produced customizable goods and sixty percent of respondents indicated that they spent a significant amount of money on capital goods for a specific buyer.

LTA usage also varied significantly across industries. Thirty-two percent of automotive manufacturers and fifty percent of aerospace manufacturers used an LTA most of the time. No other industry indicated that they used LTAs in most of their transactions (see Tables 4 and 5).

109. This subset consists of the eleven manufacturers that indicated that they use LTAs in seventy-six percent or more of their transactions.

Table 4: Percentage of Survey Respondents by Industry and LTA Usage

Industry	0-10% LTA Usage	11-25% LTA Usage	25-75% LTA Usage	76-100% LTA Usage
Auto	35%	15%	20%	30%
Aerospace	0%	20%	30%	50%
Other	44%	25%	34%	0%
All Companies	33%	21%	29%	17%

Table 5: Counts of Survey Respondents by Industry and LTA Usage

Industry	0-10% LTA Usage	11-25% LTA Usage	25-75% LTA Usage	76-100% LTA Usage
Auto	7	3	4	6
Aerospace	0	2	3	5
Other	14	8	11	0
All Companies	21	13	18	11

B. Customizable vs. Fungible Good

Generally, companies noted that LTAs could be used as a shield against loss from investments in capital equipment. The most important reasons to use LTAs or MSAs *in the event of a later lawsuit* were: (1) to protect capital equipment costs or tooling costs; (2) indemnity for intellectual property infringement; and (3) as a damages cap.[110] Recouping capital equipment costs is particularly important when the relationship between the supplier and buyer has terminated because the continuing purchase commitment would have ended prematurely. However, the top answer that manufacturers gave for entering into LTAs, *without the concern of a future lawsuit*, was "security of continuing commitment from the buyer."[111] Continuing commitment from the buyer would be particularly important where there were large sunk costs that could only be recouped by multiple purchases from the buyer over time. When the manufacturer is asked about what matters most, both in the context of a possible lawsuit and in an open-ended context, the protection of sunk costs or protection of a continuing purchase

110. *See* Kostritsky, *supra* note 15, at 1638, n.75.

111. *See* Kostritsky Ice Survey *infra* Q9 (showing the aggregated survey responses to Q9).

obligation features prominently.[112] In both cases there seem to be large investments that require contractual protection.

The second most selected reason for agreeing to an LTA was the absence of any choice by the manufacturer due to the superior leverage of the buyer. Usually LTAs are used by the largest companies that purchase goods in large volumes. Large and complex companies often have increased internal coordination costs and will use management techniques to increase internal efficiencies.[113] Many of these management techniques have analogous managerial provisions that can be found in LTAs dictating the intra-firm behavior between suppliers and buyers.[114] Over seventy-eight percent of respondents said that the most common characteristic between industries that insist on LTAs or MSAs is a large buyer or an OEM.[115] The size of the buyer may also indicate that more revenue is generated from sales to such buyers and those higher revenues may justify the LTAs' higher cost. Large sunk cost investments by suppliers are also likely to be present with large OEMs as buyers. Thus, fifty percent of manufacturers frequently using LTAs said that the most important reason for signing an LTA was because it was dictated by the buyer.

C. Diversity of Arrangements

As shown in Table 6, manufacturers that never, or seldom use LTAs, indicated that they did not use LTAs primarily because they were already doing business under other documents. Terms and conditions and purchase orders were the most likely documents to govern the transaction if an LTA was not used. Although suppliers might reap the benefits from using an LTA as a shield to protect capital expenditures and to secure a continuing commitment, suppliers have less incentive to enter into LTAs if they are protected under other agreements. The greater cost associated with negotiating an LTA, including the onerous provisions imposed by buyers, the less companies may be able to justify using such a contractual arrangement. However, the company may be justified in using an LTA if it incurs large capital costs that can only be recouped through a specific provision in the LTA or through a continuing commitment to purchase.

112. The protection of sunk costs in manufacturing, including capital equipment and investments in lean production or other specialized processes, is analogous to the need to protect intellectual property for "incentivizing creative activity." Matthew Jennejohn, *The Private Order of Innovation Networks*, 68 STAN. L. REV. 281, 284 (2016) [hereinafter Jennejohn, *Private Order*].

113. *See* Bernstein & Peterson, *supra* note 4 (manuscript at 3).

114. *Id.*

115. *See* Kostritsky Ice Survey *infra* Q14.

Table 6: Primary Reasons for Not Using an LTA

Primary Reason	Percentage of Manufacturers Seldom Using LTAs[116]	Percentage of All Manufacturers
Already doing business under other documents such as terms and conditions or purchase order	39%	29%
Terms too onerous	36%	45%
Price reduction requirements too onerous	12%	12%
Do not want to allow buyer a right to terminate for convenience	6%	5%
Other	6%	8%
Do not want to sign a competition out clause	0%	2%

Another important reason why manufacturers did not use LTAs was because LTA terms were considered too onerous. In many instances, the buyer unilaterally dictates the terms of the LTA to the manufacturer. Sixty percent of manufacturers said that they drafted less than ten percent of their LTAs and only twelve percent of manufacturers drafted the vast majority of their LTAs. Companies that more frequently used LTAs said that their primary reason not to sign an LTA was due to terms being too onerous, followed by not wanting to sign a competition out clause, and that they were already doing business under other documents. If a supplier operates in an industry where LTAs are the norm and are often dictated by the buyer, they might only refuse to engage in the LTAs if the buyer has a bad reputation for reneging on LTA terms or the buyer negotiated the terms to unilaterally benefit themselves.[117] One of the respondents indicated that if they have a strong competitive position against the buyer they would not want to lock in

116. *See* Kostritsky Ice Survey *infra* Q6 and Q12 (finding that this group of respondents indicated that they use LTAs in twenty-five percent or less of their transactions).

117. *See generally Advantages of Long Term Contracts*, UPCOUNSEL, https://www.upcounsel.com/advantages-of-long-term-contracts (last visited Nov. 28, 2020) (explaining the advantages and disadvantages of LTAs in different industries).

prices with an LTA. Another manufacturer that often signed LTAs indicated that the company would be hesitant to sign an LTA if the buyer was known to constantly change or cancel LTA terms to benefit themselves.

D. Information Sharing: How Does it Occur?

The survey revealed that generally suppliers are willing to share information within the context of an LTA; eighty-two percent of respondents said they would share information about costs or quality if they signed an LTA. In addition, survey results indicated that manufacturers might be willing to share information *outside of an LTA*. If there is no LTA signed, companies are split on whether they would share information with their buyers, especially related to costs; fifty-six percent of companies say they would share information. Seventy percent of respondents said that they were not required to attend any meetings because of the LTA, but seventy-four percent of manufacturers not required to attend meetings indicated that they would attend meetings with the buyer anyway.

Manufacturers indicated they would be more likely to share information if the government requires a cost breakdown or they are working with an aerospace or large firm. For companies that frequently use LTAs, seventy-three percent of respondents noted that they would share information even if they did not sign an LTA, making them the most likely group to share information with buyers. Manufacturers that frequently used LTAs reported that they shared information because they were required to do so by the buyer[118] and because it was an industry certification requirement.[119] Sixty percent of respondents said that they need to prequalify as a supplier to sell their products even without an LTA most of the time. Purchase orders, terms and conditions, and LTAs can all require an ongoing quality assessment by the buyer. Seventy-one percent of respondents indicated that their products had to comply with a buyer's quality or excellence manual under a purchase order or terms and conditions most of the time. An ongoing quality assessment is common under the buyers' terms and conditions.[120]

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118. Suppliers indicated they would share information even without an LTA due to asymmetric bargaining power between themselves and the buyer.

119. *See* Kostritsky Ice Survey *infra* Q11 (showing that when asked to explain why suppliers share information, respondents provided the following anecdotal responses: "[Buyer] demands to see costs and accounting data," "often required in USG contracting," and "industry certification requirement").

120. *See, e.g.*, FORD MOTOR CO., GLOBAL TERMS AND CONDITIONS FOR NON-PRODUCTION GOODS AND SERVICES ¶ 15(a) (2007), http://www.troydm.com/Shared/Repository/Web_Guides/Global_Non_production_Terms_and_Conditions.pdf ("Seller . . . will discuss with Buyer . . . any potential design, quality or manufacturing problems with Supplies Seller worked on or produced pursuant to a Purchase Order."); *id.* ¶ 20(a)(ii) (permitting buyer to "[v]iew any facility or process relating to the Supplies or the Purchase Order, including those relating to production quality"); APPLE,

"Hedging"[121] is another type of response to an LTA. Instead of actually opting out of an LTA, suppliers sign them and then hedge to protect against buyer opportunism — another way suppliers can minimize costs. The hedging by suppliers is part of a pattern of holding back information to hedge and self-protect.[122] Respondents noted they would not share information in cases where the buyer does not request it or there are no industry standards that make information sharing mandatory. Individual respondents from the survey noted that if they sold proprietary products, they would be more hesitant to share information with their buyers. Suppliers are worried about sharing information about anything that would allow the buyer to undercut the supplier and buy from someone else, including costs.[123]

E. Collaboration

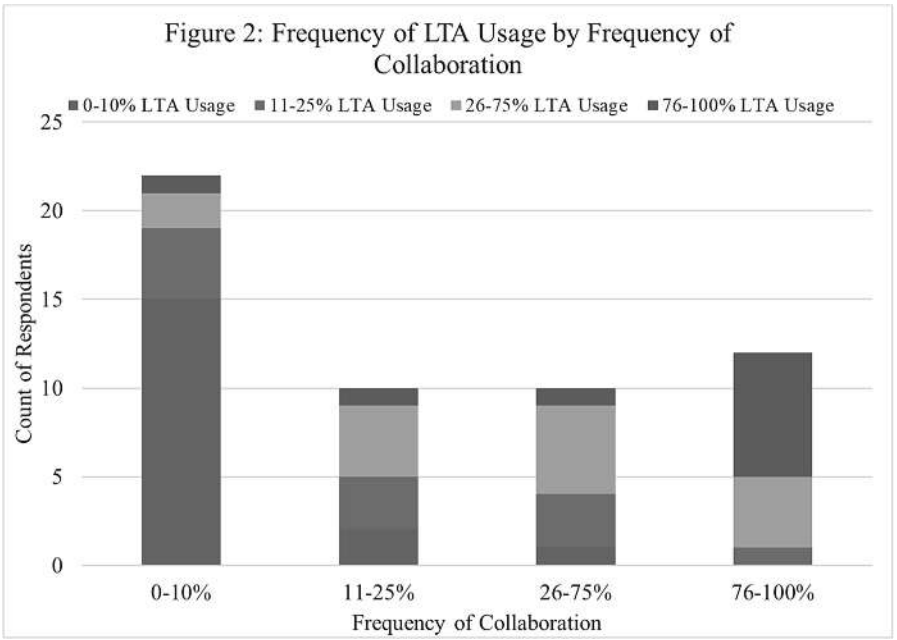
Figure 2 displays the frequency of LTA usage by the frequency of collaboration. A few companies indicated that most of their products were co-designed in collaboration with the buyer. Of the respondents that collaborated, eighty-seven percent said that the collaboration with the buyer was at least moderately successful. However, the model of collaboration seemed to vary widely across respondents. Thirty-four percent of respondents said that buyers supplied them with blueprints less than ten percent of the time, but another thirty-seven percent of respondents said that buyers supplied them with blueprints over seventy-five percent of the time. Those that did collaborate seemed only slightly more inclined to use an LTA.

PURCHASE AGREEMENT, PURCHASE ORDER TERMS AND CONDITIONS ¶ 6 (n.d.), https://www.apple.com/legal/procurement/docs/OL-APAC-AP_v.1.0.pdf (last visited Nov. 28, 2020) (permitting Apple to inspect, and test goods before acceptance); EATON INDUS., GENERAL TERMS AND CONDITIONS OF SALE, SELLING POLICY, DISTRIBUTION AND CONTROL PRODUCTS, AND SERVICE SOLUTIONS 2 (2017), https://www.eaton.com/ecm/groups/public/@pub/@electrical/documents/content/sp03000001k.pdf (permitting buyer to "witness testing" at seller's factory for an additional fee).

121. *See* WHITFORD, *supra* note 2, at 99.

122. *See id.* at 103–04.

123. *See id.* at 104.

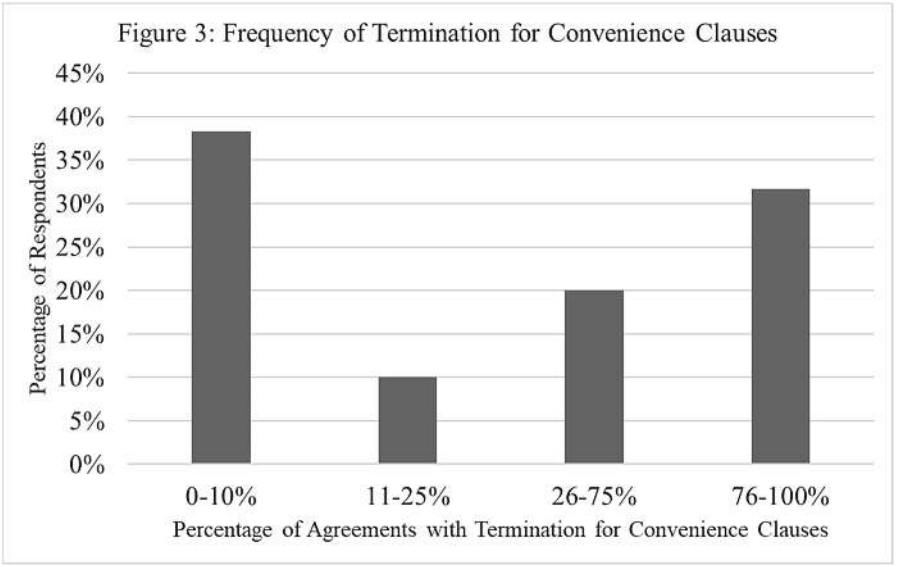


F. Enforceability of LTAs

The presence of the quantity term ensures that the agreement is enforceable. Accordingly, a quantity term may be the best way to ensure that the continuing obligation to purchase is enforceable, thereby helping to defray the sunk costs. However, only forty-five percent of respondents said that most of the time when they signed an LTA it would include a quantity term (minimum or exact quantity). Many manufactures noted they were unsure if an LTA without a quantity term would be enforceable and twenty percent responded that they believed an LTA without a quantity term would not be enforceable. Forty-four percent of manufacturers believed that an LTA without a quantity term would become enforceable at signing, while twenty-nine percent of manufacturers believed it would become enforceable when a purchase order was signed.

For manufacturers that use LTAs the most frequently, only thirty-six percent included a quantity term in most of their agreements. For the companies that used an LTA most of the time, forty-five percent believed the LTA would become enforceable when the first purchase order was signed. Twenty-seven percent believed it was enforceable at the time of signing the LTA. The discrepancy in responses between frequent LTA users and infrequent or non-LTA users might be due to a lack of awareness about the functioning of LTAs among firms that rarely use them.

Termination Clauses also impact a supplier's ability to protect sunk costs in LTAs. Figure 3 shows the percentage of agreements with termination for convenience clauses. Thirty-eight percent of suppliers said that a buyer can terminate for convenience very rarely, while another thirty-two percent said a buyer can terminate for convenience most of the time.



Many companies said that they would allow a buyer to terminate an agreement, even without a termination for convenience clause, if their tooling and investment costs had been repaid. Allowing termination for convenience or for decreased demand seems to shift the risk of fluctuations in demand to the supplier.[124] This explanation suggests that parties will make adjustments that are not required, but only if there is reciprocal protection. The supplier adjusts and allows for early termination, but only if the supplier is protected through repayment of the tooling and investment costs. These adjustments can be made outside the contract. As always, the parties weigh the benefits and costs of such adjustments. The supplier may be willing to accept that allocation because the supplier is better able to "redeploy manufacturing assets to another purpose" more easily than a buyer.[125]

Although firms might elect the protections of an LTA, they are highly unlikely to use legal remedies if a dispute arises. The vast majority of

124. *See* Matthew Viator, *Termination for Convenience Can Your Customer Terminate You Without Good Reason?*, LEVELSET, https://www.levelset.com/blog/termination-for-convenience/ (last updated Apr. 20, 2020) ("When the customer realizes they're going to run out of cash, it might be safer (and cheaper) to terminate the agreement before it's too late.").

125. *See* Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 586.

manufacturers, ninety-two percent, said they would almost never resort to suing over a dispute of an LTA. This finding supports the hypothesis that firms must derive some implicit benefit outside of legal protections for engaging in an LTA.

VIII. ANALYSIS OF RESULTS

In general, our survey results revealed that the majority of Ohio manufacturers used LTAs infrequently. However, LTA usage varied significantly across industries. The high percentage of usage of LTAs by automotive and aerospace manufacturers may be explained by the leverage those buyers yield over suppliers,[126] or the high collaboration costs associated with the industries. The presence of those sunk costs makes it important to control opportunism by the buyer in some manner since an exit is not easy as it is for fungible goods. This explanation is consistent with anecdotal feedback from a parts supplier who indicated that his company rarely used LTAs because, as a catalog supplier, his products could be easily sold to other buyers.[127]

The fact that the majority of manufacturers that used LTAs in most of their transactions had customizable goods is an important finding. If a product is customized for a particular buyer, and is not fungible, the supplier may have invested sunk costs toward customization. That investment makes a resale to others and an easy exit difficult and costly. Where such vulnerabilities exist, the need for protection may justify the costs of LTAs. In particular, the supplier can negotiate contractual protections for sunk costs or a continuing commitment to purchase. This negotiation can help defray the sunk cost investment or some other implicit protection such as helping a supplier to enter a new line of business when the market for the buyer's minivan collapsed.

While the most frequently selected reason that manufacturers gave for entering into LTAs without the concern of a future lawsuit was the *security of a continuing commitment* from the buyer, the second most selected reason was the absence of any choice due to the superior leverage of the buyer. This second factor may also be related to the presence of sunk costs. The larger buyers, such as OEMs in the automotive industry or airplane manufacturers, have the leverage to dictate their terms. Further, these relationships also likely require large sunk cost investments from their suppliers. Sunk costs that occur in the context of a buyer-supplier relationship are also likely to

126. *See* Ben-Shahar & White, *supra* note 12, at 954 (discussing "economic power" of original equipment manufacturers).

127. Interview with [Redacted], in [Redacted]. (Feb. 22, 2017) (confidential source on file with author) (interviewing firm with over $10 billion in sales for informational purposes).

have the potential for opportunism because sunk costs are endemic and will occur when bounded rationality prevents a contractual control mechanism.[128] The sunk costs lead to a fundamental transformation of the supplier relationship making exit costly or impossible. In the context of their relationship, controlling opportunism will be important, but difficult, because of the myriad of ways in which a buyer or supplier may act opportunistically, but which cannot be anticipated. Because the contract will not be able to control the problem, there may be other governance strategies.

There are many possible solutions to opportunism when large sunk costs are present. One structural solution is vertical integration.[129] Buyers could control external suppliers who could holdup buyers once the parties were locked in a bilateral dependent relationship through vertical integration.[130] However, vertical integration has become less efficient as the specialized research and development ("R&D") required for innovation is so costly that it makes sense to outsource it externally to other firms. Thus, the decision to outsource is driven by weighing the costs and benefits of vertically integrating, which includes the costs of R&D, the benefits of profit capture, and the possible holdup costs from outsourcing. As outsourcing increases, the cost of holdup has become less of a problem than once anticipated.[131] Because suppliers do not want to jeopardize future business with buyers, since that would be "suicide,"[132] they are reluctant to extort through holdup.

However, the need to minimize frictions such as opportunism, facilitate coordination, and control entropy remain current problems for both buyers and suppliers. The LTA, with its offer of implicit protections, security, and cementing relationships,[133] offers an incentive for the supplier to invest in the relationship. The LTA operates as a protective safeguard that mitigates opportunistic behavior by buyers. This safeguard encourages sunk cost

128. *See* ELLEN M. PINT & LAURA H. BALDWIN, RAND CORP., STRATEGIC SOURCING: THEORY AND EVIDENCE FROM ECONOMICS AND BUSINESS MANAGEMENT 10 (1997) ("Contracts can protect transaction-specific investments to some extent, but bounded rationality prevents contracts from specifying all possible contingencies. As contracts become more flexible, they allow more potential for opportunism.").

129. *See generally* WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 76 (providing helpful background information on vertical integration and a detailed analysis of the strategy).

130. *See* Marie-Laure Allain et al., *Vertical Integration as a Source of Hold-up*, 83 REV. ECON. STUD. 1, 1 (2016) (acknowledging that previous scholarship in the field has identified "vertical integration as a solution to hold-up problems" but ultimately disagreeing with aforementioned scholars regarding their characterization of vertical integration as a solution to the hold-up problem).

131. Ben-Shahar & White, *supra* note 12, at 975 (explaining that hold-up power of supplier is limited due to fear that hold-up will result in a loss of future business).

132. *Id.*; *see also* Gilson et al., *Contracting for Innovation*, *supra* note 38, at 438.

133. Interview with [Redacted], in [Redacted]. (Aug. 22, 2017) (confidential source on file with author).

investments by suppliers and helps to minimize the cost of uncontrolled opportunism. The value of that safeguard may diminish if the supplier suspects that the buyer will renege on its implicit commitments or on contractual commitments or opportunistically claim that the goods are defective. The LTAs furnish other cost-minimizing features, such as low-cost self-help remedies, when the product is defective or prices "competition-out" clauses to protect the buyers against the "China price."[134]

The fact that only approximately one-third of frequent LTA users in our survey insisted on a quantity term that would make the agreement legally enforceable indicates that the value of the LTA for suppliers may lie in other non-contractual protections offered by the LTA. This includes implicit contracts that prompt buyers to protect suppliers even when not legally obligated to do so.[135] The absence of a quantity term might also indicate that the supplier is relying on other constraints, such as switching costs, that will make it difficult to terminate the relationship.[136] Finally, even if there is no quantity requirement, and the supplier has large sunk costs, capital equipment, or tooling, once the first purchase order is issued, the agreement becomes enforceable. Additionally, there may be a specific provision on reimbursement for, or ownership of, equipment costs that is enforceable once the purchase order is issued. In these instances, the fact that the LTA may not contain an enforceable continuing purchase obligation may not be important because that would matter only if the cost of the capital equipment could not be otherwise recovered.

IX. LTA USAGE WITHIN A BARGAINING LENS OF ECONOMIC BEHAVIOR

In order to understand the significance of the survey results, they must be situated within the context of a bargaining lens and a model of economic behavior including bounded rationality, sunk costs, and multi-faceted opportunism. The choice of a contractual form may best be understood in terms of how the arrangement responds to durable contractual hazards that each of the parties face.[137] If contractual hazards remain uncontrolled either by contract or some governance mechanism, there will be price adjustments

134. John Paul MacDuffie & Susan Helper, *Collaboration in Supply Chains with and without Trust*, *in* THE FIRM AS A COLLABORATIVE COMMUNITY: RECONSTRUCTING TRUST IN THE KNOWLEDGE ECONOMY 417, 420 (Charles Heckscher & Paul S. Adler eds., 2006).

135. *See* Esser, *supra* note 10, at 594 (noting that parties with a pattern of collaboration rely on various implicit mechanisms to fill in contractual gaps).

136. This protection is important when sunk costs are present.

137. *See* Keith J. Crocker & Scott E. Masten, *Mitigating Contractual Hazards: Unilateral Options and Contract Length*, 19 RAND J. ECON. 327, 328 (1988) (suggesting that "the importance of [considering the] contractual hazards [when] . . . determining . . . the design of [the contract] has become increasingly apparent").

to reflect the uncontrolled hazard.[138] Each firm will sacrifice some of its interests to accommodate the other party, but only if their bargain minimizes costs and advances other interests.

A. Cost Minimization and Opportunism

The buyer faces uncertainty about the quality of the product from the supplier,[139] and about the competence and ability of the supplier. The supplier faces uncertainty about potential opportunism.[140] Opportunism could occur if the supplier invests large sunk costs and the buyer terminates early. Suppliers also face the prospect of buyers appropriating intellectual or other property.[141] The parties' agreements must also serve a planning and centralization of terms function.[142] Each party faces the bargaining process with its own private goals and will reach an agreement only if the benefits of achieving those goals through a particular type or form of agreement outweigh the costs. Firms seek a combination of strategies, both contractual and informal, that will minimize its costs while maximizing its benefits. One party may enter a formal contract largely for the implicit contracts that form in the wake of the formal contract.[143] Another party may enter the formal agreement because of particular benefits an LTA offers, such as shifting the risk of decreased demand to the other party through a termination for convenience clause.[144] The strategies are not static as they may change in response to behavior by the other party that hinder goal achievement, are contextual, and respond to the different factors, such as asset specificity or large capital equipment costs.

In some ways, each party, while seeking to minimize its own costs to advance its projects and maximize value, realizes that it must help the

138. *See* WILLIAMSON, MECHANISMS, *supra* note 14, at 62 (explaining that "technology (*k*), contractual governance/safeguards (*s*) and price (*p*) are fully interactive and are determined simultaneously").

139. This uncertainty is heightened in the case of collaborating on an innovative product, such as a new drug or medical device, since the parties cannot draft a complete contract that identifies the product.

140. Kostritsky, *supra* note 15, at 1647–49 (discussing the problems buyers and sellers alike face regarding opportunism); Gilson et al., *Contracting for Innovation*, *supra* note 38, at 438–39.

141. Kostritsky, *supra* note 15, at 1702–03 (observing the inadequacy of "low-powered sanctions" where a "party plans to end the relationship by appropriating intellectual property of the other party"); *see also* Ariel Porat & Robert E. Scott, *Can Restitution Save Fragile Spiderless Networks?*, 8 HARV. BUS. L. REV. 1, 1 (2018).

142. Kostritsky, *supra* note 15, at 1673 (noting that ease of planning and centralization of decision making are benefits of LTAs); *see also* Esser, *supra* note 10, at 594.

143. Esser, *supra* note 10, at 594.

144. *See* Viator, *supra* note 124 ("When the customer realizes they're going to run out of cash, it might be safer (and cheaper) to terminate the agreement before it's too late.").

counterparty minimize the costs of their project. The key is reciprocity.[145] There is an implicit agreement that one party will minimize its costs and the counterparty's costs, but only up to a point. When the costs of the accommodation to the other party are large, or the other party acts in an opportunistic manner, or there is a lack of trust, one party may take actions to protect itself and in doing so absorb less of the counterparty's cost minimization needs. As one party attempts to cost minimize at the expense of the other, there will be less accommodation, or a party may self-protect, or hedge and share less information.[146] At a certain point, cost minimization may actually result in litigation. When the demands of the counterparty are too great, litigation may be the only way to minimize costs.

B. Non-Contractual Cost Minimization Alternatives

It is important to understand that there may be non-contractual cost-minimizing solutions that lie outside the LTA or informal enforcement. For example, parties in the supply chain could use non-contractual mechanisms, such as insurance or a corporate structuring,[147] that give buyers more control over their suppliers. To answer the question of why buyers would enter into LTAs, one must begin with a bargaining model in which each party weighs the cost of drafting against the risk of not drafting further and operating purchase-order-by-purchase-order. What are the various ways that buyers could achieve their goals in ways that would be least costly? What are the goals that they could accomplish using terms and conditions, a quality manual, and requirements of pre-certification or other means to assure the quality of supplier's products and processes? Many of these provisions, such as supplier scorecards,[148] the International Organization for Standardization

145. KENNETH BINMORE, NATURAL JUSTICE 10 (2005) (discussing "rational reciprocity").

146. WHITFORD, *supra* note 2, at 100.

147. Interview with [Redacted], in [Redacted]. (Apr. 2017) (confidential source on file with author).

148. NATIONAL INSTRUMENTS, NI SUPPLIER HANDBOOK 13 (2018), http://www.ni.com/content/dam/web/pdfs/20181002_FINAL_32652_Supplier_handbook_2018_Ltr_WR.pdf (stating that "select suppliers" are those that usually "appear on the [National Instruments] 'top 80 percent of [National annual] spend'"); CUMMINS INC., SUPPLIER HANDBOOK (CUSTOMER-SPECIFIC REQUIREMENTS) 27 (2019), https://public.cummins.com/sites/CSP/SiteCollectionDocuments/StandardsandProcesses/SupplierQuality/Cummins%20Inc.-Supplier%20Handbook%20(Customer%20Specific%20Requirements).pdf (stating that Cummins "use[s] the Supplier Balanced Scorecard to evaluate customer satisfaction with selected external production and service suppliers").

("ISO") Certification,[149] and compliance with the buyer's quality manual,[150] can all be imposed hierarchically in a top down manner[151] through a purchase order or terms and conditions through an online portal without an LTA.

For example, buyers can dictate that suppliers must supply products that comply with their quality manual in their purchase orders or terms and conditions.[152] Even without the consent of the supplier in an LTA, the buyer can stipulate that to even be considered as a supplier, companies must comply with the buyer's quality manual. Buyers might also require suppliers to warrant that their products comply with any buyer excellence or quality manual in their purchase orders or terms and conditions. The scorecards, ISO Certification, and the quality manual give the buyer low-cost ways of minimizing misunderstandings about quality and setting standards and help

149. Companies will often require that their suppliers obtain or be ISO certified (and that this certification was done by an accredited certification body). One example of an international accreditation body is the International Accreditation Forum, and an example of a domestic accreditation body is NSI-ASQ National Accreditation Board. *See* JOHN DEERE, SUPPLIER QUALITY MANUAL — PROGRAM REQUIREMENTS 6 (2015), https://jdsn.deere.com/wps/wcm/connect/jdsn/e68e89f6-cb3a-4306-8a0a-5beeabe61fab/english.pdf?MOD=AJPERES ("[S]uppliers in the John Deere supply chain should become compliant to the ISO/TS 16949."); KOHLER CO., GLOBAL SUPPLIER QUALITY MANUAL 8 (2013), http://resources.kohler.com/corporate/kohler/pdf/supplier/GlobalSupplierQualityManual_English.pdf ("Kohler prefers suppliers of production materials with proof of certification to ISO 9001 or ISO/TS 16949 by an accredited registrar.").

150. *See* KOHLER CO., GLOBAL SUPPLIER QUALITY MANUAL, *supra* note 149, at 7 ("Prior to being awarded business from Kohler all new suppliers must read the Kohler Global Supplier Quality Manual and then confirm agreement that they will comply with its content and requirements through a method agreed with their Kohler purchasing contact."); JOHN DEERE, SUPPLIER QUALITY MANUAL – PROGRAM REQUIREMENTS, *supra* note 149, at 2 (stating that compliance with the JD Supplier Quality Manual is a precondition for all John Deere suppliers); NCR CORP., SUPPLIER QUALITY MANUAL 4 (2015), https://www.ncr.com/content/dam/ncrcom/content-type/documents/ncr-supplier-quality-manual.pdf ("These Quality requirements apply to all Suppliers providing products, parts, modules, assemblies or components . . . to NCR plants or NCR contract manufacturers or, on NCR's behalf, directly to NCR's customers (each, an 'NCR Designated Purchaser')."); NAVISTAR, INTEGRATED SUPPLIER QUALITY REQUIREMENTS 8 (2019), http://www.navistarsupplier.com/Documents/IntegratedSupplierQuality/Navistar%20Integrated%20Supplier%20Quality%20Requirements.pdf (stating that all current and potential suppliers are expected to comply with the provided Quality Manual); CATERPILLAR, SUPPLIER CODE OF CONDUCT 1 (2015), http://s7d2.scene7.com/is/content/Caterpillar/C10756688 ("We expect suppliers to comply with the sound business practices we embrace . . . ."); Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 572.

151. *But see* Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 563 (suggesting that the "network governance" is an alternative to the top-down hierarchy and achieves "many of the governance benefits of intra-firm hierarchy").

152. JOHN DEERE, TERMS AND CONDITIONS FOR THE PURCHASE OF GOODS AND/OR SERVICES 2 (2019), https://jdsn.deere.com/wps/wcm/connect/jdsn/aa788ea4-de87-4e9a-803e-08baee3ca5b9/purchasing_terms_and_conditions_us_eng.pdf?MOD=AJPERES&CVID=mOVImsB.

the buyer guard against shading by suppliers.[153] They also give suppliers a low-cost way of bonding (furnishing a credible commitment of quality). Where there is a dispute about quality, the parties can often work out the issue informally, especially if the buyer has established quality metrics in its quality manual. In addition, LTAs may include managerial provisions that define dispute resolution procedures, which can be cost-saving for both parties.[154] The desire for continued and future business will constrain all parties, especially when the parties are connected to a network.[155] Shirking could result in negative reputational effects that would hinder the ability of the buyer and supplier to obtain future contracts.

C. LTAs as a Cost Minimization Strategy

Other goals may be harder to achieve in a unilateral hierarchical fashion, and thus require the contractual consent of the other party in an LTA. This would be particularly true in a long-term supply arrangement where, for example, the buyer wants the supplier to agree to reduce its prices five percent every year or agree to competition-out clauses.[156] The standard purchase order or terms and conditions on the online portal govern all supply transactions. Annual cost reductions would only be needed for ongoing transactions where the buyer is subject to competitive price pressures that necessitate a guaranteed price reduction from its suppliers.[157] The buyer weighs the risk of entering into a long-term contract to buy with a guarantee of a fixed price, against the risk that the future supplier prices will be too high if there are competitive pressures on the buyer to reduce its prices.

A buyer may also enter into an LTA because without such an agreement, a large buyer such as an OEM would be reluctant to finance the huge investment of producing a new model car without commitments from suppliers.[158] Corporate management would be reluctant to assume such risks without assurances of price stability and commitments to furnish supplies. The LTA thus functions to protect the sunk cost investments made by the buyer. For example, one interviewee for a large OEM indicated that they

153. *See* Robert E. Scott, *Contract Design and the Shading Problem*, 99 MARQ. L. REV. 1, 8 (defining shading as "behavior that more accurately describes the vexing problems courts face in rooting out strategic behavior in contract litigation").

154. *See* Bernstein & Peterson, *supra* note 4 (manuscript at 5–6) (describing beneficial types of managerial provisions that are "conducive to . . . suppliers continuously improving their ability to deliver high quality products while reducing costs").

155. *See* Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 599.

156. *See* WHITFORD, *supra* note 2, at 86.

157. *Id.*

158. Interview with [Redacted], in [Redacted]. (Jan. 25, 2019) (confidential source on file with author).

would not proceed without an LTA.[159]

The LTA may also be important for buyers because it can "signal continuity intentions."[160] In certain collaborative LTAs, the structuring of investments constitutes examples and cements relationships of "reciprocity."[161] That may affect the price because price and governance are linked.[162] The buyer would have to pay a higher price if there were no implicit continuity protection, and the buyer might have a difficult time getting the supplier to invest sunk costs, such as the construction of a plant.[163]

The supplier makes the same calculus, weighing whether the additional costs of entering an LTA are justified and considering how its overall costs and risks can be minimized. The survey results suggest that the subset of suppliers making primarily customizable goods or involving large sunk costs enter into LTAs more frequently than the subset making primarily fungible goods or involving only minimal sunk costs.[164] The supplier has to consider whether the extra drafting and negotiating costs and other risks of an LTA, such as the onerous provisions of annual price reductions and other pro-buyer terms,[165] are outweighed by the greater security or commitment of a continuing purchase obligation — even if that purchase commitment is qualified or conditional or even terminable — that can be used to defray a large capital investment. That greater security can be achieved either by entering into an LTA, which deters early termination by raising switching costs or providing other implicit protections,[166] or by negotiating specific contractual protections.[167] The expectation of implicit contractual protections from a buyer[168] may affect the supplier's calculus of whether the LTA is cost minimizing and value maximizing. The entry into the LTA together with the provision of a unique part that is integrated into the OEM's

159. *Id.*

160. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 76, at 34.

161. *See* Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 594.

162. WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 76, at 33–34.

163. Interview with Susan Helper, *supra* note 96.

164. *See* Kostritsky Ice Survey *infra* Q6 and Q4; *supra* note 75 and accompanying chart.

165. For example, many large buyers reserve the right to terminate for convenience. *See* Ben-Shahar & White, s*upra* note 12, at 958; FORD MOTOR CO., GLOBAL TERMS AND CONDITIONS FOR NON-PRODUCTION GOODS AND SERVICES, *supra* note 120, ¶ 27.01 ("Buyer may terminate Purchase Order, in whole or in part, at any time and for any or no reason upon written notice to the Supplier."); APPLE, PURCHASE AGREEMENT, *supra* note 120, ¶ 14 (allowing Apple to terminate for any reason with ten days of written notice).

166. *See* Interview with Susan Helper, *supra* note 96.

167. These might include protection for capital equipment costs or coverage for expenditures incurred up until the date of termination.

168. *See infra* Section IX.E.

production, gives "suppliers . . . some power in the course of carrying out a long-term contract"[169] and explains the willingness to enter into LTAs. As suppliers make large investments to meet the demands of the LTA, the buyer becomes locked into the supplier since other suppliers could not make the investments required in order to meet the buyer's needs.[170]

The importance of sunk costs demonstrated in the survey data helps to situate the scholarship on LTAs in a different framework — one that emphasizes asset specificity rather than uncertainty and innovation. The sunk costs that one or both parties must invest pose risks of opportunism. The bilateral LTA is one means of governance that acts as a contractual safeguard. Innovation scholars have deftly explored the ways that information transfer mechanisms in an LTA can deter opportunism.[171] Our survey explains why these LTA provisions are important to suppliers with large sunk costs and why these safeguards are important and cost effective.

Since there is always a "braiding" of formal mechanisms (even with minimal contract documents such as purchase orders) and informal adjustment that leads to a buildup of trust and deters opportunism by raising switching costs as parties get to know each other, the question is why enter into an LTA when there are large sunk costs? The answer may be that there are implicit or explicit protections for the continuity of the relationship needed when sunk costs exist with an LTA that cannot be achieved by purchase orders, thereby providing a benefit to suppliers that justifies the higher costs. These protections include not only switching costs but other implicit protections against early termination or explicit protection for sunk costs if there is early termination.

This Article offers an explanation for why the costs of LTAs are justified, through an explanation tied to sunk costs, and a comparative cost analysis.[172] Even where there is great uncertainty about the opportunism of the counterparty or the quality of the products, if the parties did not have to invest large asset-specific costs, the need for a contractual mechanism might not be cost-justified since the parties could simply exit. As Williamson explains, "an increase in parametric uncertainty is a matter of little consequence for transactions that are nonspecific."[173]

D. Information Sharing as a Cost Minimization Strategy

Recent scholarship has identified the information-sharing protocols as a

169. Ben-Shahar & White, *supra* note 12, at 973.

170. *See id.* at 974.

171. *See* Jennejohn, *Collaboration*, *supra* note 5, at 85; *see also* Helper et al., *supra* note 5, at 444.

172. These take the form of capital equipment costs.

173. WILLIAMSON, MECHANISMS, *supra* note 14, at 59.

key feature of the modern LTA (or MSA) for both innovative manufacturing and biopharmaceutical industries.[174] One question is how and why the information-sharing protocols would be a cost minimizing strategy. Structured information sharing allows parties to enter into an agreement when uncertainty about the innovation process and final product makes it impossible to enter into a completely contingent contract. It gives the parties a cost-effective way to build up trust. By each party extending oneself to one's partner, a kind of overture and response, trust grows.[175] Such provisions make parties contractually committed to "invest in producing information," even if they cannot agree on the ultimate product.[176] The exchange of this "highly revealing information" in the LTAs provides a basis for iterative investments by both parties that constrains opportunism. Information sharing may also occur if requested by a party to the agreement since without it, the unanimity needed to go forward to the next stage of the innovative process may not be forthcoming.

This incremental exchange of information has several important benefits. It decreases uncertainty about the counterparty's competence and increases trust in the counterparty's capacity. The iterative exchange of information reduces uncertainty and therefore risk about the benefits of continuing a joint project. These observations and the knowledge of the counterparty raise switching costs for both parties. In addition, there would be negative reputational effects for leaving the relationship because it would be difficult to explain to a new party why the agreement failed.[177]

This research team has two questions that arise from this iterative sharing of information through an LTA: (1) in a manufacturing setting, how can information sharing occur outside of an LTA? and (2) if parties share information without an LTA in ways that will be described below, then when would the additional costs and burdens of an LTA be justified? Answering that second question may offer additional insights into how parties structure their transactions to minimize risk, control opportunism, and provide for security for investment. The "braiding" that has been rationalized as a way for buyers to learn more about suppliers, to provide new bases on which to informally sanction suppliers, and for providing agreement on what constitutes a breach may have another important function for the supplier.

174. *See* James A. Breen, Jr., *Message from the Chair: ISPE & Information Sharing*, PHARM. ENG'G (Apr. 2019), https://ispe.org/pharmaceutical-engineering/march-april-2019/message-from-chair-information-sharing.

175. Of course, such iterative exchange of information can occur outside an LTA.

176. Gilson et al., *Contracting for Innovation*, *supra* note 38, at 476.

177. *Id.* at 435 (defining switching costs as "the costs one party to a contract must incur in order to replace the other party to the contract"); *see id.* at 482 (discussing how switching costs present a significant barrier where "learning about the quality of potential substitute suppliers and their products is time consuming and expensive").

The investment in information raises "switching" costs,[178] thereby providing security for suppliers investing sunk costs. That protection may be further supported by implicit contracts to protect suppliers by providing them major new business when circumstances cause an early termination after a supplier has invested.

One goal of the survey was to ascertain whether information sharing took place in the absence of an LTA. Our survey revealed that over half of all manufacturers indicated they would still share information without an LTA, and this was true of nearly three-quarters of those manufacturers who frequently used LTAs. This raises a further question: why would parties undertake the additional costs of an LTA if much of the required information could be obtained without one? The surveys prompted further research *outside the survey context* into how various types of information may be obtained both through an LTA and through other means.

In the joint innovation context, where one party is investing knowledge and another party is investing dollars, each party wants to know that the other is fully committed to the endeavor. Without that assurance, there would be little reason to keep investing toward a joint innovation. The failure to comply with informational exchange would rarely be legally sanctioned except in blatant cheating or expropriation of another's property.[179] The iterative exchange builds up trust, creating it when it was not preexisting.[180]

In the manufacturing context involving large buyers, it appears that there are a lot of mechanisms for securing information for a buyer from suppliers that *do not* depend on the existence of an LTA. Buyers can secure a large amount of information without ever entering into an LTA. Many of these mechanisms are designed to reduce uncertainty about the supplier.

One means of reducing that uncertainty is to require suppliers to prequalify. That can be done outside of an LTA. Also, instead of using an LTA, the parties can utilize a supplier quality handbook or manual to share large amounts of information at a reduced cost. There are a number of options the parties can use to share and assent to the quality manual processes, including customer specific processes and general arrangements that apply to all suppliers. One option is requiring all potential suppliers to acknowledge and certify that they are agreeing to the buyer's requirements, such as the quality manual, code of conduct, and terms and conditions, as a precondition for conducting business with the buyer.[181] In addition to

178. Gilson et al., *Braiding*, *supra* note 8, at 1383 n.10.

179. *See* Kostritsky, *supra* note 15, at 1659–60 (observing that transparency can help deter cheating where parties are collaborating on new products); *see also* WILLIAMSON, ECONOMIC INSTITUTIONS *supra* note 76, at 57.

180. Gilson et al., *Braiding*, *supra* note 8, at 1377.

181. *See* KOHLER CO., GLOBAL SUPPLIER QUALITY MANUAL, *supra* note 149, at 7 ("Prior to being awarded business from Kohler all new suppliers must read the Kohler

utilizing a precertification process, the buyer may simply communicate that the quality documents are a requirement of potential and continuing business with the buyer and apply to all suppliers.[182]

Quality handbooks or manuals may contain provisions requiring suppliers to gain and maintain ISO Certification, establish minimum quality requirements, and require compliance with all relevant laws, orders, acts, and regulations.[183] Additionally, the quality handbooks and manuals can require buyers agree to on-site assessments and audits, and supplier quality assessment or certification.[184] While the quality manual places a number of requirements on the supplier, it also provides support and guidance for each supplier.[185]

In addition to the quality handbooks, buyers may unilaterally impose further conditions on suppliers such as requiring suppliers to complete buyer-developed online webinars,[186] courses, or "Supplier Development Colleges."[187] The buyer may also develop online resources and courses to

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Global Supplier Quality Manual and confirm agreement they will comply with its content and requirements."); *Prospective Suppliers*, KOHLER, www.kohler.com/corporate/supplier/prospective-suppliers.html (last visited Nov. 28, 2020) (stating that those interested in becoming a Kohler supplier must register).

182. *Criteria For Being a John Deere Supplier*, JOHN DEERE, https://jdsn.deere.com/wps/portal/jdsn/Home/Welcome/!ut/p/z1/rZJfT8IwFMU_iw97LC3sD9O3iYpBmQ8mwPqydFu3FUdb2o6Jn96CRmMiEBL21Nt7d37npgdiuICYkw2riGGCk8bWCQ7S6fjufux6_Ti8nfgoeuhP4scXfxaM-nAGMcQ5N9LUMFkWmqcdzTQz1EG7ykG6lbJhVKUF21BlO1sHSWEoN4w06U83V_YfxchOTuasgEnf9QbD6xB5WR6WA9cPPVRmZVD4g6AMfZLD-d4bOvBFCOLj1uc71rER9D1wBJFYD8NDCtMnD76esdAJMf-SYsMLio3OW3Ny6mFs6NhyvcaRTZbghr4buLhEtCy4akT2FeuIZ25YQaxoSRVVvVbZ69oYqW8c5KCu63oFtZ1eLlYOohYnWgVsIQm3HJKJ1oClqDnYjzmoEIxXIGs141Rr0DFTg1b_urTH_7i10Ha9PzgoV6vQ3YK3Mo4ByULk-nLz8VxOjZ9cfQLW9jy3/dz/d5/L2dBISEvZ0FBIS9nQSEh/ (last visited Nov. 28, 2020) (indicating that compliance with the JD Supplier Quality Manual is a precondition for all John Deere suppliers, which is communicated to all potential suppliers as a required criterion on John Deere's prospective supplier's website).

183. JOHN DEERE, SUPPLIER QUALITY MANUAL — PROGRAM REQUIREMENTS, *supra* note 149, at 2, 6; KOHLER CO., GLOBAL SUPPLIER QUALITY MANUAL, *supra* note 149, at 6–7; NAVISTAR, INTEGRATED SUPPLIER QUALITY REQUIREMENTS, *supra* note 150, at 7; NCR CORP., SUPPLIER QUALITY MANUAL, *supra* note 150, at 4, 6.

184. *See* NCR CORP., SUPPLIER QUALITY MANUAL, *supra* note 150, at 4–5, 13–14 (describing quality control requirements).

185. JOHN DEERE, SUPPLIER QUALITY MANUAL — PROGRAM REQUIREMENTS, *supra* note 149, at 2; NAVISTAR, INTEGRATED SUPPLIER QUALITY REQUIREMENTS, *supra* note 150, at 2 (providing all suppliers with online modules, expected to be completed and understood by suppliers, which detail the requirements of suppliers); NCR CORP., SUPPLIER QUALITY MANUAL, *supra* note 150, at 4.

186. *Supplier Connect*, *Supplier Development College*, CATERPILLAR, https://supplierconnect.cat.com/wps/portal/catconnect/SDC (last visited Nov. 28, 2020) (encouraging suppliers to learn from the Supplier Development program); *see also* Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 579.

187. CATERPILLAR, *supra* note 186.

support the supplier but not specifically require completion as a requirement of conducting business.[188] Further, the buyer may also require that the supplier participate in supplier performance management reviews, continuous improvement processes, and participation in supplier excellence programs.[189]

The buyer's purchase order and/or terms and conditions can thus provide protection for the buyer and result in the transfer of large amounts of information to the buyer without an LTA. Buyers may also include in their purchase order or terms and conditions provisions that cover special tooling costs, buyer supplied equipment, inspections, and indemnification.[190] The buyer's standard purchase order may contain additional provisions governing disputes and governing law, product liability and insurance, and termination for cause or convenience.[191] In case either party terminates, the purchase order can contain clauses covering the termination process including inventory indemnification, special tooling, or capital expenditures. A manufacturing company's purchase order may cover excess and defective goods, acceptance, modification, and payment.[192] Thus, rather than enter into an LTA that requires compliance with the buyer's quality manual or handbook, the buyer's purchase order or terms and conditions[193] can contain such provisions requiring compliance with both the supplier's code of conduct and quality manuals or handbooks.

The mere availability of information about a supplier's qualifications may not build trust in the same way that happens when procedures are implemented that cause the supplier and buyer to be linked, such as when the buyer sends an engineer to the supplier's plant. That linkage helps to provide

188. JOHN DEERE, SUPPLIER QUALITY MANUAL — PROGRAM REQUIREMENTS, *supra* note 149, at 7 (stating that John Deere does not require participation or completion but has created a number of online resources, including classes, manuals, and presentations, to assist suppliers).

189. *Id.* at 39 (requiring suppliers to participate in the Achieving Excellence program); *JD Supply Network*, *JD Crop*, JOHN DEERE, https://jdsn.deere.com/wps/portal/jdsn/Home/Welcome/!ut/p/z0/04_Sj9CPykssy0xPLMnMz0vMAfIjo8zifd1dXN2NTQz9LJy8TA0c3Qy9_Dz8TcPMnA31vfSj8CsAmpCZVVgY5agflZyfV5JaUaIfkZVSnBdfnppUnFmSqmoA4qkaJBYU5GQmg-0tBonFJxflF-gXZEdFAgDM2k5_/ (last visited Nov. 28, 2020) (requiring suppliers to participate in the JD Crop program); CATERPILLAR, *supra* note 186 (offering an excellence program with much less information available on it than John Deere's).

190. JOHN DEERE, TERMS AND CONDITIONS FOR THE PURCHASE OF GOODS AND/OR SERVICES, *supra* note 152, at 2 (listing a provision stating that buyers are not responsible for any excess goods, an indemnification clause, and a requirement that the seller bear the cost of special tooling).

191. *Id.*

192. *Id.*; NCR CORP., SUPPLIER QUALITY MANUAL, *supra* note 150, at 9, 18.

193. *See* JOHN DEERE, TERMS AND CONDITIONS FOR THE PURCHASE OF GOODS AND/OR SERVICES, *supra* note 152, at 1.

protection through increased switching costs that deter either party from switching. The LTA, or an informal arrangement, may also set up specific procedures that require benchmarking error and detection that help a buyer.[194] An LTA may also provide implicit security that if the buyer has to terminate early, it will find a way to compensate the investing supplier. When that implicit assurance is degraded because of perceptions of opportunistic proclivities, the supplier may hedge or refuse to sign an LTA.

Even though the survey did not collect empirical data on reasons why *buyers* enter LTAs, the increased information from LTA's may give buyers the means to identify new forms of misbehavior[195] and to provide the architecture for demonstrating "how . . . to do business"[196] and to furnish "contract administration mechanisms" which facilitate governance between firms much as the hierarchy functioned in the firm.[197] This increased information has a similar advantage of avoiding the need for legal enforcement since the mechanisms do not relate to breach, but to "create a framework for growing relational social capital . . . ."[198] Since there are other ways to grow social relational capital between firms (incrementally, over time) that do not depend on an LTA, the question is why and when buyers would enter such agreements and under what circumstances and for what reasons. The larger and more complex the firm, the greater the internal coordination costs.[199] Management techniques like lean manufacturing or key performance indicators can help reduce waste and costs in large and complex firms.[200] Since they are engaging in cost reduction strategies internally, large buyers may have greater incentive to require suppliers to adhere to the same management techniques.[201] Presumably buyers such as OEMs make the same calculus as suppliers do, choosing to enter into an LTA when that particular arrangement minimizes their costs while controlling contractual hazards and thereby maximizing value.

Although some types of information about suppliers might be obtained in

194. Helper et. al., *supra* note 5, at 451 (noting procedures implemented "without reliance on vertical integration or elaborate contracts").

195. *See* Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 604 (discussing the "broaden[ing] [of] the type of misbehavior than can be policed").

196. *Id.* at 562.

197. *Id.* at 563.

198. *Id.*

199. *See generally* Bernstein & Peterson, *supra* note 4 (manuscript at 32–37) (discussing the incentives underlying "managerial contracting").

200. *Id.* at 6, 10–14 (defining "lean manufacturing" and discussing "key performance indicators" as a means of measuring the "incorporat[ion]" of management techniques).

201. *Id.* at 27 ("Although individual . . . managerial provisions . . . have the potential to add value to contracting relationships, taken together these provisions may create governance benefits that go beyond the incentive effects associated with individual provisions.").

hierarchical means imposed outside an LTA, such as posting the quality manual on the web and mandating adherence to it or mandating compliance with ISO Certification or other certification standards, or by posting a portal for suppliers to learn about the quality requirements,[202] there are other benefits which cannot be obtained without an LTA, including a right to terminate suppliers. The investment in establishing elaborate private governance mechanisms in a setting where buyers have large fixed costs may be justified by the business planning benefits and control over the suppliers' production processes and resulting trust and increased bond that facilitates "increasingly complex and innovative value-creating undertakings."[203] Where the investments by the buyer were not significant, the need to devise such mechanisms through agreements with suppliers would not exist, at least raising the possibility that sunk costs may explain why buyers are investing in elaborate LTAs. The LTA may ensure a commitment to price reductions from suppliers.

The LTA may offer a roadmap for consultation during the course of a complex process. In each case the buyer would weigh what benefits an LTA can offer and whether those benefits can be achieved without an LTA. Most importantly, LTAs offer buyers the needed security of a guaranteed price and a commitment to supply.[204] Without this security large and complex organizations such as OEMs could not plan or operate. The sunk costs of planning a car, for example, means that the buyer cannot simply exit and redeploy its assets. It will not be able to recoup its investment unless it produces the cars profitably, which cannot occur unless the supplier commits to supply the parts for the life of the production of the car at a fixed price. Those goals cannot be achieved without an LTA. A further survey could confirm whether the presence of the buyer's large sunk costs help explain why the buyers enter into an LTA by assuring the buyer a continuing commitment but often not obligating the buyer to buy at all. It gives the buyer an option in effect.

E. Self-Help Remedies

For the buyer, the additional costs of an LTA can be spread out over a myriad of transactions with suppliers. Also, many provisions in the LTA help to minimize costs for the buyer. Many LTA provisions give the buyer the ability to engage in self-help remedies that eliminate the need to resort to a legal solution for goods that do not comply with the buyer's quality

202. Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 578.

203. *Id.* at 589.

204. *See* WHITFORD, *supra* note 2, at 84–86 (noting that although the buyer may gain security through guaranteed price reductions and a supply commitment, perhaps at a guaranteed price, the supplier often does not gain parallel security).

specifications.[205] Instead of employing the buyer remedies in the Uniform Commercial Code ("U.C.C."), the contract provides that the supplier can remove the unwanted part from the contract, relieving the buyer from any further obligation to buy.[206] Other provisions give the buyer the ability to get reimbursed for the correction of parts that do not conform, again without having to seek any remedy through the courts. Often, the buyer in an LTA is given the right to refuse goods that do not meet the buyer's standards. The ability to operate outside of the legal system minimizes costs to the buyer and explains how the LTA can facilitate self-help remedies and reduce buyer costs.

While there are many provisions that the buyer can impose on the supplier unilaterally and informally, other provisions, such as cost reduction provisions, may require the consent of the supplier.[207] Of course, self-help remedies may be possible if worked out individually between a supplier and a buyer when goods fail to conform. The LTA's higher cost may be offset by a minimization of transaction costs. Instead of having to agree (extracontractually) to self-help remedies where the supplier agrees to discount the invoice for goods the buyer complains about, the buyer is given wide discretion to be relieved of any obligation to buy goods that do not meet the buyer's metrics or standards.[208] That mechanism relieves the buyer of having to negotiate each accommodation seriatim.

The self-help provisions of the LTA may also be cost minimizing for the supplier because the supplier's willingness to sign an LTA with self-help provisions acts as a low-cost signal to the buyer — a kind of credible commitment — that the supplier will not furnish substandard goods or will readily comply with the self-help provisions of the contract. The supplier who signs such agreements may be eligible for more favorable prices than if the supplier insisted on compliance with the full regimen of the U.C.C.

F. Sunk Costs and Cost Reduction Strategies

Another function of the LTA is related to the sunk costs involved in

205. *See* Bernstein, *Beyond Relational Contracts*, *supra* note 11, at 576–78, 589 (explaining that information exchanges encourage cooperation between parties by helping avoid misunderstandings about what performance is expected).

206. *See* Matthew C. Brown et al., *Termination for Convenience Under the Uniform Commercial Code*, ABA COM. L. NEWSL. (Mar. 10, 2014), https://www.wiggin.com/publication/termination-for-convenience-under-the-uniform-commercial-code/ (explaining that termination for convenience clauses are "becoming increasingly popular in supply agreements").

207. *See supra* note 80 and accompanying text on cost reductions in LTAs.

208. *See* STRATEGIC ALLIANCE AGREEMENT CORPORATE PROCUREMENT BETWEEN WHIRLPOOL CORPORATION AND WHITESELL CORPORATION § 6.3 (2002) (on file with author).

collaborative agreements. The buyer in these supply contracts may require the supplier to undertake expensive procedures such as root-cause analysis,[209] or other large investments such as implementing a lean production methodology at the plant,[210] or building an entire plant to manufacture a single component, such as a car door. The entry into an LTA may help to induce the supplier to provide the foundation that will cement the relationship and offer the supplier implicit protections even though they are not formally in the contract.[211] That insight led one interviewee to respond that a large automotive supplier would not have undertaken the investment toward lean production without the protection of an implicit contract and security if they made the investment. That security could come in continuing purchase obligations either in the contract at issue or through help from the supplier in securing a different contract.[212] Other provisions in an LTA impose on the supplier the need to engage in a cost reduction program that will redound to the benefit of the buyer. Cost reduction programs (often called the annual five percent letter) could not be imposed unilaterally on a supplier without the supplier's express agreement.

In other instances, the LTA functions as a planning device. Parties refer to it to determine which party should be investing how much and issuing what reports. That planning function must occur in the context of an individually negotiated LTA so the standard terms and conditions or quality manual available on the web will not provide the needed blueprint for collaboration, thereby justifying costs of the individual agreement.

One remaining question is how the LTA, with its higher drafting and lawyering costs, could be a cost minimizing device for suppliers. Our survey revealed that manufacturers that used LTAs in most of their transactions tended to produce customizable goods and spend a significant amount on capital expenditures. This is an important finding, because if a product is customized for a particular buyer, and the supplier invested sunk costs toward customization, that investment makes an easy exit from the relationship or resale to others difficult and costly. Where such vulnerabilities exist, the need for protection may justify the costs of LTAs. The costs are especially justified if the supplier can negotiate contractual protection for sunk costs or a continuing commitment to purchase which can help defray the sunk cost investment.[213] LTAs may protect against sunk

209. *See* Sabel, *Real-Time Revolution*, *supra* note 2, at 122.

210. *Id.* at 118.

211. Hadfield & Bozovic, *supra* note 40, at 988.

212. *See* Interview with Susan Helper, *supra* note 96.

213. *See* Whitesell Corp. v. Whirlpool Corp., No. 1:05–CV–679, 2010 WL 1875513, at *4 (W.D. Mich. May 10, 2010) (stating that the defendant had a continuing obligation to "purchase all of Whitesell's 'pre-approved' inventory").

costs in a variety of ways, such as by providing for the protection of large capital equipment and providing that if the relationship terminates, the capital equipment belongs to the supplier.

There are two primary differences that explain why and when suppliers use LTAs. They are likely to occur when the goods are: (1) customizable non-fungible; and (2) there are large sunk capital equipment costs involved in the manufacture. These two factors make it difficult for the supplier to exit and resell the goods. The greater sunk costs and accompanying vulnerabilities may justify the greater costs of an LTA, at least if the LTA offers greater protection to the party asymmetrically investing sunk costs, either through contractual protection for capital equipment or by implicit contracting or by switching costs, all of which function to protect suppliers.

Another way to protect sunk cost investments that can occur in an LTA is through the parties investing mutual sunk costs resulting in a mutual dependency. Mutual investment could occur when the buyer invests in training suppliers and suppliers invest in training to become excellent suppliers.[214] This can occur in an LTA in which one party invests sunk costs in research and the other invests research dollars. When those sunk costs are not present, as when the supplier sells catalog items,[215] the supplier may operate using less costly arrangements, such as a purchase order or terms and conditions. The supplier has less need for contractual protections because the supplier can simply exit and resell.

This outcome linking the greater use by suppliers of LTAs to greater sunk costs is consistent with the parties achieving their goals while minimizing transaction costs. The supplier who invests large sunk costs (either capital equipment or investments in procedures such as lean production or in building an entire new plant) faces the prospect of opportunistic behavior by a buyer who terminates early. The supplier may enter into an LTA which may offer some security to purchase goods over a period of time. The protection for the supplier that comes from entering into an LTA can come through specific contractual protections for sunk costs or capital equipment in the LTA. It can also come through informal protections or implicit contracts that come once the supplier has invested sunk costs. Simply entering into an LTA may help to cement the relationship.[216] The demonstration of competence may also deter the buyer's exit from the

214. Gilson et al., *Contracting for Innovation*, *supra* note 38, at 476 (stating that the "mutual investment" serves as a safeguard against "opportunism").

215. Kostritsky, *supra* note 15, at 1673 (stating how LTAs can control terms for suppliers across the board); *see Purchase Orders Helping to Control Costs*, ZENVENTORY, https://www.zenventory.com/purchase-orders-help-control-costs/ (last visited Nov. 28, 2020).

216. Interview with [Redacted], in [Redacted]. (June 17, 2017) (confidential source on file with author).

relationship as finding other competent suppliers will take time.[217]

Thus, where the sunk costs are large and the goods are not fungible, the ability to recoup or to protect such investment will depend on a variety of strategies, some informal and some contractual. If the sunk costs are low, the LTA may not be needed. Although an LTA may offer protection for the supplier, the buyer may find enough other benefits in the LTA to offer the cost of an LTA and make it cost minimizing for the buyer. Transaction cost minimization may help to explain other differences, as discussed below.

G. Informal and Implicit Contracts

Even without a contractual provision protecting its sunk costs, a supplier may be relying on the iterative exchange of information and personnel to build up a relationship of trust. Such a relationship will serve to curb opportunistic behavior by the buyer. The information exchange leads to an incremental reduction of uncertainty about buyer opportunism. Moreover, as both parties learn more and become more comfortable as partners, switching out becomes less feasible. Entering into an LTA and engaging in the exchange of information resulting in "braiding" becomes a private strategy to bind the parties together and also results in protecting the suppliers' sunk costs. Implicit contracts then arise to protect the supplier. For example, when the Lear Company developed seats for a Honda minivan and that minivan was never made, each party accommodated the other. Lear agreed that the downturn in demand was an outside event that excused Honda from buying the seats. Honda, despite there being no enforceable obligation, helped Lear enter the side mirror and other markets. These implicit contracts that arise from long-term partnerships help to explain why suppliers with large sunk costs are willing to enter into LTAs; the implicit contract protections serve as a private strategy of protection. The supplier may believe and rest on an implicit contract that the buyer will protect suppliers who invest large sunk costs, even without being obligated to do so. Another example of this occurred with Honda Motor Company and Donnelly.[218]

Cost minimization as a tool for understanding supply chain arrangements can be understood in this way. Where there are large sunk costs being demanded of suppliers, the LTA may offer a cost-effective safeguard against opportunism. Some of these protections are implicit contracts to protect suppliers who invest for buyers. Other safeguards arise from the switching

217. It is not actually necessary to enter an LTA to demonstrate competence since a supplier investing and producing could demonstrate that competence over time, leading to a lock-in effect. The question is what protection the LTA offers suppliers in terms of a security of commitment (legal or implicit) or in terms of protection for sunk costs as, for example, a provision that obligates the buyer to pay for parts and sunk costs when the buyer decides to terminate.

218. Interview with Susan Helper, *supra* note 96.

costs from iterative investments. Where sunk costs are low, the supplier can easily exit to protect itself and the costs of an LTA may not be justified.

The cost minimization explanation linking LTAs to large sunk costs by suppliers may also explain another governance mechanism in the LTAs: the use of a veto. Professor Jennejohn explains the veto right contained in many LTAs involving intellectual property as a way of providing a "right to exclude."[219] The party wants a veto power to exclude the counterparty from appropriating his foreground intellectual property. The veto is a governance mechanism. The question is why it would be a cost minimizing way to deal with the threat of appropriation of intellectual property. The answer is that without the veto, there is the threat that the property may be shared and the boundaries improperly delineated. Once that occurs, it may be difficult to unwind and separate out the intellectual property. The type of governance mechanisms featured in the work of the innovation scholars that bind parties together and prevent an early exit or opportunism in the form of shading of quality may not work with protecting "foreground IP."[220] Once the property is shared, "U.S. patent law allows a joint owner to license and otherwise exploit a jointly owned asset," and the most cost-effective mechanism is to prevent the appropriation from occurring in the first place.[221] Informal sanctioning would not work because there would be nothing to sanction once the intellectual property had been appropriated. Thus, the parties may agree to an LTA that contains a veto right since the problem of protecting foreground intellectual property cannot be solved through informal sanctioning. In this situation, an LTA with a veto provision may be needed. The LTA veto provision responds to a risk that cannot be controlled with the informal sanctioning. Thus, the extra conduct provision is cost minimizing.

Another example of an LTA as a cost minimization strategy can be found with *Apple and SCI*. On their face, the extensive collaboration provisions reflected in the agreement between *Apple and SCI* may seem burdensome and costly.[222] However, the costs of those undertakings by the supplier in a collaborative undertaking will be considered, along with the risk of multiple suppliers, and weighed against the greater switching costs if the supplier can demonstrate that it is a worthier, more collaborative supplier than other Apple suppliers. Then, Apple will bear the greater investment in collaborative efforts going forward because it would be loath to lose the worthy supplier as a partner. The supplier would consider the benefits of

219. Jennejohn, *Private Order*, *supra* note 112, at 324.

220. Gilson et al., *Braiding*, *supra* note 8, at 1410–11 (stating how parties use different governing mechanisms to lock each other into an agreement); Jennejohn, *Private Order*, *supra* note 112, at 308.

221. Jennejohn, *Private Order*, *supra* note 112, at 324.

222. *See Apple-SCI Agreement*, *supra* note 99.

such loyalty and security along with the other benefits of the contract, including the initial three-year purchase commitment.

If the supplier encounters a circumstance that changes its calculus of whether the implicit contract will still offer protection without an explicit provision to do so, the supplier may no longer view the LTA as a cost minimizing strategy. Parties and courts constantly trade off these costs. Parties will no longer participate in the informal governance mechanism if the costs are not offset by greater benefits in achieving parties' goals while minimizing costs. For example, the supplier's willingness to enter into an LTA may depend on whether the supplier believes the buyer is trustworthy. When the supplier believes that the buyer is opportunistic and will renege on any obligations in the LTA, the supplier's calculus changes because the buyer's propensity to act opportunistically will require additional protections. Once the buyer decides that it can cancel at will, the implicit protections afforded by iterative investment may no longer be effective.

Doubts about the buyer's use of supplier information might lead to another cost minimizing strategy — hedging. In circumstances where the supplier has doubts about the buyer, the supplier may start to hedge and withhold some private information. That hedging strategy can be seen as a cost minimizing strategy by the supplier to control buyer opportunism when the contract itself does not constrain such behavior. The hedging strategy differs from opting out of an LTA. Instead of opting out, a supplier holds back information while technically complying with its obligations under an LTA.

X. CONCLUSION

Manufacturers seem to be making deliberate choices about whether to operate using an LTA or an alternative arrangement, such as a purchase order or terms and conditions. These deliberate choices are often tied to whether a manufacturer is likely to incur significant capital expenditures or the potential for large sunk costs as the result of the transaction. When a supplier does not have large sunk costs and is making a fungible good, and can easily exit the relationship without sacrificing large investments, the cost minimizing strategy may be to use an alternative to the LTA and rely on other arrangements.

Although the sample size in this study was small, our results provide additional insights into manufacturer decision making regarding contractual arrangements. Our survey of Ohio manufacturers highlights that manufacturers have to weigh many considerations before entering into an LTA. Weighing these considerations leads to a diversity of contractual arrangements among manufacturers, with only a small minority (seventeen percent) using LTAs in most of their transactions.

Our empirical findings are consistent with a model of bargaining under

conditions that include bounded rationality, sunk costs, and opportunism. In instances where a supplier is requested to customize a product for a buyer, and such customization results in significant sunk costs for the manufacturer, then the manufacturer rationally may seek to protect itself through an LTA. Without the protection of an LTA, the buyer may exit the relationship easily and the overall transaction becomes costly for the supplier. LTAs can also provide additional frameworks, such as information-sharing provisions, to help safeguard the supplier's relationship with the buyer. These findings provided from manufacturer surveys serve as a useful complement to current research reviewing existing LTAs and theoretical models exploring the potential use of such agreements.

QUESTIONNAIRE FOR SUPPLIERS SELLING TO CUSTOMERS

Requesting Participation in Survey
Case Western Reserve University

Dear Manufacturer,

I am a professor at Case Western Reserve University Law School. My special areas of expertise are Contracts and Law and Economics. I am studying the legal relationships between manufacturing companies and their customers in the supply chain. In order to complete this study, we are conducting a survey of various suppliers who manufacture goods or parts for their customers. Your response to this survey would be invaluable to the study. All responses will remain anonymous. You have been selected because you are a manufacturer in Ohio, Wisconsin, or Michigan who produces products or parts used by customer/buyers who may use your input in a product they manufacture and sell. You are either in Sales and Marketing or the General Counsel's office. If you receive this survey and another person at your company is better equipped to answer the survey, please redirect it to them. The purpose of this survey is to determine when manufacturing companies and their customers rely on various long-term or master supply agreements (LTAs; MSAs) to guide their interactions. Specifically, we are hoping to learn when companies use these agreements, what specific purposes the agreements serve, when companies use alternatives to an LTA or MSA (such as a purchase order, quote and acknowledgement or another arrangement such as acting as a contract manufacturer or entering a licensing agreement on a jointly developed product without using an LTA or MSA). Feel free to include any additional comments you deem necessary or relevant to our study.

BACKGROUND QUESTIONS

Q1 **What are your company's main products?**

_____

Q2 **What percentage of your work for customers is a customizable good?**

- o 0-10% (1)
- o 11-35% (2)
- o 36-66% (3)
- o 67-100% (4)

Q3 **What percentage of your work for customers is a commodity or fungible good?**

- o 0-10% (1)
- o 11-35% (2)
- o 36-66% (3)
- o 67-100% (4)

Q4 **For what percentage of sales do you acquire capital equipment or tooling that will be used for a specific buyer that is significant in cost?**

- o 0-10% (1)
- o 11-35% (2)
- o 36-66% (3)
- o 67-100% (4)

LONG TERM AGREEMENT ("LTA") / MASTER SUPPLY AGREEMENT ("MSA") OR OTHER GOVERNING DOCUMENTS

Q5 **If you use LTAs or MSAs, which of the following provisions is the MOST and LEAST important to you in terms of a possible lawsuit later on? Please organize the options for 1 MOST important to 6 LEAST important.**

____Provision to protect capital equipment costs or tooling costs (1)
____Indemnity for intellectual property infringement (2)
____Damages cap (3)
____Indemnity for damages caused to a third party (4)
____Warranty disclaimers (5)
____Limitation of remedies provision (6)

Q6 **In what percentage of transactions do you sign an LTA or MSA?**

- o 0-10% (1)
- o 11-25% (2)
- o 26-75% (3)
- o 76-100% (4)

Q7 **What percentage of firm revenues do transactions with an LTA or MSA represent for your firm?**

- o 0-25% (1)
- o 26-50% (2)
- o 51-75% (3)
- o 76-100% (4)

Q8 **If you sign an LTA or MSA, in what percentage is the agreement drafted by you?**

- o 0-10% (1)
- o 11-25% (2)
- o 26-75% (3)
- o 76-100% (4)

Q9 **What are the main reasons you sign LTAs or MSAs?**

- ☐ Security of continuing commitment from the buyer (1)
- ☐ No choice; dictated by the buyer (2)
- ☐ Establish an efficient system for information sharing to improve your product (3)
- ☐ Demonstrate your commitment to the quality of your product or process (4)
- ☐ Other, explain below: (5) _____

Q10 **If you sign an LTA or MSA, are you required to share information with the buyer about engineering, costs and/or quality?**

- o Yes (1)
- o No (2)
- o No (3)

Q11 **If you do NOT sign an LTA or MSA with the sharing of information, do you supply that information to your buyer anyway? Please explain your response.**

- o Yes, explain: (1) _____
- o No, explain: (2) _____

Q12 **If you do NOT sign LTAs or MSAs, please rank order the reasons you did not sign an LTA with 1 being the MOST important the 6 being the LEAST important.**

____Terms too onerous (1)
____Do not want to sign a competition out clause (2)
____Do not want to allow buyer a right to terminate for convenience (3)
____Price reduction requirements too onerous (4)
____Already doing business under other documents such as terms and conditions or purchase order (5)
____Other, explain below: (6) _____

Q13 **What type of buyers or industries insist on an LTA or MSA?**

_____

Q14 **Do the buyers or industries that insist on LTAs or MSA have any of the following characteristics in common?**

- o Buyer is large in size or an Original Equipment Manufacturer (1)
- o Buyer is engaged in intensive collaboration with us on innovated product (2)
- o Other, explain below: (3) _____

Q15 **Select the answer that best applies. Are the buyers who insist on using LTAs or MSAs:**

- o In the top 20% of companies you work with in terms of size and/or revenue (1)
- o In the top 50% of companies you work with in terms of size and/or revenue (2)
- o In the bottom 20% of companies you work with in terms of size and/or revenue (3)

Q16 **In what percentage of your deals do you agree to manufacture a product without an LTA or MSA in place?**

- o 0-10% (1)
- o 11-35% (2)
- o 36-75% (3)
- o 76-100% (4)

Q17 **If you do agree to manufacture a product without an LTA or MSA, what document/s would govern this transaction? <u>Pick all that apply.</u>**

- ☐ Intellectual Property and Licensing Agreements (1)
- ☐ Blueprints only; you act as a contract manufacturer (2)
- ☐ Terms and Conditions (3)
- ☐ Purchase order/quote/acknowledgement (4)
- ☐ Other, explain below: (5) _____

Q18 **If you sign an LTA or MSA, in what percentage of agreements does it contain a minimum quantity, percentage volume, or exact quantity term?**

- o 0-10% (1)
- o 11-35% (2)
- o 36-66% (3)
- o 67-100% (4)

Q19 **If the LTA or MSA has no quantity clause or no minimum quantity clause and no percentage volume commitment, would you consider the agreement at the time that it is signed to be?**

- o Legally enforceable (1)
- o Legally unenforceable (2)
- o Not sure (3)

Q20 **If the LTA or MSA lacks a quantity term, when do you think the LTA or MSA would become enforceable?**

- o When the first purchase order was signed (1)
- o When the LTA or MSA is signed (2)
- o Another time, explain below: (3) _____

Q21 **In what percentage of cases do you agree that the buyer can terminate for convenience as a clause in the LTA or MSA?**

- o 0-10% (1)
- o 11-25% (2)
- o 26-75% (3)
- o 76-100% (4)

Q22 **Suppose your LTA/MSA had NO termination for convenience clause. If your buyer indicated it no longer needed your parts and wanted to terminate 2 years into a 3-year contract, would you allow the buyer to exit anyway?**

- o Yes (1)
- o No (2)
- o In some cases only, explain below: (3) _____

Q23 **In what percentage of cases do you need to prequalify as a supplier to sell your products to a buyer even if there is no LTA or MSA?**

- o 0-25% (1)
- o 26-50% (2)
- o 51-75% (3)
- o 76-100% (4)

Q24 **In what percentage of sales does the Purchase Order or Terms and Conditions from your buyer or Instructions on the Buyer's website require your product to comply with a buyer quality or excellence manual?**

- o 0-25% (1)
- o 26-50% (2)
- o 51-75% (3)
- o 76-100% (4)

Q25 **If you are required to participate in an ongoing quality assessment program by the buyer, how is it required? Please select any that apply.**

- ☐ LTA or MSA (1)
- ☐ Terms of a purchase order (2)
- ☐ Terms and conditions of your customer (3)
- ☐ Other, explain below: (4) _____

INTERACTIONS BETWEEN MANUFACTURER AND BUYER

Q26 **Are you required to attend any, or a certain number of, meetings with the buyer because of an LTA or MSA provision?**

- o Yes (1)
- o No (2)

Q27 **If not required to attend meetings with the buyer as required under the LTA or MSA, do you attend meetings anyway?**

- o Yes (1)
- o No (2)

PRODUCT DESIGN

Q28 **What percentage of your products are co-designed in collaboration with the buyer?**

- o 0-10% (1)
- o 11-25% (2)
- o 26-75% (3)
- o 76-100% (4)

Q29 **If there is significant collaboration with a buyer, in what percentage of cases do you enter an LTA or MSA?**

- o 0-10% (1)
- o 11-25% (2)
- o 26-75% (3)
- o 76-100% (4)

Q30 **If you collaborated in design, how successful would you rate the collaboration?**

- o Not at all successful (1)
- o Somewhat successful (2)
- o Moderately successful (3)
- o Very successful (4)

Q31 **In what percentage of cases does the buyer supply you with blueprints for the end product (or, together, you determine the blueprints for the end product) and your only job is to execute the blueprints?**

- 0-10% (1)
- 11-25% (2)
- 26-75% (3)
- 76-100% (4)

COUNSEL AND DISPUTES

Q32 **In any arrangement with the buyer under a purchase order, LTA, or MSA, in what percentage of cases would you resort to suing the buyer because of a dispute?**

- 0-10% (1)
- 11-25% (2)
- 26-75% (3)
- 76-100% (4)

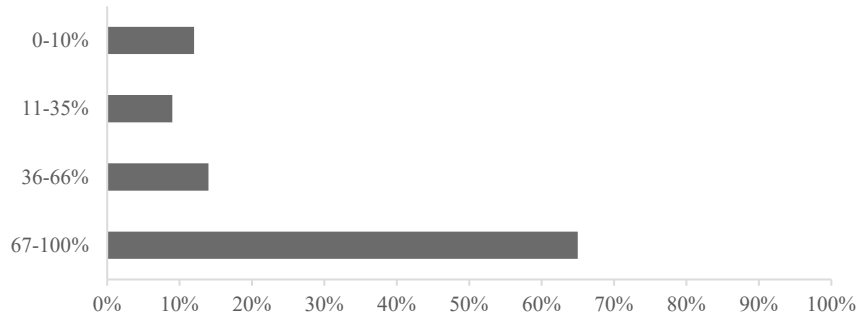
Q40 **Is there any additional information that you would like to share with us at this time?**

_____

AGGREGATED SURVEY RESPONSES

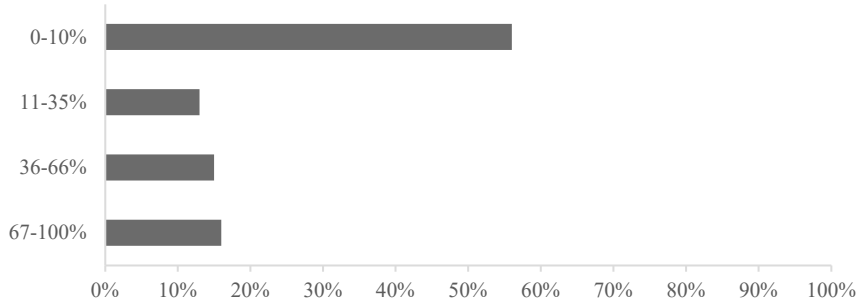
Q1 – What are your company's main products?

Q2 – What percentage of your work for customers is a customizable good?



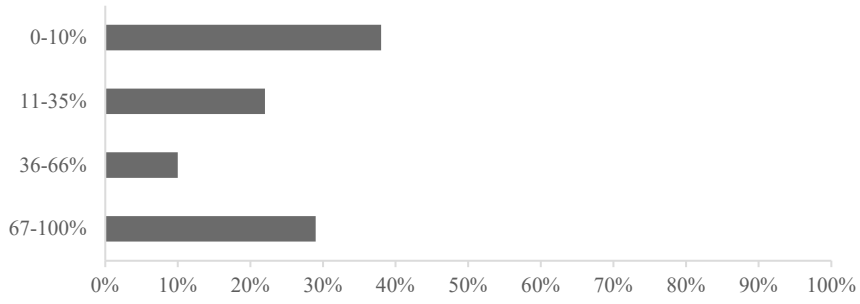
#	Answer	%	Count
4	67-100%	65%	45
3	36-66%	14%	10
2	11-35%	9%	6
1	0-10%	12%	8
	Total	100%	69

Q3 – What percentage of your work for customers is a commodity or fungible good?



#	What percentage of your work for customers is a commodity or fungible good?	Percentage
1	0-10%	56%
2	11-35%	13%
3	36-66%	15%
4	67-100%	16%
	Total	68

Q4 – For what percentage of sales do you acquire capital equipment or tooling that will be used for a specific buyer that is significant in cost?

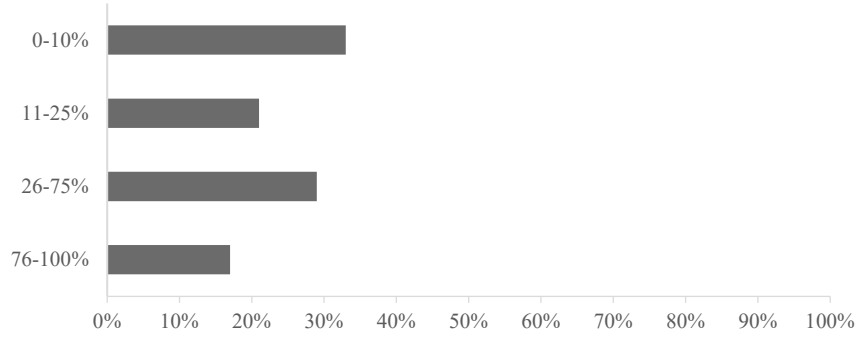


#	Answer	%	Count
1	0-10%	38%	26
2	11-35%	22%	15
3	36-66%	10%	7
4	67-100%	29%	20
	Total	100%	68

Q5 – If you use LTAs or MSAs, which of the following provisions is the MOST and LEAST important to you in terms of a possible lawsuit later on? Please organize the options for 1 MOST important to 6 LEAST important.

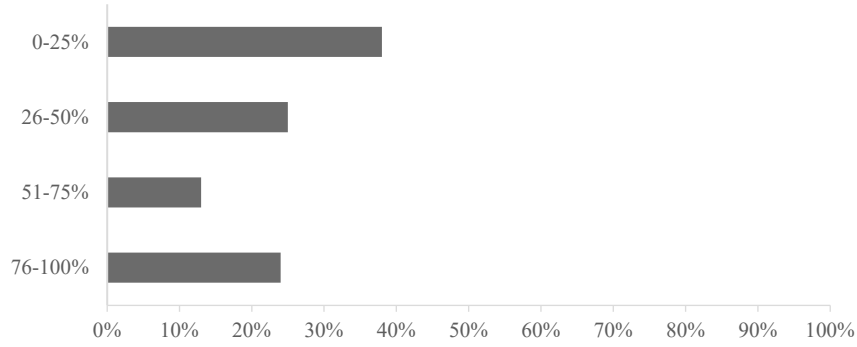
#	Question	1	2	3	4	5	6	Total
1	Provision to protect capital equipment costs or tooling costs	30%	17%	4%	6%	11%	32%	47
2	Indemnity for intellectual property infringement	23%	11%	9%	17%	17%	23%	47
3	Damages cap	17%	19%	26%	23%	6%	9%	47
4	Indemnity for damages caused to a third party	15%	13%	21%	28%	17%	6%	47
5	Warranty disclaimers	9%	30%	13%	19%	26%	4%	47
6	Limitation of remedies provision	6%	11%	28%	6%	23%	26%	47

Q6 – In what percentage of transactions do you sign an LTA or MSA?



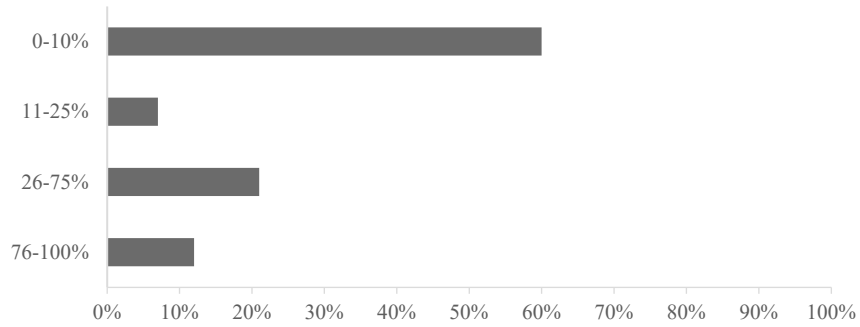
#	Answer	%	Count
1	0-10%	33%	21
2	11-25%	21%	13
3	26-75%	29%	18
4	76-100%	17%	11
	Total	100%	63

Q7 – What percentage of firm revenues do transactions with an LTA or MSA represent for your firm?



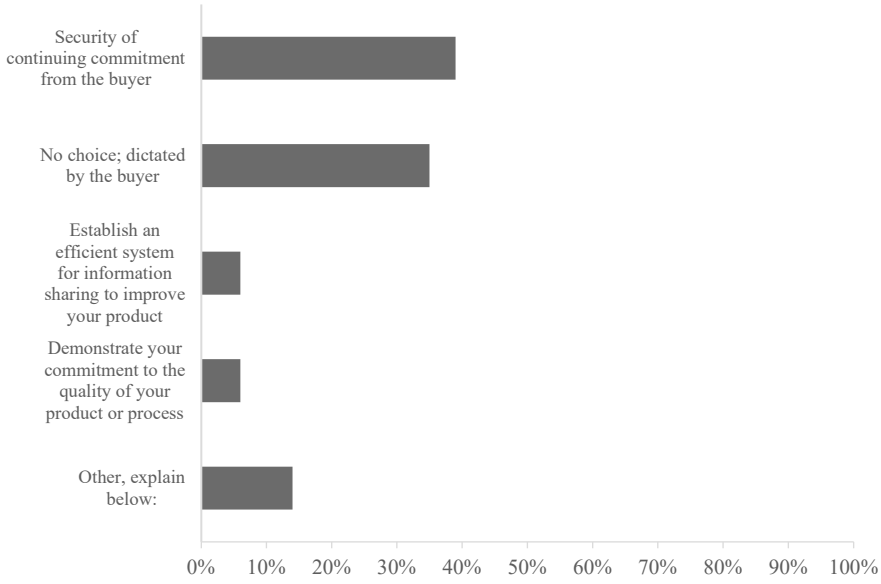
#	What percentage of firm revenues do transactions with an LTA or MSA represent for your firm?	Percentage
1	0-25%	38%
2	26-50%	25%
3	51-75%	13%
4	76-100%	24%
	Total	63

Q8 – If you sign an LTA or MSA, in what percentage is the agreement drafted by you?



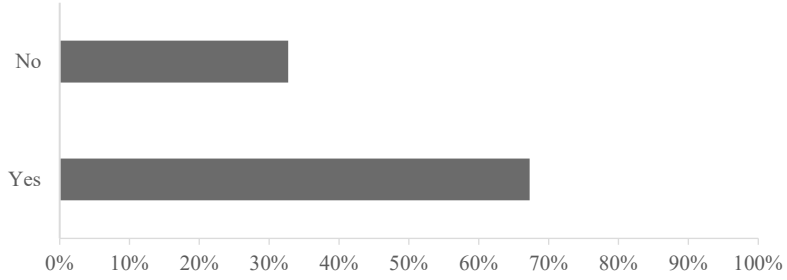
#	If you sign an LTA or MSA, in what percentage is the agreement drafted by you?	Percentage
1	0-10%	60%
2	11-25%	7%
3	26-75%	21%
4	76-100%	12%
	Total	58

Q9 – What are the main reasons you sign LTAs or MSAs?

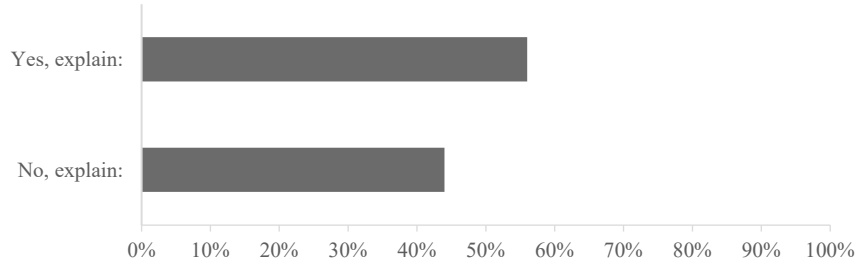


#	What are the main reasons you sign LTAs or MSAs? - Selected Choice	Percentage
1	Security of continuing commitment from the buyer	39%
2	No choice; dictated by the buyer	35%
3	Establish an efficient system for information sharing to improve your product	6%
4	Demonstrate your commitment to the quality of your product or process	6%
5	Other, explain below:	14%
	Total	80

Q10 – If you sign an LTA or MSA, are you required to share information with the buyer about engineering, costs and/or quality?



Q11 – If you do NOT sign an LTA or MSA with the sharing of information, do you supply that information to your buyer anyway? Please explain your response.



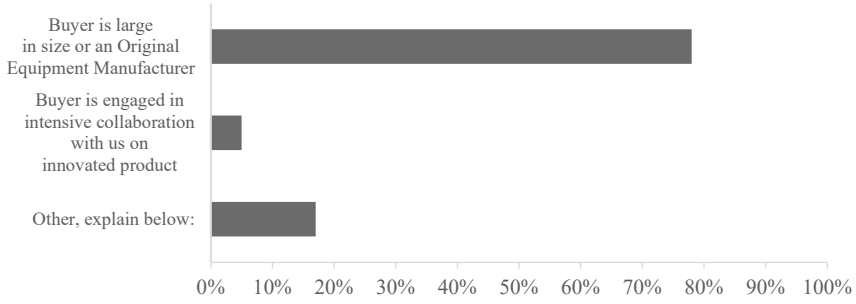
#	If you do NOT sign an LTA or MSA with the sharing of information, do you supply that information to your buyer anyway? Please explain your response. - Selected Choice	Percentage
1	Yes, explain:	56%
2	No, explain:	44%
	Total	64

Q12 – If you do NOT sign LTAs or MSAs, please rank order the reasons you did not sign an LTA with 1 being the MOST important the 6 being the LEAST important.

#	Question	1	2	3	4	5	6	Total
6	Other, explain below:	8%	3%	2%	0%	3%	85%	65
5	Already doing business under other documents such as terms and conditions or purchase order	29%	11%	6%	6%	40%	8%	65
4	Price reduction requirements too onerous	12%	17%	11%	37%	20%	3%	65
3	Do not want to allow buyer a right to terminate for convenience	5%	8%	38%	31%	18%	0%	65
2	Do not want to sign a competition out clause	2%	32%	26%	17%	18%	5%	65
1	Terms too onerous	45%	29%	17%	9%	0%	0%	65

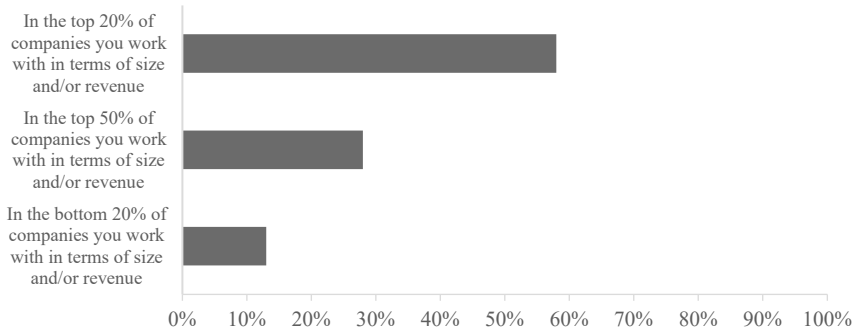
Q13 – What type of buyers or industries insist on an LTA or MSA?

Q14 – Do the buyers or industries that insist on LTAs or MSA have any of the following characteristics in common?



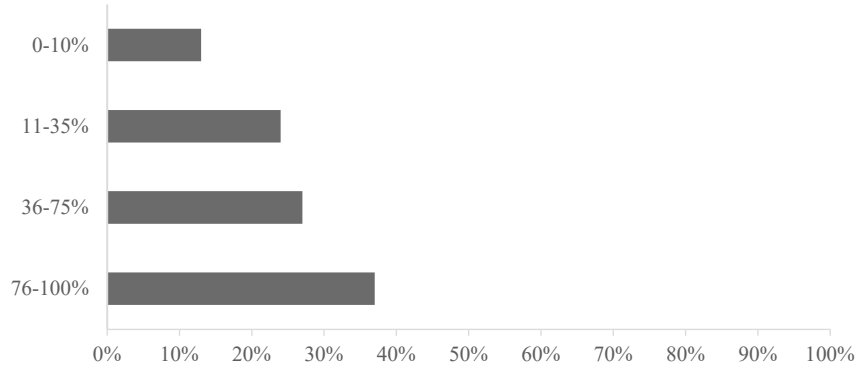
#	Do the buyers or industries that insist on LTAs or MSA have any of the following characteristics in common? - Selected Choice	Percentage
1	Buyer is large in size or an Original Equipment Manufacturer	78%
2	Buyer is engaged in intensive collaboration with us on innovated product	5%
3	Other, explain below:	17%
	Total	64

Q15 – Select the answer that best applies. Are the buyers who insist on using LTAs or MSAs:



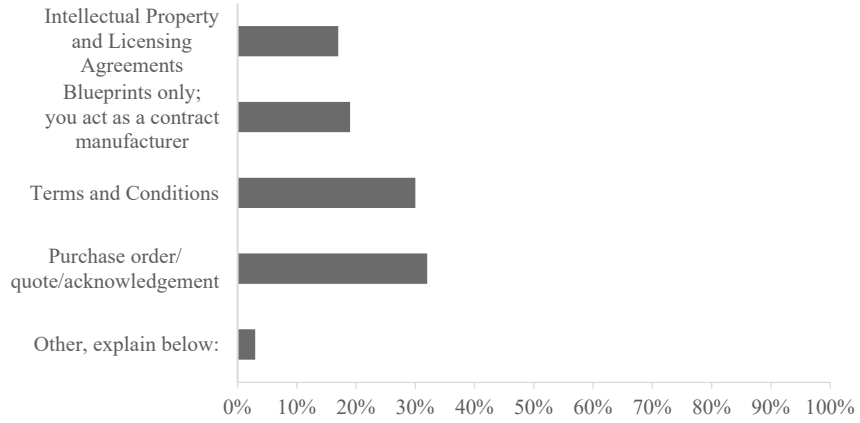
#	Select the answer that best applies. Are the buyers who insist on using LTAs or MSAs:	Percentage
1	In the top 20% of companies you work with in terms of size and/or revenue	58%
2	In the top 50% of companies you work with in terms of size and/or revenue	28%
3	In the bottom 20% of companies you work with in terms of size and/or revenue	13%
	Total	60

Q16 – In what percentage of your deals do you agree to manufacture a product without an LTA or MSA in place?



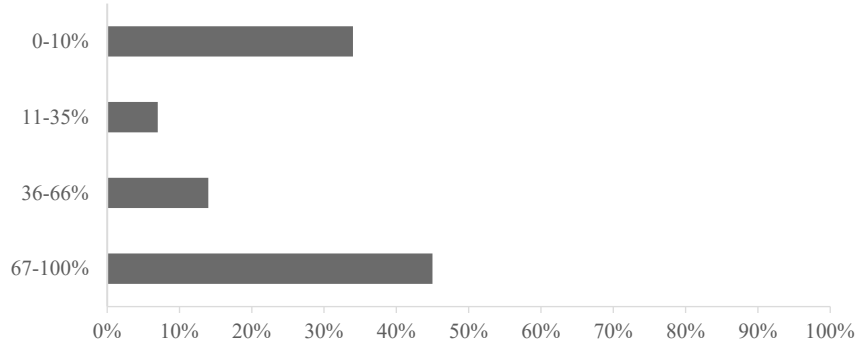
#	In what percentage of your deals do you agree to manufacture a product without an LTA or MSA in place?	Percentage
1	0-10%	13%
2	11-35%	24%
3	36-75%	27%
4	76-100%	37%
	Total	63

Q17 – If you do agree to manufacture a product without an LTA or MSA, what document/s would govern this transaction? Pick all that apply.



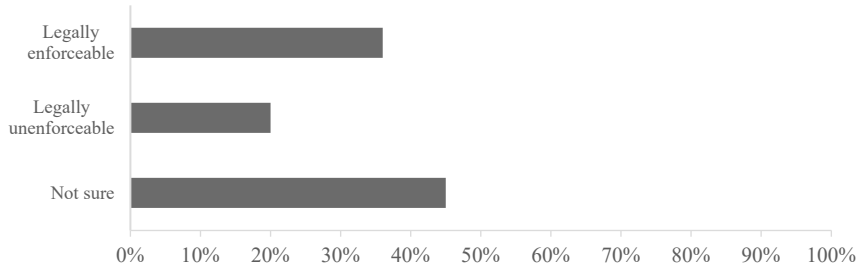
#	If you do agree to manufacture a product without an LTA or MSA, what document/s would govern this transaction? Pick all that apply. - Selected Choice	Percentage
1	Intellectual Property and Licensing Agreements	17%
2	Blueprints only; you act as a contract manufacturer	19%
3	Terms and Conditions	30%
4	Purchase order/quote/acknowledgement	32%
5	Other, explain below:	3%
	Total	155

Q18 – If you sign an LTA or MSA, in what percentage of agreements does it contain a minimum quantity, percentage volume, or exact quantity term?



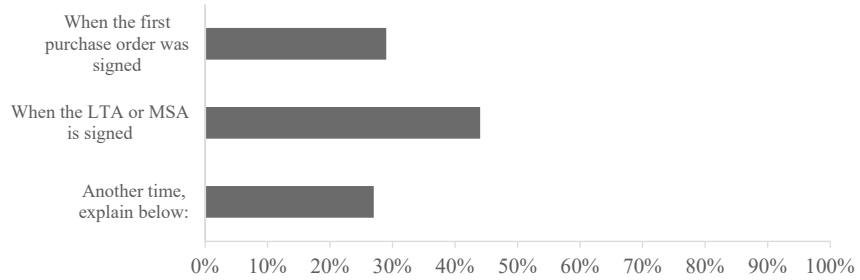
#	If you sign an LTA or MSA, in what percentage of agreements does it contain a minimum quantity, percentage volume, or exact quantity term?	Percentage
1	0-10%	34%
2	11-35%	7%
3	36-66%	14%
4	67-100%	45%
	Total	56

Q19 – If the LTA or MSA has no quantity clause or no minimum quantity clause and no percentage volume commitment, would you consider the agreement at the time that it is signed to be?



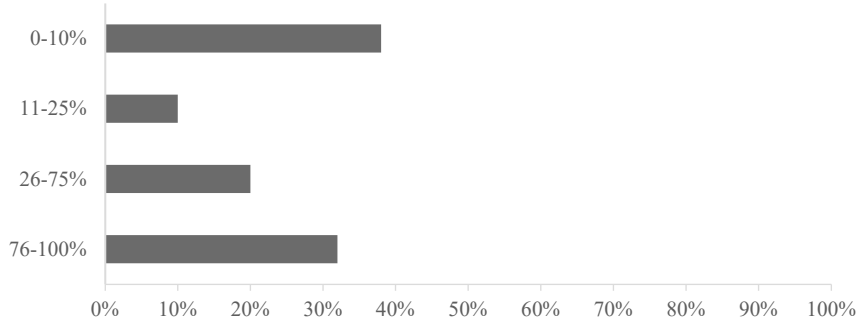
#	If the LTA or MSA has no quantity clause or no minimum quantity clause and no percentage volume commitment, would you consider the agreement at the time that it is signed to be?	Percentage
1	Legally enforceable	36%
2	Legally unenforceable	20%
3	Not sure	45%
	Total	56

Q20 – If the LTA or MSA lacks a quantity term, when do you think the LTA or MSA would become enforceable?



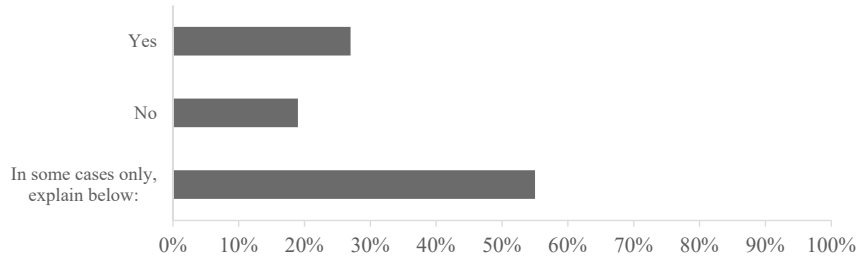
#	If the LTA or MSA lacks a quantity term, when do you think the LTA or MSA would become enforceable? - Selected Choice	Percentage
1	When the first purchase order was signed	29%
2	When the LTA or MSA is signed	44%
3	Another time, explain below:	27%
	Total	62

Q21 – In what percentage of cases do you agree that the buyer can terminate for convenience as a clause in the LTA or MSA?



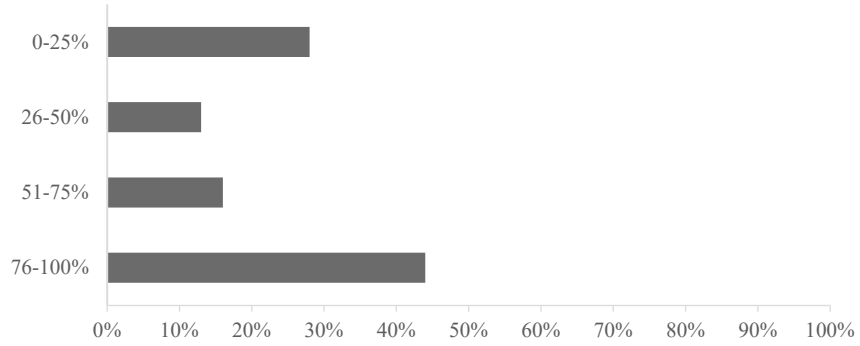
#	Answer	%	Count
4	76-100%	32%	19
3	26-75%	20%	12
2	11-25%	10%	6
1	0-10%	38%	23
	Total	100%	60

Q22 – Suppose your LTA/MSA had NO termination for convenience clause. If your buyer indicated it no longer needed your parts and wanted to terminate 2 years into a 3-year contract, would you allow the buyer to exit anyway?



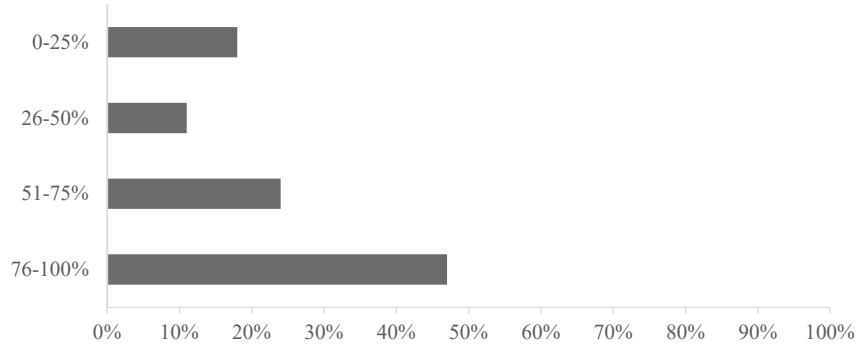
#	**Suppose your LTA/MSA had NO termination for convenience clause. If your buyer indicated it no longer needed your parts and wanted to terminate 2 years into a 3-year contract, would you allow the buyer to exit anyway? - Selected Choice**	**Percentage**
1	Yes	27%
2	No	19%
3	In some cases only, explain below:	55%
	Total	64

Q23 – In what percentage of cases do you need to prequalify as a supplier to sell your products to a buyer even if there is no LTA or MSA?



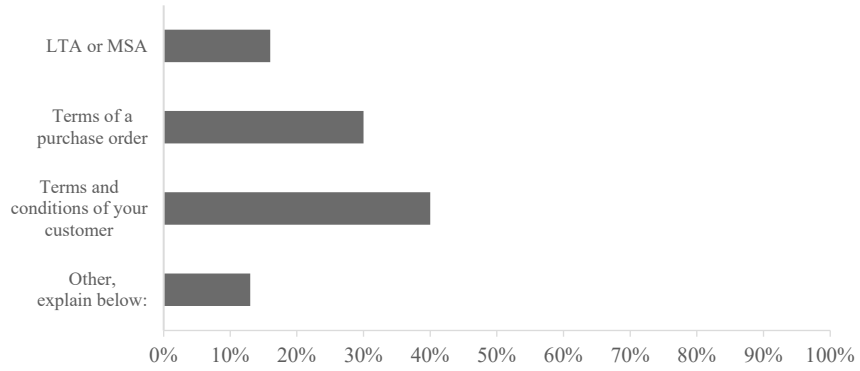
#	**In what percentage of cases do you need to prequalify as a supplier to sell your products to a buyer even if there is no LTA or MSA?**	**Percentage**
1	0-25%	28%
2	26-50%	13%
3	51-75%	16%
4	76-100%	44%
	Total	64

Q24 – In what percentage of sales does the Purchase Order or Terms and Conditions from your buyer or Instructions on the Buyer's website require your product to comply with a buyer quality or excellence manual?



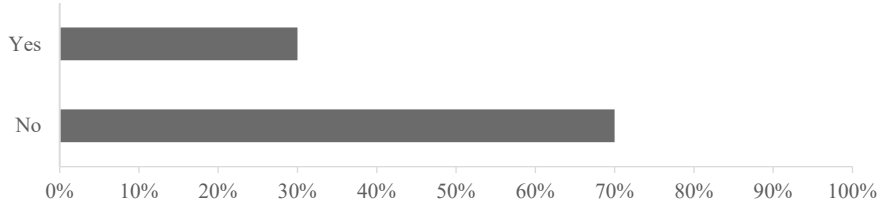
#	In what percentage of sales does the Purchase Order or Terms and Conditions from your buyer or Instructions on the Buyer's website require your product to comply with a buyer quality or excellence manual?	Percentage
1	0-25%	18%
2	26-50%	11%
3	51-75%	24%
4	76-100%	47%
	Total	66

Q25 – If you are required to participate in an ongoing quality assessment program by the buyer, how is it required? Please select any that apply.



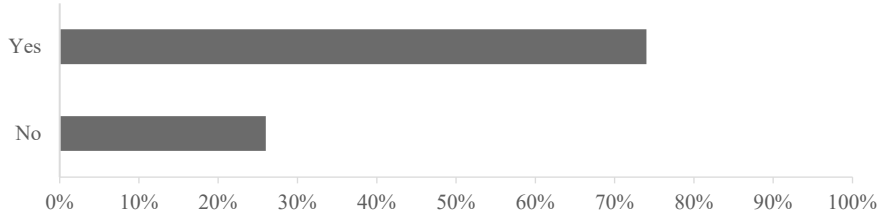
#	If you are required to participate in an ongoing quality assessment program by the buyer, how is it required? Please select any that apply. - Selected Choice	Percentage
1	LTA or MSA	16%
2	Terms of a purchase order	30%
3	Terms and conditions of your customer	40%
4	Other, explain below:	13%
	Total	105

Q26 – Are you required to attend any, or a certain number of, meetings with the buyer because of an LTA or MSA provision?



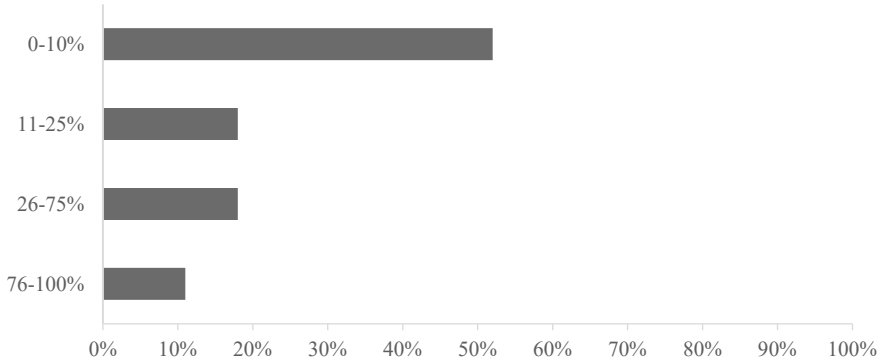
#	Are you required to attend any, or a certain number of, meetings with the buyer because of an LTA or MSA provision?	Percentage
1	Yes	30%
2	No	70%
	Total	61

Q27 – If not required to attend meetings with the buyer as required under the LTA or MSA, do you attend meetings anyway?



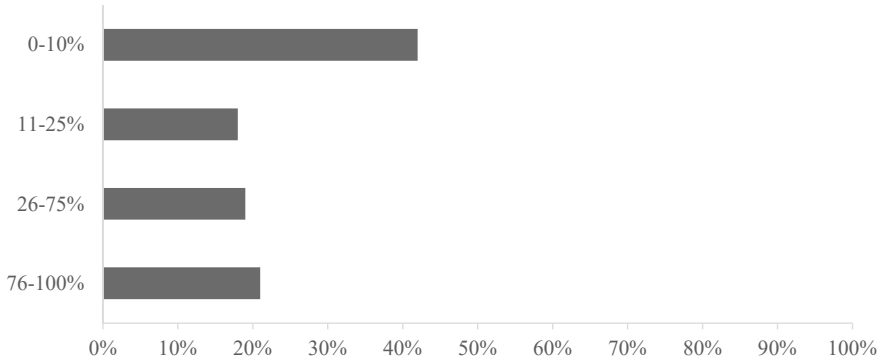
#	If not required to attend meetings with the buyer as required under the LTA or MSA, do you attend meetings anyway?	Percentage
1	Yes	74%
2	No	26%
	Total	43

Q28 – What percentage of your products are co-designed in collaboration with the buyer?



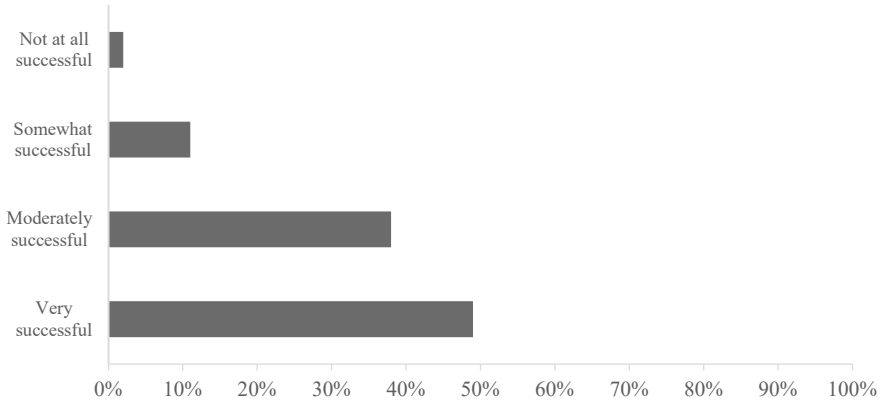
#	What percentage of your products are co-designed in collaboration with the buyer?	Percentage
1	0-10%	52%
2	11-25%	18%
3	26-75%	18%
4	76-100%	11%
	Total	65

Q29 – If there is significant collaboration with a buyer, in what percentage of cases do you enter an LTA or MSA?



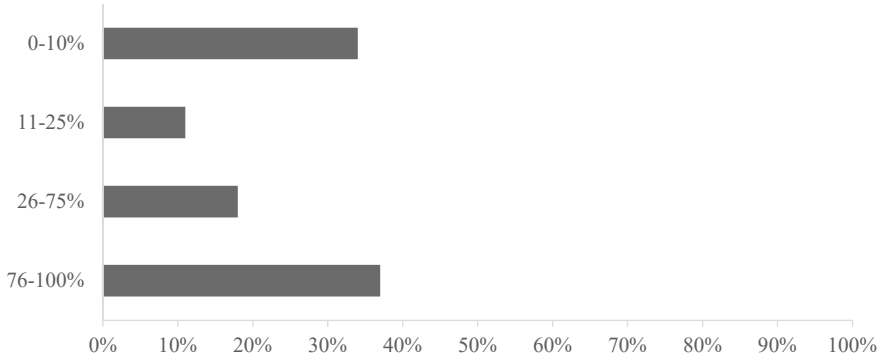
#	If there is significant collaboration with a buyer, in what percentage of cases do you enter an LTA or MSA?	Percentage
1	0-10%	42%
2	11-25%	18%
3	26-75%	19%
4	76-100%	21%
	Total	57

Q30 – If you collaborated in design, how successful would you rate the collaboration?



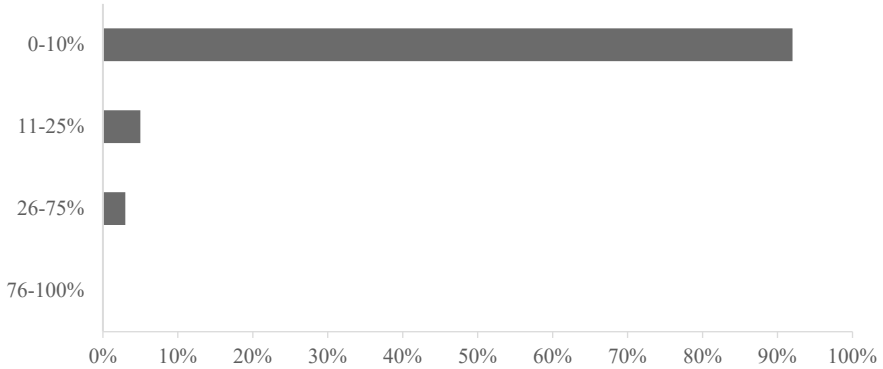
#	If you collaborated in design, how successful would you rate the collaboration?	Percentage
1	Not at all successful	2%
2	Somewhat successful	11%
3	Moderately successful	38%
4	Very successful	49%
	Total	53

Q31 – In what percentage of cases does the buyer supply you with blueprints for the end product (or, together, you determine the blueprints for the end product) and your only job is to execute the blueprints?



#	In what percentage of cases does the buyer supply you with blueprints for the end product (or, together, you determine the blueprints for the end product) and your only job is to execute the blueprints?	Percentage
1	0-10%	34%
2	11-25%	11%
3	26-75%	18%
4	76-100%	37%
	Total	65

Q32 – In any arrangement with the buyer under a purchase order, LTA, or MSA, in what percentage of cases would you resort to suing the buyer because of a dispute?



#	**In any arrangement with the buyer under a purchase order, LTA, or MSA, in what percentage of cases would you resort to suing the buyer because of a dispute?**	**Percentage**
1	0-10%	92%
2	11-25%	5%
3	26-75%	3%
4	76-100%	0%
	Total	64

AUTHORIZATION OF DISCOVERY IN INTERNATIONAL COMMERCIAL ARBITRATION: DEMYSTIFYING THE SIXTH CIRCUIT'S STATUTORY CONSTRUCTION OF 28 U.S.C. § 1782(a)

JASON ARENDT*

* Note and Comment Editor, *American University Business Law Review*, Volume 10; J.D. Candidate, 2021, American University Washington College of Law. I am forever grateful for the valuable guidance from the *American University Business Law Review* staff who made this piece possible. I would like to thank my parents, brother, and grandparents for their support. This piece is dedicated to my late grandmother, Marlen.

I. INTRODUCTION

International commercial arbitration is a dispute resolution method between two or more parties who are contractually bound by the rules of a private arbitral body.[1] Parties voluntarily enter into contractual agreements that require arbitration if a dispute arises for a more predictable, efficient, and cost-effective dispute resolution method.[2] As international arbitration awards are subject to international treaties and conventions, parties may be certain their awards are enforceable regardless of venue.[3]

In March 2018, a dispute arose in the Dubai International Financial Centre-London Court of International Arbitration ("DIFC-LCIA") between Abdul Latif Jameel Transportation Company ("ALJ") and FedEx International Corporation.[4] In July 2018, the District Court for the Western District of Tennessee denied Abdul Latif Jameel's request for discovery citing a lack of authority to assist in discovery requests under 28 U.S.C. § 1782(a).[5] On appeal, the Sixth Circuit reversed the district court's opinion

1. Susan Gualtier, *International Commercial Arbitration*, HAUSER N.Y.U.L.: HAUSER GLOBAL L. SCH. PROGRAM (Nov./Dec. 2014), https://www.nyulawglobal.org/globalex/International_Commercial_Arbitration.html.

2. *See* NBC v. Bear Stearns & Co., 165 F.3d 184, 190–91 (2d Cir. 1999) (citing Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 280 (1995)) (noting that arbitration's popularity as a dispute resolution method can be attributed to its "efficiency and cost-effectiveness"). *See generally* LATHAM & WATKINS, GUIDE TO INTERNATIONAL ARBITRATION (2017), https://www.lw.com/thoughtleadership/guide-to-international-arbitration-2017 (attributing the rise of international commercial arbitration to multilateral enforceability, neutral forums, procedural flexibility, arbitrators' experience, and party autonomy).

3. *See, e.g.*, Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. 2, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3 (enforcing foreign arbitral awards among member states who are parties to the agreement).

4. Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings), 939 F.3d 710, 714 (6th Cir. 2019) (explaining that the dispute between ALJ and FedEx arose from a General Service Provider Agreement that was broken when FedEx partnered with an ALJ competitor).

5. *In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d at 716; Order, *In re* Application of Abdul Latif Jameel Transp. Co., No. 2:18-mc-00021 (W.D. Tenn. Mar. 13, 2019) (denying Application for Judicial Assistance and holding that the district court did not need to apply the discretionary factors laid out in *Intel Corp.*

and remanded to the lower court to determine whether to grant discovery under a test set forth in *Intel Corp. v. Advanced Micro Devices, Inc.*[6] The Sixth Circuit's decision in *Abdul Latif Jameel Transportation Co. v. FedEx Corp.*[7] departed from the pre-*Intel* decisions of the Second and Fifth Circuits, significantly altering the role of district courts in discovery assistance in international commercial arbitration.[8]

This Comment will support the Sixth Circuit's construction of 28 U.S.C. § 1782(a) over the earlier constructions of the Second and Fifth Circuits because of the U.S. Supreme Court's expansion of a district court's authority to compel discovery under 28 U.S.C. § 1782(a). Part II of this Comment will first provide context surrounding the history, development, and current domestic discovery practices of international commercial arbitration. Part II will then discuss the evolution, modern statutory function, and traditional tools used to interpret 28 U.S.C. § 1782(a). Part II will conclude by discussing the Second and Fifth Circuits' dicta on 28 U.S.C. § 1782(a), the influence of *Intel Corp. v. Advanced Micro Devices, Inc.*, and the procedural history of *Abdul Latif Jameel Transportation Co. v. FedEx Corp.* Part III of this Comment will analyze the construction of 28 U.S.C. § 1782(a) through the statutory interpretation structure set forth in Part II. The tests established in *Intel* will then be applied to *Abdul Latif Jameel* in affirmance of the Sixth Circuit's opinion. Part IV of this Comment will recommend that Congress directly address this issue in a similar fashion to the 1964 Amendments to § 1782(a) to resolve the discrepancy between the Sixth Circuit opinion and the opinions of the Second and Fifth Circuits.[9] This Comment proposes that the

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v. Advanced Micro Devices, Inc., where the district court lacked the authority to compel discovery). *See generally* 28 U.S.C. § 1782(a) (2018) (granting district courts the authority to assist in discovery requests from interested parties or arbitrators in an international tribunal and authorizing the district court to control which, if any, materials are discoverable and the procedure by which the materials are made discoverable — without reliance on foreign practices).

6. 542 U.S. 241 (2004); *In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d at 732 (reversing on the grounds that the district court had the authority, but not the obligation, to assist in discovery); *see Intel Corp.*, 542 U.S. at 264–65 (recommending district courts consider the nature of the discovery request, the nature of the tribunal, attempts to circumvent foreign proof-gathering restrictions, and the burden placed on the party against which the discovery is sought).

7. 939 F.3d 710 (6th Cir. 2019).

8. *See id.* at 714; *see also* NBC v. Bear Stearns & Co., 165 F.3d 184, 185–86, 191 (2d Cir. 1999) (declining to grant district courts the authority to compel discovery in international commercial arbitration, further prohibiting the district court from applying the discretionary factors laid out in *Intel Corp. v. Advanced Micro Devices, Inc.*); Kaz. v. Biedermann Int'l, 168 F.3d 880, 881 (5th Cir. 1999) (following the Second Circuit in declining to grant district courts the authority to compel discovery in international commercial arbitration).

9. *See* Act of Oct. 3, 1964, Pub. L. No. 88-619, § 9(a), 78 Stat. 997; *see also* Harry

U.S. Supreme Court review and affirm the Sixth Circuit's decision and clarify the district court's role in international commercial arbitration.

II. DEVELOPMENT, HISTORY, AND MODERN APPLICATION OF 28 U.S.C. § 1782(a)

Section 1782(a) allows district courts to assist in discovery requests in international arbitration.[10] Since the adoption of § 1782(a), the U.S. Supreme Court has clarified the district court's scope of authority, opening U.S. courts to assist in foreign arbitration.[11]

a. The History of International Commercial Arbitration

International commercial arbitration has long been used to resolve disputes between private parties outside a traditional courtroom setting.[12] As international trade became increasingly more common, so too did commercial arbitration as a cost-effective and less-burdensome alternative to traditional legal action.[13] English courts addressing merchant disputes before the Industrial Era initially rejected arbitration as an alternative dispute resolution method by invalidating arbitration awards to force parties into courts of common law.[14] As England industrialized, the volume of commercial disputes necessitated English Parliamentary action to recognize arbitration agreements.[15] England's formalization of commercial arbitration

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LeRoy Jones, *A Commission and Advisory Committee on International Rules of Judicial Procedure*, 49 AM. J. INT'L L. 379, 379–80, 384 (1955) (detailing the need for Congress to adopt liberal discovery standards in international arbitration to affirm the United States' role as a global economic leader and reverse previous economic and legal isolationism).

10. *See* Walter B. Stahr, *Discovery Under 28 U.S.C. § 1782 for Foreign and International Proceedings*, 30 VA. J. INT'L L. 597, 620 (1990) (noting that courts' limited role in international arbitration includes discovery assistance).

11. *See Intel Corp.*, 542 U.S. at 246–47, 264–65 (granting district courts the authority to compel discovery in international arbitration under two four-part tests: (1) the *Intel* authority test; and (2) the *Intel* discretionary factors test).

12. *See* Lynden Macassey, *International Commercial Arbitration, — Its Origin, Development and Importance*, 24 AM. BAR ASS'N J. 518, 519–20 (1938) (finding an increase in international trade, a separate body of commercial law, tedious and time-consuming litigation, and the courts' lack of familiarity with merchant disputes were vital factors that led to an increase in international commercial arbitration).

13. *See id.* at 522–23 (detailing the rationale and rise of commercial arbitration within the United States and outlining the mechanisms of international commercial arbitration).

14. *See id.* at 520 (remarking that English courts had an "active hostility to arbitration").

15. *See id.* at 520–21 (highlighting English Parliament's efforts to standardize and enforce arbitral agreements and awards to promote trade).

legitimized the practice and led the United States to adopt similar legislation.[16]

The industrialization of the U.S. economy also brought Congress to recognize and regulate arbitral agreements.[17] In 1925, Congress passed the Federal Arbitration Act, which recognized domestic arbitral agreements and permitted arbitrators to petition a federal court to assist in discovery requests.[18] Following the passage of the Federal Arbitration Act, U.S. courts lacked the authority to assist in foreign arbitration on behalf of arbitrators or interested parties.[19]

b. The Statutory History of 28 U.S.C. § 1782(a)

Until 1854, foreign litigants could successfully petition U.S. courts to assist in discovery through letters rogatory and commissions.[20] Because international litigation was far more difficult in the pre-Industrial era, no record exists of a foreign litigant exercising this privilege.[21] In 1855, Attorney General Caleb Cushing issued an opinion letter prohibiting U.S. courts from authorizing discovery pursuant to a French court's letter rogatory.[22]

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16. *See* Sabra A. Jones, *Historical Development of Commercial Arbitration in the United States*, 12 MINN. L. REV. 240, 246 (1928) (recognizing Parliament's 1889 arbitration legislation as the main inspiration for the Federal Arbitration Act).

17. *See* Gabriel Herrmann, *Discovering Policy Under the Federal Arbitration Act*, 88 CORNELL L. REV. 779, 780 (2003) (describing the Federal Arbitration Act as a "concrete expression of the new federal policy favoring arbitration"); *cf.* Jay E. Grenig, *Evolution of the Role of Alternative Dispute Resolution in Resolving Employment Disputes*, 71 DISP. RESOL. J. 99, 105–07 (2016) (enumerating state government actions recognizing and enforcing arbitration agreements before the passage of the Federal Arbitration Act).

18. *See* Act of July 30, 1947, ch. 392, Pub. L No. 80-282, § 4, 61 Stat. 671 (codified as amended at 9 U.S.C. § 7 (2018)) (permitting arbitrators to petition a district court for any evidence of value to arbitration and further authorizing district courts to hold parties of an arbitration in contempt of court if they fail to comply with the court order).

19. *Compare* Michael Campion Miller et al., *28 U.S.C. § 1782 and the Evolution of International Judicial Assistance in United States Courts*, FED. LAW., May 2012, at 44, 44 (detailing Congress's initial unwillingness to provide judicial assistance to foreign discovery requests), *with* Arbitration Act 1996, c. 23, §§ 2, 43, 44 (Eng., Wales, & N. Ir.) (requiring permission of all interested parties or the tribunal to procure evidence for use in an international commercial arbitration).

20. *See* Miller et al., *supra* note 19, at 44 (citing case law tending to show that U.S. courts understood they had the authority to compel discovery on behalf of foreign litigants).

21. *See, e.g.*, *id.* (recognizing the inability of merchants to participate in foreign legal proceedings without a means to quickly travel across the Atlantic Ocean).

22. *See* Brief for the United States as Amicus Curiae Supporting Affirmance at 3, Intel Corp. v. Advanced Micro Devices, Inc., 542 U.S. 241 (2004) (citing 7 Op. Att'y Gen. 56 (1855)) (outlining the difficulty in conducting international legal matters due to

In an attempt to override the Attorney General's obstruction of discovery requests, Congress passed legislation that would have granted district courts the authority to assist in discovery requests; however, the law was lost and never enacted.[23] Instead of replacing the lost legislation, Congress changed its course in 1863, limiting discovery for use in foreign litigation where the foreign country is an interested party and "at peace" with the United States.[24] Although discovery aid was requested under this new authority, no federal record exists of any granted request.[25] Foreign litigants relied on state courts to assist in discovery requests, which was met with scrutiny from domestic and international commentators.[26]

In 1948, Congress readopted the core principles of the previously lost 1855 Act, codifying the statute at 28 U.S.C. § 1782.[27] The original text of § 1782 kept the 1863 Act's requirement that the foreign nation be "at peace" with the United States.[28] The first iteration also required that the discovery request be in connection with a civil action in a foreign court.[29] Under the newly passed statute, testimony could only be procured from witnesses residing within the United States.[30]

In 1949, Congress amended 28 U.S.C. § 1782 to further liberalize discovery aid to foreign decisionmakers.[31] Congress eliminated the requirement that witnesses reside in the United States and authorized district

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indexing errors and poor communication).

23. *See* Miller et al., *supra* note 19, at 44 (attributing the loss of the statute to "a comedy of errors . . . , a series of indexing mishaps result[ing] in the act literally becoming lost and accordingly disregarded by the federal courts").

24. *See* Act of Mar. 3, 1863, ch. 95, § 1, 12 Stat. 769; Miller et al., *supra* note 19, at 44 (theorizing Congress's shift away from liberal discovery in foreign courts resulted from international support for the Confederacy).

25. *See* Stahr, *supra* note 10, at 601–02 (postulating that the lack of federal record of a granted request was the result of barriers to international trade and the narrow confines of the 1863 Act).

26. *See id.* at 602 (noting that state courts were more receptive to arbitral discovery requests than federal district courts and crediting the start of World War II as the major cause in delaying foreign discovery assistance reform).

27. 28 U.S.C. § 1782 (2018); *see* Stahr, *supra* note 10, at 602–03 (crediting the discovery of the lost 1855 Act as the impetus for adopting § 1782 in 1948); *see also* Miller et al., *supra* note 19, at 44–45 (hypothesizing that the liberal approach to foreign discovery assistance was inspired by the United States' commitment to the newly-formed United Nations).

28. *See* Miller et al., *supra* note 19, at 45.

29. *See id.*

30. *See id.* (including temporary residents as persons residing in the United States for purposes of § 1782(a) discovery).

31. *See* Stahr, *supra* note 10, at 602–03 (clarifying that the 1949 Amendments were corrections made by Congress to conform to the 1855 Act).

courts to assist in discovery requests in judicial proceedings, not just civil actions.[32]

In 1964, Congress broadened the scope of § 1782 by allowing discovery aid for use in foreign tribunals, permitting district courts to grant requests from any interested person, and omitting the requirement that the foreign nation be "at peace" with the United States.[33] By embracing liberal discovery aid in international litigation and arbitration, Congress hoped that other countries would follow the precedent set forth in § 1782; although, foreign nations have been apprehensive to adopt the same standard.[34]

c. 28 U.S.C. § 1782(a) Modern Statutory Language

Congress created two routes for discovery under 28 U.S.C. § 1782. While § 1782(b)[35] permits a person within the United States to voluntarily give testimony for use in an international tribunal, § 1782(a) grants authority to district courts to compel discovery for use in international tribunals. Section 1782(a) sets forth:

> The district court . . . may order him to give his testimony . . . for use in a proceeding in a foreign or international tribunal . . . . The order may be made pursuant to a . . . request made, by a foreign or international tribunal or upon the application of any interested person . . . . The order may prescribe the practice and procedure . . . . A person may not be compelled to give his testimony . . . in violation of any legally applicable privilege.[36]

Upon passage of § 1782(a) in 1964, the Senate published a report detailing the purpose and intent behind enacting the statute.[37] This report, in part,

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32. *See id.* at 603 (opening the door for federal courts to provide discovery aid to those residing outside of the United States if they have availed themselves of U.S. laws); *id.* (describing Congress's intent in changing the language of 28 U.S.C. § 1782 in 1949 as an effort to conform the statute with the 1855 Act); *see also* Miller et al., *supra* note 19, at 45.

33. *See* Miller et al., *supra* note 19, at 45–46; Stahr, *supra* note 10, at 605–06 (noting the functional overlap of the Trading with the Enemy Act and the peace requirement of § 1782).

34. *See* Stahr, *supra* note 10, at 604 ("The general purpose of the [§ 1782] changes . . . was to provide 'wide judicial assistance . . . on a wholly unilateral basis' . . . [and] 'equitable and efficacious procedures for the benefit of tribunals and litigants involved in litigation with international aspects'"); *see also* Marat A. Massen, *Discovery for Foreign Proceedings after* Intel v. Advanced Micro Devices*: A Critical Analysis of 28 U.S.C. § 1782 Jurisprudence*, 83 S. CAL. L. REV. 875, 885 (2010) ("The perceived intrusiveness of American discovery has led civil law nations to enact blocking statutes or other legal obstacles to American encroachment on their legal systems.").

35. 28 U.S.C. § 1782(b) (2018).

36. *Id.* § 1782(a).

37. *See* S. REP. NO. 88-1580 (1964), *as reprinted in* 1964 U.S.C.C.A.N. 3782, 3782 (explaining that the legislative aim of 28 U.S.C. § 1782(a) is to improve the effectiveness

relied upon an article by Hans Smit to justify the Senate's liberalization of § 1782(a).[38]

d. Methods and Presumptions in Statutory Interpretation

Statutory interpretation must begin with a determination that a given statute is ambiguous or contains ambiguous terms.[39] Only in cases where a plain reading of unambiguous terms would clash with the intentions of the drafters should courts interfere with such a construction.[40] As congressional drafters have remained silent as to whether unambiguous terms in § 1782(a) are being improperly applied, only the construction of ambiguous terms should be considered.[41]

In the statutory language of 28 U.S.C. § 1782(a), "foreign or international tribunal" is an ambiguous term used throughout the statute.[42] A plain reading of the statute does not indicate to what extent quasi-judicial bodies must interact with a foreign nation's government to be considered a "foreign or international tribunal."[43] As a result, traditional tools for statutory interpretation may be relied upon to resolve ambiguity.[44]

When deciphering ambiguous language, courts should assume that Congress intended the term follow its "customary meaning."[45] This is a

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of international litigation).

38. *Id.* at 3784 (citing Hans Smit, *Assistance Rendered by the United States in Proceedings Before International Tribunals*, 62 COLUM. L. REV. 1264 (1962) [hereinafter Smit, *Assistance Rendered*]); *see also id.* at 3788–89; Hans Smit, *International Litigation Under the United States Code*, 65 COLUM. L. REV. 1015, 1033–34 (1965) [hereinafter Smit, *International Litigation*].

39. United States v. Inv. Enters., Inc., 10 F.3d 263, 274 (5th Cir. 1993) ("Except in rare circumstances, judicial inquiry is complete when the terms of a statute are unambiguous.").

40. Demarest v. Manspeaker, 498 U.S. 184, 190 (1991) (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982)) (limiting judicial interference in a plainly unambiguous statute to rare instances where the applied statute produces a result inconsistent with the drafters' intent).

41. *Cf. id*.

42. *See, e.g.*, Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings), 939 F.3d 710, 726 (6th Cir. 2019) (identifying "tribunal" as an ambiguous term).

43. *See* 28 U.S.C. § 1782(a) (2018) (failing to specify what qualifies as a "foreign or international tribunal").

44. Aslanidis v. U.S. Lines, Inc., 7 F.3d 1067, 1073 (2d Cir. 1993) ("Only where doubt or ambiguity resides . . . may legislative history and other tools of interpretation beyond a plain reading of the statute's words be utilized to shed light on verbiage that is unclear.").

45. United States v. Detroit Med. Ctr., 833 F.3d 671, 674 (6th Cir. 2016) (citing Morissette v. United States, 342 U.S. 246, 263 (1952)) ("In the absence of any statutory definition to the contrary, courts assume that Congress adopts the customary meaning of

context-based approach and presumes that the same term used multiple times in the same statute has the same meaning throughout.[46]

Statutes rarely stand alone, free from the explicit control or implicit influence of other statutes or legal frameworks.[47] Therefore, courts should assume, absent evidence of a direct conflict, that statutes coexist to form a larger statutory scheme.[48] Courts should also assume that Congress repeals statutes explicitly.[49]

e. Initial Attempts to Determine the Scope of § 1782(a): The Role of the Second and Fifth Circuits

In 1999, the Second and Fifth Circuits decided *NBC v. Bear Stearns*[50] and *Republic of Kazakhstan v. Biedermann International*,[51] respectively. These cases concluded that Congress did not intend for § 1782(a) to apply to international commercial tribunals.[52]

In *NBC*, the Second Circuit declined to extend authority to the Southern District of New York to grant a discovery request under § 1782(a) to NBC for use in an international commercial tribunal.[53] NBC sought to compel discovery from TV Azteca, a Mexican television broadcast company, through TV Azteca's investment firm, Bear Stearns, for use in an International Chamber of Commerce arbitral tribunal.[54] The Second Circuit

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the terms it uses.").

46. Nat'l Org. of Veterans' Advocates, Inc. v. Sec'y of Veterans Affairs, 260 F.3d 1365, 1379 (Fed. Cir. 2001) (presuming identical words have the same meaning throughout a statutory scheme, especially when the word serves the same purpose throughout).

47. FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 132–33 (2000) (finding that Congress typically intends for statutes to work within a cohesive system that does not needlessly repeal or supersede related statutes); *see also* Joseph B. Judkins, *The Rise of Footnote 9 (And Why Some TCJA Regulations Fail Chevron Step One)*, TAXES THE TAX MAG., Mar. 2020, at 51, 51–52, 56 (clarifying that courts interpret the statutory scheme established by the legislature).

48. *Brown & Williamson*, 529 U.S. at 133; *see also* Posadas v. Nat'l City Bank, 296 U.S. 497, 503 (1936) ("Where there are two acts upon the same subject, effect should be given to both if possible.").

49. *Posadas*, 296 U.S. at 503 ("The cardinal rule is that repeals by implication are not favored.").

50. 165 F.3d 184 (2d Cir. 1999).

51. 168 F.3d 880 (5th Cir. 1999).

52. *NBC*, 165 F.3d at 191; *Biedermann*, 168 F.3d at 883.

53. *NBC*, 165 F.3d at 191 ("Opening the door to the type of discovery sought by NBC in this case likely would undermine one of the significant advantages of arbitration, and . . . would stand in stark contrast to the limited evidence gathering provided in 9 U.S.C. § 7 . . . .").

54. *Id.* at 185–86.

found that the text of § 1782(a) does not necessarily exclude an International Chamber of Commerce arbitral tribunal, but rather, legislative history and the limitations of the Federal Arbitration Act imply that Congress did not intend for this tribunal to receive judicial assistance.[55]

In *Biedermann*, the Fifth Circuit followed the Second Circuit's framework regarding whether the Arbitration Institute of the Stockholm Chamber of Commerce was contemplated by the drafters of § 1782(a).[56] The Republic of Kazakhstan sought to procure several documents and a deposition from a nonparty for use in arbitration in the Stockholm Chamber of Commerce.[57] The Fifth Circuit relied upon statutory history and the limitations of the Federal Arbitration Act.[58] The Fifth Circuit's opinion gave great weight to the fear that § 1782(a) allows foreign parties to circumvent traditional discovery techniques in their country or through their arbitral body.[59]

Despite the agreement between the Second and Fifth Circuits, in 2004, the U.S. Supreme Court decided *Intel Corp. v. Advanced Micro Devices, Inc.*, altering the standards employed by district courts to determine whether to grant a discovery request in connection with international arbitration.[60] Following *Intel*, the Second and Fifth Circuit opinions hold significantly less precedential value.[61]

f. An Avenue for Granting International Arbitration Discovery Requests: Intel Corp. v. Advanced Micro Devices, Inc.

In 2004, the U.S. Supreme Court decided *Intel Corp. v. Advanced Micro Devices, Inc.*, providing guidance to district courts contemplating a discovery request under 28 U.S.C. § 1782(a).[62] Advanced Micro Devices ("AMD") filed an antitrust complaint against Intel with the Directorate-

55. *See id.* at 187, 188–90 (observing ambiguity in the statute and relying upon traditional methods of statutory interpretation).

56. *Biedermann*, 168 F.3d at 881, 883.

57. *Id.* at 881.

58. *See id.* at 881–83 (remarking that it would be improper to think that Congress intended for international arbitration to be afforded a more liberal discovery standard than domestic arbitration).

59. *See id.* at 883 (noting that Congress likely did not authorize federal courts to provide parties in foreign private arbitration more discovery aid than they are provided in domestic arbitration).

60. *See* Intel Corp. v. Advanced Micro Devices, Inc., 542 U.S. 241, 264–65 (2004).

61. *See, e.g.*, *In re* Children's Inv. Fund Found., 363 F. Supp. 3d 361, 368–70 (S.D.N.Y. 2019) (questioning *NBC*'s applicability following *Intel Corp. v. Advanced Micro Devices, Inc.*).

62. *See generally Intel Corp.*, 542 U.S. 241 (providing two four-pronged inquiries regarding § 1782 and the district court's role in discovery requests for matters engaged in foreign or international arbitration).

General for Competition of the Commission of the European Communities, a branch of the European Union.[63] AMD failed to persuade the Directorate-General to seek documents from Intel in a separate antitrust suit in an Alabama federal court.[64] AMD then petitioned the U.S. District Court for the Northern District of California to order Intel to produce the documents under § 1782(a).[65] The district court did not believe § 1782(a) authorized discovery and denied the request.[66] On appeal, the Ninth Circuit reversed and remanded, and the U.S. Supreme Court affirmed the Ninth Circuit's opinion to extend authority to the Northern District of California to assist in discovery.[67]

The U.S. Supreme Court in *Intel* clarified the four-part inquiry into whether a district court has the authority to assist in discovery requests.[68] The application must be by an "interested person" seeking testimony or documents free from privilege for use in a reasonably contemplated proceeding before a "foreign or international tribunal" regardless of the foreign nation's discovery practices.[69]

The U.S. Supreme Court further established a four-part inquiry into whether a district court should grant discovery requests.[70] First, district courts should consider whether the petitioner is a party or interested person in the litigation.[71] Then, the district court should determine whether the request is "an attempt to circumvent foreign proof-gathering restrictions."[72] Next, it must determine whether the request is "unduly intrusive or

63. *Id.* at 246.

64. *See id.* at 250–51.

65. *See* Advanced Micro Devices, Inc. v. Intel Corp., No. C-01-7033 MISC WAI, 2002 WL 1339088, at *1–2 (N.D. Cal. Jan. 7, 2002).

66. *Id.*

67. *Intel Corp.*, 542 U.S. at 246, 266–67. *See generally* Advanced Micro Devices, Inc. v. Intel Corp., 292 F.3d 664 (9th Cir. 2002) (denying the request without considering the *Intel* discretionary factors).

68. *Intel Corp.*, 542 U.S. at 246.

69. *Id.* at 261 ("Section 1782 is a provision for assistance to tribunals abroad. It does not direct United States courts to engage in comparative analysis to determine whether analogous proceedings exist here."); *see* Miller et al., *supra* note 19, at 45 (noting that the change in language to § 1782 means that "assistance is not confined to proceedings before conventional courts . . . [and] extends to administrative and quasi-judicial proceedings all over the world").

70. *Intel Corp.*, 542 U.S. at 246–47.

71. *Id.* at 264 (finding that AMD is an interested person under § 1782(a) and declining to limit the inquiry to litigants only).

72. *Id.* at 265. *Compare id.* (permitting district courts to consider foreign-discoverability requirements when granting discovery requests), *with id*. at 263 (prohibiting district courts from considering foreign-discoverability requirements when determining their authority to assist in discovery).

burdensome."[73] Finally, the district court must consider the nature of the foreign tribunal and its receptivity to federal court assistance.[74] Following *Intel*, district courts exercised the tests set forth by the U.S. Supreme Court when deciding whether to grant a request under § 1782(a).[75]

g. The Sixth Circuit's Interpretation of § 1782(a) in Abdul Latif Jameel Transportation Co. v. FedEx Corp.

A party may be subject to arbitration resulting from operations within a special economic zone.[76] Special economic zones operate outside the economic and regulatory schemes of the founding nation to provide a conducive business environment for foreign investors.[77] One such special economic zone, the Dubai International Financial Centre ("DIFC"), subjects parties to arbitration through the Dubai International Financial Centre-London Court of International Arbitration.[78] The DIFC-LCIA arbitrates disputes under the London Court of International Arbitration Rules.[79]

Following a contractual dispute with FedEx International Corporation, Abdul Latif Jameel Transportation Company, a private Saudi corporation, petitioned the U.S. District Court for the Western District of Tennessee for assistance in discovery for documents related to the performance of the

73. *Id.* at 265 (balancing the amount at issue in the dispute with the burden of the request and necessitating that the burden on the party against which the discovery is sought be unduly intrusive or overly burdensome as any discovery request is a burden).

74. *Id.* at 264 (emphasizing the need for the tribunal to be receptive to the requested documents; absent a clear and explicit prohibition on the discovery from the arbitral panel, the tribunal is assumed to be receptive).

75. *See, e.g.*, *In re* Application of Guy, No. M 19–96., 2004 WL 1857580, at *1–4 (S.D.N.Y. Aug. 19, 2004) (granting modified discovery assistance under *Intel*). *But see* Schmitz v. Bernstein Liebhard & Lifshitz, LLP, 376 F.3d 79, 84–85 (2d Cir. 2004) (declining to grant discovery assistance under *Intel*).

76. *See* TERESA CHENG, DEP'T OF JUSTICE GOV'T OF H.K. SPECIAL ADMIN. REGION, SPECIAL ECONOMIC ZONES: A CATALYST FOR INTERNATIONAL TRADE AND INVESTMENT IN UNSETTLING TIMES? 31 (2019), https://www.doj.gov.hk/en/community_engagement/speeches/pdf/sj20190211e1.pdf (highlighting the pervasiveness and utility of special economic zones and describing the legal implications of joining a special economic zone).

77. *See id.* at 4 (explaining the allure of special economic zones to foreign investors).

78. *See* Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings), 939 F.3d 710, 715 (6th Cir. 2019) (explaining the rules and procedures for the DIFC-LCIA); *About*, DUBAI INT'L FIN. CTR., https://www.difc.ae/about/ (last visited Aug. 9, 2020) (detailing the DIFC's commitment to foreign investment and consistent legal standards).

79. *Overview*, DIFC-LCIA ARB. CTR. [hereinafter *Overview*, DIFC-LCIA ARB. CTR.], http://difc-lcia.org/overview.aspx (last visited Aug. 9, 2020) (describing the DIFC-LCIA as an arbitral body governed by English arbitration laws subject to limited review by the governments of Dubai and United Arab Emirates).

contract.[80] The district court denied ALJ's request, citing a lack of authority in § 1782(a) to compel discovery in connection with a private international tribunal; on appeal, the Sixth Circuit reversed and remanded to the district court to decide whether the request should be granted.[81] Although this dispute has yet to be resolved, this decision created a conflict between the liberal Sixth Circuit's interpretation and the restrictive Second and Fifth Circuits' interpretations.[82]

III. PERMISSIVE CONTEMPLATION OF INTERNATIONAL COMMERCIAL TRIBUNALS UNDER 28 U.S.C. § 1782(a)

The Sixth Circuit Court of Appeals properly ruled in *Abdul Latif Jameel Transportation Co. v. FedEx Corp.* that district courts have the authority, but not the obligation, to assist in discovery requests from interested parties in arbitration before a foreign or international tribunal, such as the DIFC-LCIA, under the test put forth in *Intel*.[83]

a. The Intel Test for District Court Authority

The Sixth Circuit properly applied the test set out in *Intel Corp. v. Advanced Micro Devices Inc.* when determining the authority of district courts to assist in discovery. The Sixth Circuit was correct in granting the authority to the Western District of Tennessee to assist in discovery, regardless of whether discovery assistance would be provided on remand.[84]

The first prong of the four-step inquiry into a district court's authority to compel discovery requires a court to examine whether the request comes from an interested person seeking documents or testimony.[85] The U.S.

80. *In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d at 714–15 (identifying ALJ's cause for the dispute as FedEx's acquisition of TNT Express, N.V., an ALJ competitor in Saudi Arabia, the lack of communication between FedEx and ALJ regarding the acquisition, and the nonrenewal of the General Service Provider Agreement).

81. *See id*. at 732 (allowing, but not obligating, the Western District of Tennessee to assist in ALJ's discovery request).

82. *Compare id*. (granting authority and allowing the district court to address the *Intel* discretionary factors), *with* Kaz. v. Biedermann Int'l, 168 F.3d 880, 880 (5th Cir. 1999) (denying authority to assist in a discovery request for litigants in private international arbitration proceedings), *and* NBC v. Bear Stearns & Co., 165 F.3d 184, 185 (2d Cir. 1999) (holding that § 1782(a) does not compel district courts to assist in discovery requests for proceedings heard before a private arbitration panel).

83. *See* Intel Corp. v. Advanced Micro Devices, Inc., 542 U.S. 241, 247 (2004).

84. *See id.* at 264 ("[A] district court is not required to grant a § 1782(a) discovery application simply because it has the authority to do so."); *In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d at 732 (noting that the trial court is in the best position to make a case-by-case determination of the *Intel* factors).

85. *See Intel Corp.*, 542 U.S. at 256 (arguing that, as a complainant, AMD should

Supreme Court in *Intel* plainly read § 1782(a) to broadly include any interested person.[86] ALJ is a party to the arbitration and, therefore, has an interest under § 1782(a) to request documents or testimony.[87] ALJ made seventy-nine production requests from FedEx in connection with the arbitration and requested all documents concerning the ALJ-FedEx contract from the district court under § 1782(a).[88] As such, the first prong of the *Intel* authority inquiry is satisfied.

The second prong prevents a district court from assisting in discovery requests of privileged materials.[89] Lower courts had been divided on whether this inquiry should include a foreign-discoverability rule.[90] In *Intel*, the U.S. Supreme Court rejected the foreign-discoverability rule and, in its place, required courts to determine whether the requested documents are subject to "any legally applicable privilege."[91] As *Intel* struck down the foreign-discoverability requirement, and ALJ's requested materials are not subject to privilege, this prong is satisfied.[92]

The third prong grants a district court authority to assist in discovery in a reasonably contemplated proceeding.[93] The 1964 Amendments to § 1782(a)

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not be included as an "interested person" and should only be afforded "limited rights").

86. *Id.* at 256–57 (quoting Smit, *International Litigation*, *supra* note 38, at 1027) ("'[A]ny interested person' is 'intended to include not only litigants before foreign or international tribunals, but also foreign and international officials as well as any other person whether he be designated by foreign law or international convention or merely possess a reasonable interest in obtaining assistance.'").

87. *See In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d at 714; *see also Intel Corp.*, 542 U.S. at 256 (explaining that litigants are considered "interested person[s]" and are, therefore, eligible to invoke § 1782(a)).

88. Brief for the Respondent-Appellee FedEx Corp. at 11–12, Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings), 939 F.3d 710 (6th Cir. 2019) (No. 24); *In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d at 716.

89. *Intel Corp.*, 542 U.S. at 259–61.

90. *See, e.g.*, Euromepa S.A. v. R. Esmerian, Inc., 51 F.3d 1095, 1098 (2d Cir. 1995) (declining to authorize a foreign-discoverability rule as U.S. judges are only permitted to interpret U.S. legal standards). *But see, e.g.*, *In re* Lo Ka Chun v. Lo To, 858 F.2d 1564, 1566 (11th Cir. 1988) (remanding to the district court to determine whether the evidentiary rules of Hong Kong would permit discovery).

91. *Intel Corp.*, 542 U.S. at 259–63 (prohibiting discovery of privileged materials under the discovery procedures of the United States, the foreign nation, or the arbitration tribunal).

92. *See* Reply Brief for Movant-Appellant Abdul Latif Jameel Transp. Co. at 7 n.3, Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings), 939 F.3d 710 (6th Cir. 2019) (No. 27) (noting § 1782(a)'s exclusion of any privileged materials).

93. *See Intel Corp.*, 542 U.S. at 259 ("Instead, we hold that § 1782(a) requires only that a dispositive ruling by the Commission, reviewable by the European courts, be within reasonable contemplation."); *see also* 28 U.S.C. § 1782(a) (2018) ("The district

removed the requirement that the proceeding be pending.[94] Instead, the 1964 Amendments require a reasonably contemplated proceeding to petition a court under § 1782(a).[95] Since 1964, one amendment was made to § 1782(a) in 1996, affording the same discovery privileges to foreign criminal investigations.[96] As the U.S. Supreme Court noted in *Intel*, the 1996 amendment sought to expand the scope of the reasonably contemplated proceeding prong.[97] The appellees do not contest the third prong of the *Intel* authority inquiry and thus this prong is satisfied.[98]

The final prong of the *Intel* authority inquiry requires that the discovery request be in connection with a "foreign or international tribunal."[99] A "foreign or international tribunal" is ambiguous and thus courts should primarily rely upon traditional and customary usage of the term before relying upon legislative history.[100]

Courts may resolve the ambiguity of a term by looking at how the term is used elsewhere in the statutory scheme.[101] The preceding section, 28 U.S.C. § 1781, contains the only other instance of "foreign or international tribunal" in the statutory scheme and, likewise, does not explicitly include or exclude private arbitral bodies.[102] The Second and Fifth Circuits improperly assumed that because the statute does not explicitly include private arbitral bodies, then, by negative inference, these bodies must be excluded.[103]

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court . . . may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding in a foreign or international tribunal . . . .").

94. Act of Oct. 3, 1964, Pub. L. No. 88-619, § 9(a), 78 Stat. 997.

95. *See* 28 U.S.C. § 1782(a).

96. *See id.*

97. *See Intel Corp.*, 542 U.S. at 259 (noting that the 1996 amendment affirms the U.S. Supreme Court's construction of § 1782(a)).

98. *See generally* Corrected Brief for Respondent-Appellee FedEx Corp., Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings,), 939 F.3d 710 (6th Cir. 2019) (No. 26) (foregoing the opportunity to argue that the proceeding has not reached the level of reasonable contemplation).

99. *See* 28 U.S.C. § 1782(a).

100. *E.g.*, *In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d at 726–27 (concurring with the Second Circuit and Fifth Circuit opinions that "foreign or international tribunal" is an ambiguous term).

101. *See* Nat'l Org. of Veterans' Advocates, Inc. v. Sec'y of Veterans Affairs, 260 F.3d 1365, 1379 (Fed. Cir. 2001) (stating that when a word is used in two different sections of a statutory scheme, the rule is to assume the words have the same intended meaning).

102. *See* 28 U.S.C. § 1781 ("The Department of State has power . . . to receive a letter rogatory issued . . . by a foreign or international tribunal . . . .").

103. *Compare* NBC v. Bear Stearns, & Co., 165 F.3d 184, 190 (2d Cir. 1999) (relying upon the lack of congressional contemplation of private arbitral bodies to negatively infer that those bodies were intentionally excluded), *and* Kaz. V. Biedermann Int'l, 168 F.3d

Absent a clear statutory definition, courts should consider the customary meaning of an ambiguous term.[104] Before the adoption of § 1782(a) in 1948, the U.S. Supreme Court often referred to purely commercial arbitral bodies as "tribunals."[105] During the formative years between the adoption of § 1782(a) and the 1964 Amendments, the U.S. Supreme Court continued to refer to such bodies as "tribunals."[106] Following the 1964 Amendments of § 1782(a), the U.S. Supreme Court continued to refer to purely commercial arbitral bodies as "tribunals."[107] The Second and Fifth Circuits failed to address the customary usage of "tribunals" when determining district court authority; therefore, the Second and Fifth Circuits prematurely relied upon a restrictive construction of § 1782(a)'s legislative history.[108]

While traditional legal usage suggests that international commercial arbitration resides within the contemplation of § 1782(a), the U.S. Supreme Court provides that a tribunal is within the scope of § 1782(a) where it functions as a "first-instance decisionmaker."[109] The DIFC-LCIA arbitrates disputes as a "first-instance decisionmaker" as it permits the submission and gathering of evidence, imposes liability and awards on parties, and is subject to limited judicial review.[110] Given that the traditional and customary legal

880, 882 (5th Cir. 1999) (denying extending § 1782(a) to private international arbitrations because Congress did not include international commercial arbitration in the statute's language), *with* Robinson v. Shell Oil Co., 519 U.S. 337, 344–45 (1997) (discouraging the use of negative inferences in statutory construction).

104. *See* United States v. Detroit Med. Ctr., 833 F.3d 671, 674 (6th Cir. 2016) (recognizing that courts rely upon a context-based approach to determine the customary meaning of an ambiguous term).

105. *See* Red Cross Line v. Atlantic Fruit Co., 264 U.S. 109, 121 n.1 (1924) (citing Tobey v. County of Bristol, 3 Story 800, 821 (Cir. Ct. D. Mass. 1845)) (discussing private arbitration where parties appoint the arbitrators as a "tribunal").

106. *See* Bernhardt v. Polygraphic Co. of Am., 350 U.S. 198, 203 (1956) (recognizing a dispute before the American Arbitration Association as a proceeding before a "tribunal").

107. *See generally* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614 (1985) (referring to an arbitration pursuant to a private contract as a proceeding before a "transnational tribunal" and a "foreign tribunal").

108. *See NBC*, 165 F.3d at 188–90 (examining House and Senate reports pertaining to § 1782); *see also Biedermann*, 168 F.3d at 881 (following the precedent set by the Second Circuit of reviewing the language and legislative history of the statute).

109. Intel Corp. v. Advanced Micro Devices, Inc., 542 U.S. 241, 246–47 (2004); *see also id.* at 257 (noting that a "first-instance decisionmaker" resolves disputes and may, but need not, collect proof from parties); *e.g.*, *Mitsubishi Motors Corp.*, 473 U.S. at 623 ("[T]he court directed the District Court to consider in the first instance how the parallel judicial and arbitral proceedings should go."). *See generally* S. REP. No. 88-1580 (1964), *as reprinted in* 1964 U.S.C.C.A.N. 3782 (providing background about sections of the U.S. Code concerning international litigation and their proposed amendments).

110. *See* Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *supra* note 3, art. 5 (reviewing arbitral awards where there was a procedural

usage, legislative history, and the considerations put forth in *Intel* all imply that commercial arbitration is within the scope of § 1782(a), the Sixth Circuit properly extended the authority, but not the obligation, to the district court to assist in discovery.[111]

b. The Intel Test for Granting Discovery

The Sixth Circuit properly deferred to the district court to determine whether to grant ALJ's discovery requests on remand.[112] On review, appellate courts should not decide discretionary matters traditionally left to lower courts.[113] As at least one of the *Intel* discretionary factors is a fact-intensive review, the Sixth Circuit properly recused itself from deciding whether to grant the discovery requests.[114] The U.S. Supreme Court laid out a four-part inquiry for lower courts to consider when granting discovery.[115]

The first *Intel* discretionary factor favors FedEx.[116] When determining whether to grant discovery requests, district courts should consider whether the request was made to a participant to the dispute.[117] ALJ sought contract performance documents from FedEx International, a subsidiary of FedEx Corporation, through the parent entity.[118] As ALJ could discover these

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deficiency, the incapacity of one or more parties, or the jurisdiction was improper, but not where the substance of the arbitral agreement is at issue). *But see* Pak. v. Arnold & Porter Kaye Scholer LLP, No. 18-103 (D.D.C. signed Apr. 10, 2019) (labeling the International Centre for Settlement of Investment Disputes Tribunal as a tribunal contemplated under § 1782(a) despite the lack of judicial review).

111. *See* Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings), 939 F.3d 710, 730–31 (6th Cir. 2019).

112. *See id*. at 732 (refusing to address the *Intel* discretionary factors).

113. *See* Davis v. Lifetime Capital, Inc., 560 F. App'x 477, 495 (6th Cir. 2014) (leaving discretionary issues to the lower court unless the issue is "purely legal" or "in the interest of judicial economy").

114. *See Intel Corp.*, 542 U.S. at 264 (remarking that district courts should review §1782(a) requests); *In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d at 731–32.

115. *See Intel Corp.*, 542 U.S. at 264–65 (recommending courts should consider whether the requested material is within the jurisdiction of the tribunal, the nature of the tribunal and its receptivity to the requested materials, whether the request is "an attempt to circumvent foreign proof–gathering restrictions," and whether the request is "unduly intrusive or burdensome").

116. *See id*. at 264 ("First, when the person from whom discovery is sought is a participant in the foreign proceeding (as Intel is here), the need for § 1782(a) aid generally is not as apparent as it ordinarily is when evidence is sought from a nonparticipant in the matter arising abroad.").

117. *See id.* ("[N]onparticipants in the foreign proceeding may be outside the foreign tribunal's jurisdictional reach; hence, their evidence, available in the United States, may be unobtainable absent § 1782(a) aid.").

118. *In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d

documents through the DIFC-LCIA evidentiary rules, the first discretionary factor favors FedEx.[119]

The second discretionary factor, a fact-intensive review of the nature of the tribunal and its receptivity to the requested material, favors ALJ.[120] Absent clear evidence that the tribunal would not be receptive to the documents requested, this factor weighs in favor of the petitioners.[121] Respondents have the burden of showing that the discovery would offend the foreign jurisdiction.[122] Given that there is no showing that the DIFC-LCIA is deficient, and the DIFC-LCIA has not explicitly stated their opposition to this discovery, the second discretionary factor favors ALJ.[123]

The third discretionary factor, whether the request is an attempt to circumvent the tribunal's discovery rules, favors FedEx.[124] Article 34 of the DIFC Arbitration Law provides that a party, with the consent of the tribunal, may petition the DIFC courts to execute a discovery request.[125] Because ALJ has not petitioned the DIFC courts through the proper discovery channels, their § 1782(a) request is an attempt to circumvent the tribunal's discovery

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at 714.

119. *See* Corrected Brief for Respondent-Appellee FedEx Corp., *supra* note 98, at 42–45; *see also In re* Judicial Assistance Pursuant to 28 U.S.C. § 1782 by Macquarie Bank Ltd., No. 2:14-cv-00797-GMN-NJK, 2015 WL 3439103, at *14 (D. Nev. May 28, 2015) (declining to grant a discovery request when the petitioner seeks discovery from a separate, but related entity).

120. *See Intel Corp.*, 542 U.S. at 264–65 (stating that multiple factors, including the nature of the foreign tribunal, the characteristics of the proceedings underway abroad, and the foreign government's receptiveness are taken into account when presented with a request).

121. *E.g.*, Euromepa S.A. v. R. Esmerian, Inc., 51 F.3d 1095, 1100 (2d Cir. 1995) (ruling that courts should reject evidence obtained under § 1782 if there is "authoritative proof that a foreign tribunal" would not consider it).

122. *See In re* Application Pursuant to 28 U.S.C. § 1782 for an Order Permitting Bayer AG, 146 F.3d 188, 196 (3d Cir. 1998) (holding the opposing party had the burden of demonstrating that the application should be denied based on the foreign jurisdiction or any other relevant matter).

123. *See* Corrected Brief for Movant-Appellant at 48–49, Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings), 939 F.3d 710 (6th Cir. 2019) (No. 22) ("FedEx International failed to show that the law governing the DIFC-LCIA Arbitration prohibited ALJ from seeking Section 1782 relief."). *See generally* Corrected Brief for Respondent-Appellee FedEx Corp., *supra* note 98 (stating that DIFC Court's denial of FedEx's motion to enjoin ALJ's § 1782 application is not proof of the court's receptivity).

124. *See Intel Corp.*, 542 U.S. at 265.

125. DIFC, ARBITRATION LAW NO. 1 14 (2008), http://www.arbiter.com.sg/pdf/laws/UAE%20DIFC%20Arbitration%20Law%20(2008).pdf (stating that, with the Arbitral Tribunal's approval, a party may request assistance from the DIFC Court in taking evidence).

rules.[126]

The fourth discretionary factor, whether the request is overly burdensome or intrusive, favors ALJ.[127] The discovery request by ALJ, although wide-ranging, enjoys the presumption that the district court judge will limit discovery to only the necessary documents.[128] The burden must be proportionally larger than the amount at issue in the arbitration.[129] As over $100 million is in dispute in this arbitration, the final discretionary factor favors ALJ.[130]

Since the first and third discretionary factors of the *Intel* inquiry favor denying the discovery request, the U.S. District Court for the Western District of Tennessee will likely deny ALJ's request. Nevertheless, the Sixth Circuit properly granted the authority to the district court on remand to decide these four factors.

c. Reconciling NBC v. Bear Stearns and Republic of Kazakhstan v. Biedermann International

In 1999, the Second and Fifth Circuits improperly decided *NBC v. Bear Stearns* and *Republic of Kazakhstan v. Biedermann International*, respectively.[131] Following the U.S. Supreme Court's decision in *Intel*, courts in the Second and Fifth Circuits have called into question the applicability and precedential value of the 1999 decisions.[132] These courts correctly

126. *See* Corrected Brief for Respondent–Appellee FedEx Corp., *supra* note 98, at 48–49 (arguing that ALJ failed to seek approvals required by DIFC Arbitration Law "to obtain the discovery sought in the § 1782 Application," that ALJ is in violation of the third-party discovery prohibition rules, and that ALJ seeks deposition testimony without a proper "basis under DIFC-LCIA Arbitration Law or in the GSP Contract").

127. *See Intel Corp.*, 542 U.S. at 265 ("[U]nduly intrusive or burdensome requests may be rejected or trimmed.").

128. *See* Euromepa S.A. v. R. Esmerian, Inc., 51 F.3d 1095, 1101 (2d Cir. 1995) (preferring a district court limit the discoverable materials over outright rejection of a broad discovery request).

129. *See* FDIC v. Ark-La-Tex Fin. Servs., LLC, No. 1:15 CV 2470, 2016 WL 3460236, at *3 (N.D. Ohio June 24, 2016) (approving the review of tens of thousands of documents in a $1.5 million dispute, arguing it is not "overly burdensome").

130. *See* Reply Brief for Movant-Appellant Abdul Latif Jameel Transp. Co., *supra* note 92, at 24–25 (comparing the relative burden placed on the party against whom the discovery is sought with the amount at issue in the dispute).

131. *See* NBC v. Bear Stearns & Co., 165 F.3d 184, 190–91 (2d Cir. 1999) (concluding § 1782(a) did not apply to "an arbitral body established by private parties" according to the statute's text and the legislative history); *see also* Kaz. v. Biedermann Int'l, 168 F.3d 880, 883 (5th Cir. 1999) (holding the mention of "foreign and international tribunals" in § 1782(a) was not an authorization for courts to assist with discovery in international commercial arbitrations).

132. *See, e.g.*, Ecuador v. Connor, 708 F.3d 651, 658 (5th Cir. 2013) (declining to extend the holding in *Biedermann* following *Intel Corp. v. Advanced Micro Devices,*

discounted the precedential value of *NBC* and *Biedermann* and, following the Sixth Circuit's decision in *ALJ*, all district courts should adopt this liberalized discovery standard.[133]

i. Evaluating the Second and Fifth Circuits' Reliance on Legislative History

Both the Second and Fifth Circuit opinions rely upon legislative history to interpret the ambiguous term, "foreign or international tribunal," in § 1782(a).[134] The Second and Fifth Circuits should not have immediately relied upon legislative history where traditional tools of statutory construction could have resolved the ambiguity.[135] Analyzing statutory history through congressional reports may not accurately reflect Congress's intent, only the intent of a majority of the legislators.[136] While statutory history and legislative intent may be helpful tools in resolving ambiguity, they should not be viewed as dispositive evidence of a certain statutory construction.[137]

ii. Repudiating the Second and Fifth Circuits' Interpretation of the Legislative History

Despite the arguments from the Second and Fifth Circuits, the legislative history of 28 U.S.C. § 1782(a) provides that Congress may have intended international commercial tribunals to fall within the scope of § 1782(a).[138]

Inc.); *see also In re* Children's Inv. Fund Found., 363 F. Supp. 3d 361, 368–70 (S.D.N.Y. 2019) (questioning *NBC*'s applicability following *Intel Corp. v. Advanced Micro Devices, Inc.*).

133. *See* Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings), 939 F.3d 710, 726–28 (6th Cir. 2019).

134. *See NBC*, 165 F.3d at 188–90 (analyzing the legislative history § 1782 to interpret the statute); *Biedermann*, 168 F.3d at 881–82 (following the precedent set by the court in *NBC* and using the legislative history to interpret § 1782).

135. *See* Lamie v. United States Tr., 540 U.S. 526, 539, 542 (2004) (recommending courts consider statutory history and legislative intent only where other statutory construction tools do not provide a clear resolution to the ambiguity, and the history helps to add more clarity than confusion).

136. *See* Hirschey v. FERC, 777 F.2d 1, 7–8 (D.C. Cir. 1985) (Scalia, J., concurring) (cautioning against adherence to legislative history because of the lack of bipartisan participation and negotiation).

137. *See* Frank H. Easterbrook, *The Role of Original Intent in Statutory Construction*, 11 HARV. J.L. & PUB. POL'Y 59, 60–61 (1988) (dismissing legislative history as solely indicative of the drafters' intent, not the statute's intent); *see also* Towne v. Eisner, 245 U.S. 418, 425 (1918) ("A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.").

138. *See generally* S. REP. NO. 88-1580 (1964), *as reprinted in* 1964 U.S.C.C.A.N. 3788 (emphasis added) ("The proposed revision of section 1782, set forth in section 9(a)

Furthermore, the legislative history of § 1782(a) suggests a permissive reading of the ambiguity, not the restrictive reading the Second and Fifth Circuits follow.[139]

Congress revised § 1782(a) in 1964 to pertain broadly to tribunals, not just courts.[140] This purposeful liberalization opened U.S. courts to discovery requests from interested parties in foreign arbitration.[141] Upon passage of the 1964 Amendments to § 1782(a), the Senate released a report detailing its purpose and aims in liberalizing the language of the statute, contradicting the restrictive view of the Second and Fifth Circuits.[142] The main purpose of retooling § 1782(a), the Senate Report details, was to assist with discovery requests for proceedings before foreign tribunals.[143]

The legislative history of § 1782(a) does not explicitly exclude international commercial arbitration, and the Sixth Circuit properly held that the district court's broad authority to compel discovery, curtailed by the *Intel* discretionary factors, is a reasonable construction of § 1782(a).[144] The Senate Report demonstrates that district court judges have the ultimate gatekeeping authority when granting § 1782(a) requests; Congress constructed the statute with a broad interpretation of "tribunal" that would be limited by the district court judge.[145] Therefore, the Second and Fifth

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clarifies and *liberalizes* existing U.S. procedures for assisting foreign and international tribunals . . . .").

139. *See* Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings), 939 F.3d 710, 727–28 (6th Cir. 2019) (acknowledging the successive steps taken by Congress to liberalize international arbitration discovery rules through changes to § 1782(a) and disagreeing with the overly restrictive reading of the legislative history by the Second and Fifth Circuits).

140. *See generally* S. REP. NO. 88-1580 (opening U.S. courts to assist broadly in judicial proceedings, including tribunals).

141. *See generally id.* (liberalizing the applicability of § 1782(a) to include international tribunals and extend beyond conventional courts).

142. *Compare* NBC v. Bear Stearns & Co., 165 F.3d 184, 188–89 (2d Cir. 1999) (establishing that the authors of the Senate and House Reports had clearly stated what constituted a tribunal), *and* Kaz. v. Biedermann Int'l, 168 F.3d 880, 881–82 (5th Cir. 1999) (narrowing congressional interpretation of the statute), *with* S. REP. NO. 88–1580, at 3782 (granting district courts broad authority to compel discovery).

143. *See* S. REP. NO. 88-1580, at 3782 ("The purpose of the proposed legislation is to improve U.S. judicial procedures for — (1) Serving documents in the United States in connection with proceedings before foreign and international tribunals.").

144. *See In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d at 726 (recognizing that the broad authority of district courts is reined in by the *Intel* discretionary factors). *See generally* S. REP. NO. 88-1580 (making no mention of the still primitive international commercial arbitration tribunals that would gain popularity abroad following the amendments to § 1782(a) in 1964).

145. *See* S. REP. NO. 88–1580, at 3788–90 (clarifying that assistance is open to all proceedings before a foreign court, tribunal, or quasi-judicial agency and that the district

Circuits improperly identified § 1782(a) as the primary limitation on discovery, not the district court judge as *Intel* and *ALJ* provide.[146]

The Senate Report cites Hans Smit's *International Litigation Under the United States Code*, a law review article written by a professor who helped draft the 1964 Amendments to clarify the term "tribunal."[147] Smit's definition, although not dispositive, broadly includes adjudicative bodies of all kinds.[148] The Second Circuit only recognizes the authority of Smit's article insofar as it claims that international tribunals are the result of an international agreement.[149] An international agreement is an ambiguous term broad enough to include the private tribunal in *ALJ* created by an international agreement between the DIFC and the LCIA.[150]

Although Congress's policy intentions when drafting and amending § 1782(a) are not controlling, they may supply some insight when determining the intended statutory function.[151] The United States' unique position as a global economic leader may influence other countries to adopt similar discovery standards in international arbitration.[152] Out-of-court dispute resolution methods are becoming more common; Congress's intention to

court judge ultimately decides whether the dispute at issue needs judicial assistance from U.S. courts).

146. *Compare NBC*, 165 F.3d at 188–89 (misinterpreting the scope of § 1782 based on its legislative history), *and Biedermann*, 168 F.3d at 881–82 (stating § 1782 is limited and should be interpreted based on Congress's deliberate intentions), *with* Intel Corp. v. Advanced Micro Devices, Inc., 542 U.S. 241, 259 (2004) ("Nothing suggests that this amendment was an endeavor to rein in, rather than to confirm, by way of example, the broad range of discovery authorized in 1964."), *and In re Application to Obtain Discovery for Use in Foreign Proceedings*, 939 F.3d at 725–26 (establishing the Second and Fifth Circuits' misconceptions of the statute).

147. *See* S. REP. NO. 88-1580, at 3788.

148. Smit, *International Litigation*, *supra* note 38, at 1026 n.71 ("The term 'tribunal' embraces all bodies exercising adjudicatory powers, and includes . . . arbitral tribunals . . . .").

149. *See NBC*, 165 F.3d at 190 (concluding that Congress intended to include intergovernmental arbitral tribunals in its 1964 Amendments).

150. *See Overview*, DIFC-LCIA ARB. CTR., *supra* note 79 (describing the DIFC-LCIA as a joint venture between the two arbitration groups for the purpose of making Dubai a regional hub for international commercial arbitration and mediation).

151. *See* Stafford v. Briggs, 444 U.S. 527, 536 (1980) (quoting Brown v. Duchesne, 60 U.S. 183, 194 (1856)) (stressing the importance of considering "the objects and policy of the law" alongside the statute's text).

152. *Compare* Miller et al., *supra* note 19, at 45 (recognizing that Congress's intent to influence foreign countries' discovery laws in arbitration have thus far failed to materialize), *with* Richard Wike et al., *Globally, More Name U.S. than China as World's Leading Economic Power*, PEW RES. CTR. (July 13, 2017), https://www.pewresearch.org/global/2017/07/13/more-name-u-s-than-china-as-worlds-leading-economic-power/ (labeling the United States as the global economic superpower influencing economies abroad).

broadly open discovery to first-instance decisionmaking bodies would include international commercial arbitration as it becomes more commonplace.[153] Following the passage of § 1782(a), the U.S. Supreme Court's disposition towards international commercial arbitration has followed Congress's.[154] Foreign corporations would likely be hesitant to contract with U.S. corporations if U.S. courts stonewalled judicial assistance to those foreign entities.[155] Congress's policy intentions suggest a permissive reading of § 1782(a) to allow discovery aid in international commercial tribunals.[156]

iii. The Federal Arbitration Act and the Role of District Court Judges in International Commercial Arbitration

The Second and Fifth Circuits incorrectly inferred that the constraints of the Federal Arbitration Act and 9 U.S.C. § 7 implicitly restricted the construction of 28 U.S.C. § 1782(a).[157] The Federal Arbitration Act only applies to domestic arbitration, where discovery rules are a matter of contract and courts will not intervene unless there is a clear abuse of discovery power.[158] Parties willingly submit to domestic arbitration as an alternative

153. *See* S. REP. NO. 88–1580, at 3788–89 ("In view of the constant growth of administrative and quasi-judicial proceedings all over the world, the necessity for obtaining evidence in the United States may be as impelling before a foreign administrative tribunal or quasi-judicial agency as in proceedings before a conventional foreign court."); *see also* Markus Altenkirch & Malika Boussihmad, *International Arbitration Statistics 2018 — Another Busy Year for Arbitral Institutions*, GLOB. ARB. NEWS (July 2, 2019) https://globalarbitrationnews.com/international-arbitration-statistics-2018-another-busy-year-for-arbitral-institutions/ (observing a fifty-percent increase in resolved disputes through arbitration from 2013 to 2018).

154. *See* M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 9 (1972) ("The expansion of American business and industry will hardly be encouraged if . . . we insist on a parochial concept that all disputes must be resolved under our laws and in our courts."); *see also id.* ("We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts.").

155. Todd Weiler et al., *Are United States Courts Receptive to International Arbitration?*, 27 AM. U. INT'L L. REV. 869, 890 (2012) (encouraging U.S. courts to embrace a more liberal and receptive discovery standard, such as the one adopted by Canada, to increase parity between international parties).

156. *See* S. REP. NO. 88-1580, at 3788–89 (granting district courts broad authority to compel discovery in foreign tribunals).

157. *See* NBC v. Bear Stearns, & Co., 165 F.3d 184, 191 (2d Cir. 1999); *see also* Kaz. v. Biedermann Int'l, 168 F.3d 880, 883 (5th Cir. 1999).

158. *See* George E. Lieberman, *Discovery in an Arbitration Proceeding and Appealing an Award Under the Federal Arbitration Act: It's Not That Simple (and What You Do Not Know Can Hurt You)*, FED. LAW., May 2009, at 54, 54 https://www.fedbar.org/wp-content/uploads/2009/05/discoveryinarbitrationmay2009-pdf-1.pdf (stating that without an overreach "by the party with greater bargaining power, the courts will respect what the parties contracted for in terms of discovery" under the

to burdensome and costly litigation.[159] Because the parties control the discovery rules, the Federal Arbitration Act grants discovery power to arbitrators to balance their power with the parties' power.[160]

Discovery in international commercial arbitration in a special economic zone, such as the DIFC, is not necessarily a matter of contract.[161] U.S. parties must submit to foreign discovery procedures of the arbitral panel that may weaken their ability to resolve disputes.[162] As a result, § 1782(a) grants district courts the authority to assist in discovery requests to balance the power between U.S. parties, foreign parties, and arbitrators.[163] Although 9 U.S.C. § 7 grants arbitrators discovery power to balance the power disparity between arbitrator and party, 28 U.S.C. § 1782(a) grants parties and interested persons discovery power through district courts to balance the power disparity between domestic parties, foreign parties, and arbitrators.[164]

Following the Sixth Circuit's decision, the Second Circuit reinforced the district court judge's role in equalizing the power imbalance between parties to an arbitration.[165] The Second Circuit clarified that § 1782(a) permits district courts to compel discovery of extraterritorial materials.[166] As a result, domestic parties to an international commercial arbitration would enjoy the same privileges to compel extraterritorial materials as an

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Federal Arbitration Act).

159. *See* Thomas J. Stipanowich, *Arbitration: The "New Litigation,"* 2010 UNIV. ILL. L. REV. 1, 4 (2010) (attributing the increase in arbitration rate and decrease in trial rate from 1962 to 2002 to the cost, delays, and risks associated with trial).

160. 9 U.S.C. § 7 (2018) (granting discovery power in domestic arbitration exclusively to arbitrators).

161. *See generally DIFC-LCIA Arbitration Rules 2016*, DIFC-LCIA ARB. CTR. (Oct. 1, 2016), http://www.difc-lcia.org/arbitration-rules-2016.aspx (establishing that when operating within the DIFC, there are specific arbitral rules parties must follow as opposed to parties being able to contract arbitral rules themselves).

162. *But see* Carolyn B. Lamm et al., *International Arbitration in a Globalized World*, DISP. RESOL. MAG., Winter 2014, at 4, 5 (recommending several well-established arbitration panels' rules to avoid unforeseen intrusive discovery).

163. *See* Intel Corp. v. Advanced Micro Devices, Inc., 542 U.S. 241, 264 (2004) (giving greater weight to § 1782(a) requests from nonparticipants in the first *Intel* discretionary inquiry, implying that the district court judge resolves power imbalances in international arbitration through § 1782(a) authority).

164. 9 U.S.C. § 7; 28 U.S.C. § 1782(a) (2018).

165. *See In re* Del Valle Ruiz, 939 F.3d 520, 533–34 (2d Cir. 2019); *see also id.* at 533 (quoting Mees v. Buiter, 793 F.3d 291, 302 (2d Cir. 2015)) ("[W]e have instructed that it is far preferable for a district court to reconcile whatever misgivings it may have about the impact of its participation in the foreign litigation by issuing a closely tailored discovery order rather than by simply denying relief outright.").

166. *See id.* at 533–34 (holding that the Federal Rules of Civil Procedure authorize extraterritorial discovery).

international party's privilege to compel domestic materials.[167]

IV. NECESSITY FOR UNIFIED APPLICATION OF 28 U.S.C. § 1782(a)

The Sixth Circuit's deviation from the Second and Fifth Circuits' precedents regarding discovery in international commercial arbitration will inevitably lead to foreign litigants and arbitral parties forum shopping for judicial assistance.[168] To prevent inconsistent standards in discovery, Congress and the U.S. Supreme Court should address this issue directly.

Before the passage of the 1964 Amendments to § 1782(a), Congress assembled a group of legal experts to retool the statute.[169] This group altered the statute to reflect changes in the global economy and arbitration.[170] Congress should likewise convene another commission with the sole intent to address discovery in international commercial arbitration. The commission should work with lawmakers to enact effective, easily interpretable legislation for district and appeals courts to follow. This commission should aim to codify the *Intel* authority inquiry and the discretionary inquiry to provide further guidance on how courts should interpret these factors. The commission should also reaffirm the district court's role as a negotiator between the parties, balancing the power disparity between U.S. parties, foreign parties, and foreign arbitrators. The district court should have the authority to limit the discovery requests, limit the purpose for which the evidence is entered, and negotiate an exchange of documents, where appropriate.

Congress should quickly enact the proposed changes by this commission and further publish a legislative report detailing the tribunals entertained under § 1782(a).[171] Congress should specifically identify arbitral panels that

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167. *See id.; see also* Marisa Marinelli et al., *Discovery in International Arbitration: The Ever-Expanding Scope*, HOLLAND & KNIGHT (Oct. 31, 2019), https://www.hklaw.com/en/insights/publications/2019/10/discovery-in-international-arbitration-the-ever-expanding-scope (arguing that courts granting private arbitration applications provide an advantage to non-domestic parties seeking discovery from U.S.-based entities).

168. *See* Kenneth Beale et al., *Solving the § 1782 Puzzle: Bringing Certainty to the Debate Over 28 U.S.C. § 1782's Application to International Arbitration*, 47 STAN. J. INT'L L. 51, 93 (2011) (outlining how inconsistent rulings on § 1782 have created an incentive for foreign companies to forum shop for jurisdictions with less restrictive interpretations of the statute).

169. *See* Miller et al., *supra* note 19, at 45 (highlighting the success of the commission and Congress's acceptance of the 1964 Amendments).

170. *See id.* (illustrating how the federal courts' review of § 1782(a) cases underscored Congress's aim of refitting the statute for "modern commercial needs").

171. *See* Beale et al., *supra* note 168, at 93 (highlighting the harmful impact of inconsistent judicial interpretations of § 1782(a)).

fall within the purview of the second *Intel* discretionary factor, the nature of the tribunal, and its receptivity to U.S. courts.[172] Additional credence should be granted to arbitral panels that have adopted the rules of one of the whitelisted arbitral panels, such as the DIFC-LCIA.

Absent clear direction from Congress, the U.S. Supreme Court should address this issue to resolve any potential forum shopping. The U.S. Supreme Court can often react to changes in legal standards faster than Congress, although later congressional action may supersede the U.S. Supreme Court's ruling. Although no petition for a writ of certiorari has been filed, FedEx should challenge the Sixth Circuit's ruling that the district court had the authority, but not the obligation, to assist in discovery. On appeal, the U.S. Supreme Court should affirm the Sixth Circuit's judgment. The U.S. Supreme Court should further support its authority and discretionary factors from *Intel* by providing additional guidance on how to interpret and adjudicate on those factors. The U.S. Supreme Court should explicitly abrogate the decisions in *NBC* and *Biedermann* to prevent confusion among the lower courts.

If the U.S. Supreme Court does not clarify whether international commercial arbitration tribunals fall within the scope of § 1782(a), district and appeals courts should err towards liberal discovery authority to provide equitable and reliable relief to arbitral parties. In the interests of international comity and parity, district courts should follow the Sixth Circuit's permissive construction of § 1782(a).[173]

Finally, on remand, the district court should deny ALJ's request for discovery assistance in connection with the DIFC-LCIA tribunal. As previously noted, the first and third discretionary factors from *Intel* heavily favor the respondents, and therefore, the request should be denied. The Sixth Circuit properly overturned the denial of discovery assistance based on a lack of district court authority, however, that does not necessarily suggest that the district court should grant the discovery request. Instead, the district court should deny the request, not on the grounds of lack of authorization, but rather, as the requests were made to a party to the arbitration and the request

172. *See* Intel Corp. v. Advanced Micro Devices, Inc., 542 U.S. 241, 264–65 (2004) (recommending district courts consider the nature of the discovery request, the nature of the tribunal, "attempt[s] to circumvent foreign proof-gathering restrictions," and the burden placed on the party against which the discovery is sought).

173. *See* Abdul Latif Jameel Transp. Co. v. FedEx Corp. (*In re* Application to Obtain Discovery for Use in Foreign Proceedings), 939 F.3d 710, 732 (6th Cir. 2019); *see also Intel Corp.*, 542 U.S. at 261 ("While comity and parity concerns may be important as touchstones for a district court's exercise of discretion in particular cases, they do not permit our insertion of a generally applicable foreign-discoverability rule into the text of § 1782(a).").

was an attempt to circumvent foreign proof-gathering restrictions.

Regardless of the outcome of a congressional statute or a U.S. Supreme Court decision, a unifying standard for discovery in international commercial arbitration is necessary. Foreign parties will be less likely to contract with U.S. companies if there is legal uncertainty surrounding how evidence will be gathered in the event of a contractual dispute.

V. CONCLUSION

The Sixth Circuit properly decided *Abdul Latif Jameel Transportation Co. v. FedEx Corp.* when the court found that international commercial arbitration tribunals fall under the scope of 28 U.S.C. § 1782(a). The Sixth Circuit correctly applied the *Intel* authority test to determine that district courts have the authority, but not the obligation, to assist in discovery requests. On remand, the district court will determine whether ALJ's discovery request should be granted under the *Intel* discretionary factors.

The need for consistent discovery standards in the evolving body of international commercial arbitration will only increase as the prevalence of such arbitration increases. The Sixth Circuit's proper application of the *Intel* authority test should be adopted by other jurisdictions to promote efficacious out-of-court dispute resolution.

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BIG TECH MAKES BIG DATA OUT OF YOUR CHILD: THE FERPA LOOPHOLE EDTECH EXPLOITS TO MONETIZE STUDENT DATA

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I. INTRODUCTION

The high cost of education and decreasing academic performance presented an opportunity for the education technology industry ("EdTech"), with a worldwide market exceeding $250 billion annually, to attract large investment and development in the United States.[1] Promising cost savings and productivity efficiency, EdTech companies offer educators big data analysis by collecting and providing access to student information, assessment results, and business intelligence tools.[2] As a result of the influx in datafication of students, the educational market is the third-highest target for data hackers, behind only the health and financial sectors.[3] Data breaches of education records place student safety at risk, ranging from immediate threats of danger and cyberbullying, to long-term risks of identity theft.[4]

1. *See* Jake Williams, *U.S. EdTech Market Is Biggest Globally, Reports Says*, EDSCOOP (Feb. 13, 2020), https://edscoop.com/u-s-edtech-market-biggest-globally-report-says/ (reporting worldwide EdTech market value is projected to reach $252 billion in 2020 with the United States, home to forty-three percent of EdTech companies, leading the world in EdTech venture capital funding); *see also* Mike Montgomery, *Edtech: The Savior Our Schools Need Should Be a Startup Gold Mine*, FORBES (May 7, 2019, 6:03 PM), https://www.forbes.com/sites/mikemontgomery/2019/05/07/edtech-the-savior-our-schools-need-should-be-a-startup-gold-mine/#337a1b9799c0 (arguing the need for clear standards and goals when implementing technology to effectively impact learning; mere presence of technology is not enough).

2. *See* OMIDYAR NETWORK, SCALING ACCESS AND IMPACT: REALIZING THE POWER OF EDTECH 4 (2019) (suggesting educational models integrating technology can be impactful and cost-effective); U.S. DEP'T OF EDUC., REIMAGINING THE ROLE OF TECHNOLOGY IN EDUCATION: 2017 NATIONAL EDUCATION TECHNOLOGY PLAN UPDATE 55 (2017) (describing how EdTech provides diverse data sets to create a more complete picture and provide feedback and personalized learning strategies). *But see* SOPHIE SHANK, ABDUL LATIF JAMEEL POVERTY ACTION LAB, WILL TECHNOLOGY TRANSFORM EDUCATION FOR THE BETTER? 9 (2019) (cautioning that the effectiveness of technology on education outcomes varies depending on the implementation strategy).

3. Meghan Bogardus Cortez, *Education Sector Data Breaches Skyrocket in 2017*, EDTECH MAG. (Dec. 1, 2017), https://edtechmagazine.com/higher/article/2017/12/education-sector-data-breaches-skyrocket-2017 (showing a 103% increase in education data breaches in the first half of 2017).

4. *See id.* (noting that seventy-four percent of data breaches in higher education were caused by outsiders with malicious intentions).

High investigation costs and ransomware payments also present financial consequences for students.[5]

With the increase of technology use in schools, parents, students, and privacy advocates have growing concerns that current regulation is inadequate to meet the rapidly advancing technology EdTech companies employ.[6] Commercial companies must abide by the Children's Online Privacy Protection Act ("COPPA"), which regulates online operators' collection and use of children's personally identifiable information ("PII").[7] However, the Federal Trade Commission ("FTC"), the enforcement agency overseeing COPPA, issued an exception for data disclosed by schools to online operators acting as authorized educational partners.[8] The FTC maintains that student PII disclosed as an education record is regulated by the Family Educational Right and Privacy Act ("FERPA").[9] The legislation's overly broad definition of education records, combined with the 2011 Amendments expanding FERPA to permit schools to disclose data to third parties, creates a loophole for the EdTech industry to avoid COPPA regulation regarding student data.[10] As a result, commercial companies can

5. *See* Bob Sullivan, *FBI Warns EdTech Needs Stronger Defenses for Students' Personal Data*, SECURITY INTELLIGENCE (Jan. 11, 2019), https://securityintelligence.com/fbi-warns-edtech-needs-stronger-defenses-for-students-personal-data/ (reporting that hackers used stolen student data to extort parents and schools).

6. *See* Sara Friedman, *Survey: More Teacher Training Needed for Ed Tech Tools*, JOURNAL (Oct. 14, 2019), https://thejournal.com/articles/2019/10/14/survey-more-teacher-training-needed-for-ed-tech-tools.aspx (attributing increased use of classroom technology to schools replacing aging technology with cloud-based solutions and integrated learning experiences).

7. Children's Online Privacy Protection Act (COPPA), 15 U.S.C. §§ 6501–6506 (2018).

8. 16 C.F.R. § 312.3 (2020); *see also* Isaac Mamaysky, *The FTC Has Its Sights on COPPA, and Edtech Providers Should Take Notice*, EDSURGE (Oct. 8, 2019), https://www.edsurge.com/news/2019-10-08-the-ftc-has-its-sights-on-coppa-and-edtech-providers-should-take-notice ("[S]chools can currently consent as the parents' agent when websites collect information solely for the benefit of the students or the school and not for a commercial purpose.").

9. *Complying with COPPA: Frequently Asked Questions*, FED. TRADE COMM'N [hereinafter FED. TRADE COMM'N, *Complying with COPPA*], https://www.ftc.gov/tips-advice/business-center/guidance/complying-coppa-frequently-asked-questions (last visited Feb. 28, 2020) (follow "N. COPPA and Schools" hyperlink); *see* Family Educational Rights and Privacy Act (FERPA), 20 U.S.C. § 1232g(b)(1)(F) (2018); *see also* JOEL REIDENBERG ET AL., FORDHAM LAW SCH. CTR. ON LAW & INFO. POLICY, PRIVACY AND CLOUD COMPUTING IN PUBLIC SCHOOLS 11 (2013) (explaining COPPA does not apply to data obtained directly from a school).

10. *See* 34 C.F.R. § 99.31(a)(1)(i)(B)(2) (2020) (permitting educational agencies to disclose student PII to contractors under direct control of the institution or providing services the institution would typically perform without the consent of students or parents); Henry Kronk, *Student Data Security Is at Risk. We Need to Update FERPA*,

quickly amass large amounts of data and potentially avoid the FTC's oversight of COPPA compliance by contracting directly with schools.[11] This practice runs afoul of legislative intent for both FERPA and COPPA, places student data at risk by creating a vacuum of oversight, and leaves little recourse for violations of data collection or use in the EdTech industry.[12]

This Comment argues that the EdTech industry is exploiting a loophole in federal regulations to grow the business sector by mining children's data online at the expense of student privacy. Part II provides background on current laws protecting student data, how the laws are applied to the EdTech industry, and how the acts are enforced. Part III analyzes the application of FERPA to the EdTech industry, finding the collection of PII incompatible with the education record standard, and arguing that the Department of Education ("ED") is ill-equipped to provide oversight or deterrence for commercial companies. Part IV presents solutions to increase security of student data. Part V concludes with a review of the growing imperative to address safety concerns of EdTech applications in schools and recaps how the regulation loopholes are increasing the risks to student privacy.

II. HOW EDTECH IS AMASSING STUDENT DATA IN THE UNITED STATES

Students, parents, and privacy advocates are raising concerns about data protection as an influx of capital in EdTech companies has led to more schools utilizing third-party commercial products such as cloud computing services, online applications, and data analytics tools.[13] As more commercial EdTech tools are integrated into the U.S. education system, schools struggle

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ELEARNING INSIDE (Nov. 25, 2018), https://news.elearninginside.com/student-data-security-is-at-risk-we-need-to-update-ferpa/ (describing the loophole in FERPA regulation that permits schools to disclose student PII to EdTech companies without parental or student consent by considering the commercial entity an authorized school official).

11. *See* Natasha Singer, *How Google Took Over the Classroom*, N.Y. TIMES (May 13, 2017) [hereinafter Singer, *How Google Took Over*], https://www.nytimes.com/2017/05/13/technology/google-education-chromebooks-schools.html (showing that Google is amassing a substantial amount of user data on minors due to its use in more than half of primary and secondary schools).

12. *See* JODY FEDER, CONG. RESEARCH SERV., RS22341, THE FAMILY EDUCATIONAL RIGHTS AND PRIVACY ACT (FERPA): A LEGAL OVERVIEW 6 (2013) (citing the need to revise data practices to increase transparency for students and parents, while closing current regulation loopholes).

13. *See* REIDENBERG ET AL., *supra* note 9, at 1–2 (finding parents have rising concerns with third-party cloud data collection); *see also* John Rogers, *Education Is the New Healthcare, and Other Trends Shaping Edtech Investing*, EDSURGE (Feb. 28, 2020), https://www.edsurge.com/news/2020-02-28-education-is-the-new-healthcare-and-other-trends-shaping-edtech-investing (predicting an increase in privacy concerns as a result of accelerated capital investments in EdTech).

to enforce student data protection due to intersecting federal regulations, COPPA, and FERPA, enforced through multiple agencies.[14]

a. Federal Regulations of Student Data Collection Practices

In 1974, Congress enacted FERPA to regulate schools' practice of releasing student information, and mandate a degree of parental oversight and transparency.[15] After the innovation of the internet and adoption of online services, Congress enacted COPPA to regulate business practices for collecting data from children online.[16] Today, FERPA governs the disclosure and use of student data from schools, and COPPA regulates collection and use of children's PII by online operators.[17] As a commercial industry conducting business with schools, EdTech operates within a cross-section of COPPA and FERPA.[18]

i. Overview of Family Educational Rights and Privacy Act

FERPA protects students' PII by regulating school policies involving disclosure of student information and requiring parental transparency regarding education records.[19] However, not all school records fall within FERPA regulation. To be considered a confidential FERPA record, the material must be directly related to a student and be maintained by the

14. *See* FED. TRADE COMM'N, *Complying with COPPA*, *supra* note 9 (describing how schools must consider obligations under FERPA, COPPA, and potentially state student privacy laws when disclosing information to online operators).

15. *See FERPA and Access to Public Records*, STUDENT PRESS L. CTR. (May 6, 2005), https://splc.org/2005/05/ferpa-and-access-to-public-records/ (describing FERPA co-author Sen. James Buckley's driving concerns behind presenting the legislation as the lack of both parental access to student records and consistency in schools' policies governing disclosure of student records); *see also* Zach Greenberg, *Let Ferpa Be Ferpa*, CHRON. HIGHER EDUC. (Jan. 14, 2018), https://www.chronicle.com/article/Let-Ferpa-Be-Ferpa/242232 (quoting Sen. James Buckley) (stating the reason for FERPA was "to protect the rights of students and their parents and to prevent the abuse of personal files and data in the area of federally assisted educational activities").

16. *See* Children's Online Privacy Protection Act (COPPA), 15 U.S.C. §§ 6501–6506 (2018); *see also* FED. TRADE COMM'N, *Complying with COPPA*, *supra* note 9 (stating the main purpose of COPPA under sub-header A "General Questions about the COPPA Rule").

17. 15 U.S.C. § 6502; Family Educational Rights and Privacy Act (FERPA), 20 U.S.C. § 1232(a) (2018).

18. *See Student Privacy and Ed Tech*, FED. TRADE COMM'N, [hereinafter FED. TRADE COMM'N, *Student Privacy*] https://www.ftc.gov/news-events/events-calendar/2017/12/student-privacy-ed-tech (last visited Oct. 10, 2020) (focusing on how the rising integration of EdTech applications is causing schools to evaluate the intersection of FERPA and COPPA regulations).

19. 20 U.S.C. § 1232(g); 34 C.F.R. § 99.3 (2020).

school.[20] While FERPA does not define the direct link requirement for education records, schools can conduct a case-by-case analysis by applying guidelines from the ED.[21] When evaluating photos or videos containing students, the ED considers factors such as the activity depicted, the intended uses by the educational institution, and whether the image contains PII otherwise found in the student's record.[22] The ED further states that student images incidentally captured, as in the background of a photo, are not considered directly linked to a student.[23]

To be considered an education record under FERPA, the document or file must be maintained by the school or an agent of the school.[24] In *Owasso Independent School District v. Falco*,[25] the U.S. Supreme Court reasoned that FERPA's language implies schools are required to demonstrate a temperament of permanency or intent to retain a file for a student record to be considered maintained.[26] The Court held that peer-graded quizzes were not education records under FERPA because the grade was maintained by students rather than an institution.[27] Similarly, a federal court ruled in *S.A. v. Tulane County Office of Education*[28] that e-mails stored on individual teachers' hard drives are not education records until the document is centrally located.[29] Therefore, data collected online may be covered under

20. 20 U.S.C. § 1232g(a)(4)(A) ("'[E]ducation records' means . . . records, files, documents, and other materials which — (i) contain information directly related to a student; and (ii) are maintained by an educational agency or institution or by a person acting for such agency or institution."). *But see What Records Are Exempted from FERPA?*, U.S. DEP'T OF EDUC., https://studentprivacy.ed.gov/faq/what-records-are-exempted-ferpa (last visited Aug. 16, 2020) (noting exceptions to education records, including personal observations).

21. *See FAQs on Photos and Videos under FERPA*, U.S. DEP'T OF EDUC., [hereinafter FAQS ON PHOTOS] https://studentprivacy.ed.gov/faq/faqs-photos-and-videos-under-ferpa (last visited Aug. 16, 2020) (listing factors to consider when evaluating whether a photo or video is directly linked to a student).

22. *Id*.

23. *See id*. (hypothesizing that a photo capturing basketball players and spectators in the background is only directly linked to focused players; the image is not directly linked to students portrayed in the background); *see also* STUDENT PRESS L. CTR., *supra* note 15 (suggesting the FERPA authors did not intend for the law "to apply to documents that only tangentially refer to students" or do not influence school decision-making about students).

24. 20 U.S.C. § 1232g(a)(4)(A)(ii).

25. 534 U.S. 426 (2002).

26. *See id.* at 432–33.

27. *Id.*

28. No. CV F 08–1215 LJO GSA, 2009 U.S. Dist. LEXIS 93170 (E.D. Cal. Oct. 5, 2009).

29. *See id.* at *10 (reasoning that Congress did not "contemplate that educational records are maintained in numerous places," when enacting FERPA, but instead intended

FERPA if the information is maintained by the school, but the same information exchanged via an email or messaging application not maintained by the school is not covered.[30]

FERPA grants parents access and some control over education records, such as the right to inspect and the ability to amend inaccurate or misleading information.[31] Additionally, FERPA requires schools to obtain written parental consent prior to releasing non-directory student information.[32] However, FERPA permits exceptions to the parental consent requirement if schools are releasing records to officials for educational purposes, to accrediting organizations, to parties in connection with financial aid, or to organizations conducting studies on behalf of the school.[33] In 2011, the ED further revised FERPA guidelines to authorize schools to disclose student PII to third-party companies if the company is a designated school official.[34] The exception does not create privacy standards for the commercial companies; the law simply mandates that officials comply with the individual school's student data policy.[35]

The ED enforces FERPA; as a result, there are limited remedies for violations.[36] Schools in violation of FERPA may lose federal funding or become ineligible for future funding.[37] However, this remedy has never been used.[38] Students are unable to pursue private claims of action for FERPA violations because the statute failed to create any individual rights for

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'maintain' to mean records kept in a single secure permanent storage space).

30. *Id.* at *11–12 (holding that emails are temporary and are only education records if printed and placed in a student file).

31. 20 U.S.C. § 1232g(a), (b); *see Family Educational Rights and Privacy Act (FERPA)*, ELEC. PRIVACY INFO. CTR., https://epic.org/privacy/student/ferpa/ (last visited Aug. 10, 2020) (discussing the importance of parents' ability to access student information in order to protect their children's interests as a driving concern for proposing FERPA).

32. 20 U.S.C. § 1232g(b)(1) (requiring parental consent for schools to release education records or PII).

33. *Id.*; 34 C.F.R. § 99.31(a) (2020).

34. 34 C.F.R. § 99.31(a)(6) (granting schools the right to disclose student records to third parties providing services otherwise performed by the school, if under direct control of the school and subject to FERPA rules).

35. *See id.* § 99.31(a)(1)(i)(B)(3)(ii).

36. *See id.* § 99.67(a) (listing the remedies for FERPA violations as withholding federal funding, compelling compliance by cease and desist orders, or ending funding eligibility).

37. *Id.*

38. *See Student Privacy, FERPA, and Its Weakening by the US Department of Education*, PARENT COAL. STUDENT PRIVACY [hereinafter PARENT COAL.], https://www.studentprivacymatters.org/ferpa-changes/ (last visited on Aug. 16, 2020).

enforcement.[39] If a student believes his FERPA rights were violated, he can file a complaint with the ED.[40] The ED reviews each complaint on a case-by-case basis to determine if a school violated disclosure of student PII.[41] The ED may determine a school did not violate FERPA if the disclosed information falls outside of the Act's regulation, such as data that does not meet the requirements of education records.[42]

ii. History of Children's Online Privacy Protection Act

In 1998, Congress passed COPPA to govern the collection of children's PII from online operators.[43] The law specifies business responsibilities when collecting and using children's PII online.[44] A core element of the law, COPPA requires online operators to provide notice and receive parental consent prior to collecting PII from children under the age of thirteen.[45]

When first enacted, COPPA focused on PII used to contact a child, such as name, address, and phone number.[46] In 2012, the FTC amended COPPA regulations to include persistent identifiers, such as cookies or fingerprints;

39. *See* Gonzaga Univ. v. Doe, 536 U.S. 273, 288–89 (2002) (ruling an individual cannot sue to enforce FERPA); *see also* Tarka v. Franklin, 891 F.2d 102, 104 (5th Cir. 1989) (noting there is no language in FERPA indicating congressional intent for a private right of action); Smith v. Duquesne Univ., 612 F. Supp 72, 80 (W.D. Pa. 1985) (holding there is no private remedy for FERPA violations because the underlying purpose was to stop careless policies of releasing records, not ensuring student individual privacy).

40. 34 C.F.R. § 99.63 (instructing eligible individuals to file FERPA complaints with the ED); *see* 20 U.S.C. § 1232(f) (2018) (requiring the ED to establish an office "to investigate, process, review, and adjudicate" all violations of FERPA).

41. *See* 34 U.S.C. § 99.64 (describing how FERPA complaints are individually investigated); FAQS ON PHOTOS, *supra* note 21 (confirming the need for case-by-case analysis for evaluating potential education records such as photographs and video recordings).

42. *See, e.g.*, Owasso Indep. Sch. Dist. No. I–011 v. Falvo, 534 U.S. 426, 432–33 (2002) (holding peer-graded papers are not education records because schools do not maintain them).

43. *See* 15 U.S.C. §§ 6501–6506 (2018); *see also* Laurel Jamtgaard, *Big Bird Meets Big Brother: A Look at the Children's Online Privacy Protection Act*, 16 SANTA CLARA COMPUTER HIGH TECH. L.J. 385, 387 (2000) (summarizing COPPA's enactment as a response to concerns regarding online collection of children's data without parental consent).

44. 15 U.S.C. § 6502(b)(1)(A) (regulating when website operators can collect a child's personal information); *see also* INTERACTIVE ADVERT. BUREAU, GUIDE TO NAVIGATING COPPA: RECOMMENDATIONS FOR COMPLIANCE IN AN INCREASINGLY REGULATED CHILDREN'S MEDIA ENVIRONMENT 2 (2019), https://www.iab.com/wp-content/uploads/2019/10/IAB_2019-10-09_Navigating-COPPA-Guide.pdf (summarizing COPPA's parameters and defining identifiers regulated by the law).

45. 15 U.S.C. § 6502(b)(1)(A).

46. *See* Act of Oct. 21, 1998, Pub. L. No. 105-277, § 1303, 112 Stat. 2681 (1998); 15 U.S.C. § 6501(8).

IP address and geolocation; and a range of media files now prevalent online such as photos and video recordings.[47] Online services that target children are required to comply with COPPA regulations, regardless of the device used to access the service.[48]

Under the statute, the FTC enforces COPPA compliance.[49] Online operators who fail to comply with COPPA regulations may face civil penalties of up to $43,280 per violation.[50] The FTC can also require a company to change business practices as a remedy for a COPPA violation.[51] Currently, the FTC only investigates COPPA compliance by businesses; the FTC excludes schools from COPPA enforcement, stating that FERPA regulates the enforcement of school data disclosure.[52]

b. The Information EdTech Is Collecting on Students

EdTech businesses offer schools access to big data, which can drive learning initiatives for students as well as financial decision making for administrators.[53] A prime example of EdTech's presence is Google's integration into public schools: in 2017, more than half of K-12 students used Google's education apps, and Google Chromebooks accounted for more than fifty percent of mobile devices in schools.[54] Similarly, EdTech

47. 16 C.F.R. § 312.2 (2020); *see also* FED. TRADE COMM'N, *Complying with COPPA*, *supra* note 9.

48. *See* INTERACTIVE ADVERT. BUREAU, *supra* note 44, at 2 (explaining COPPA applies to all online services, including shared devices).

49. 15 U.S.C. § 6502(c); 16 C.F.R. § 312.9 (stating violations of COPPA will be enforced by the FTC).

50. FED. TRADE COMM'N, *Complying with COPPA*, *supra* note 9 (outlining the penalties for violating COPPA); *see also* Press Release, Fed. Trade Comm'n, Google and YouTube Will Pay Record $170 Million for Alleged Violations of Children's Privacy Law (Sept. 4, 2019), https://www.ftc.gov/news-events/press-releases/2019/09/google-youtube-will-pay-record-170-million-alleged-violations (reporting the record settlement Google will pay the FTC and New York for violating COPPA rule).

51. *See, e.g.*, Press Release, Fed. Trade Comm'n, TRUSTe Settles FTC Charges it Deceived Consumers Through Its Privacy Seal Program (Nov. 17, 2014), https://www.ftc.gov/news-events/press-releases/2014/11/truste-settles-ftc-charges-it-deceived-consumers-through-its (describing that settlement requirements include prohibiting misrepresentations about TRUSTe practices in messaging).

52. *See* 20 U.S.C. § 1232g(f) (2018); FED. TRADE COMM'N, *Complying with COPPA*, *supra* note 9 (noting school operators need to consider FERPA regulations, adding that compliance is administered by the ED).

53. *See* Benjamin Herold, *How (and Why) Ed-Tech Companies Are Tracking Students' Feelings*, EDUC. WK. (June 12, 2018), https://www.edweek.org/ew/articles/2018/06/12/how-and-why-ed-tech-companies-are-tracking.html (describing how data analytics are driving adaptive learning, developing personalized programs to identify knowledge gaps, and increasing efficacy).

54. *See* FRIDA ALIM ET AL., ELEC. FRONTIER FOUND., SPYING ON STUDENTS:

company ClassDojo claims that more than ninety-five percent of U.S. K-8 schools are actively using its application.[55] Many EdTech applications provide big data insights driven by student's PII, including behavioral data, such as tracking student actions and engagement with others.[56]

There is a wide range of data collected by EdTech applications.[57] Direct data is voluntarily entered or transferred from schools to EdTech companies, such as account information submitted to create a user profile within the application.[58] Examples of direct information include student names, student IDs, contact information, or grades.[59] Direct information can be supplied by schools, teachers, parents, or student users.[60] When using online applications for educational activities, a potential pitfall for schools is students' tendency to share PII.[61] A 2013 study found that teens under the age of eighteen exhibit a high likelihood of revealing PII online, and that teens are more likely to share information about themselves online than in the past.[62] The study also found that only nine percent of teens had "a high level of concern about third-party access to their data."[63]

Beyond direct data, EdTech companies collect indirect or trace data.[64] Indirect data is information collected in the application itself, such as

SCHOOL-ISSUED DEVICES AND STUDENT PRIVACY 5 (2017) (detailing the heavy use of school-issued devices for K–12 students).

55. *Press*, CLASSDOJO, https://www.classdojo.com/press/ (last visited Aug. 16, 2020) (describing the prevalent use of ClassDojo by teachers to share photographs and videos of students, creating a communication hub for teachers, students, and parents).

56. *See* ALIM ET AL., *supra* note 54, at 7–8 (stating the ED is encouraging schools to adopt the use of big data from EdTech applications to improve assessments of learning objectives and educational innovation).

57. *See* CHILDREN'S COMM'R, WHO KNOWS WHAT ABOUT ME? 5–8 (2018), https://pwxp5srs168nsac2n3fnjyaa-wpengine.netdna-ssl.com/wp-content/uploads/2018/11/Childrens-commissioner-Who-Knows-What-About-Me-i-internet-matters.pdf (explaining the types of children data being collected online).

58. *See id.* at 6 (describing the "direct data" collected on students).

59. *Id.*

60. *See id.* at 5–6 (providing examples of "direct data" that schools provide to EdTech companies).

61. *See* Perry Drake, *Is Your Use of Social Media FERPA Compliant?*, EDUCAUSE REV. (Feb. 24, 2014), https://er.educause.edu/articles/2014/2/is-your-use-of-social-media-ferpa-compliant (imagining various scenarios of data sharing online).

62. *See* Mary Madden et al., *Teens, Social Media, and Privacy*, PEW RES. CTR. (May 21, 2013), https://www.pewresearch.org/internet/2013/05/21/teens-social-media-and-privacy/ (finding that ninety-one percent of teens report posting photos of themselves, ninety-two percent share their name online, eighty-two percent share their birth date, and seventy-one percent reveal the town or city they live in).

63. *Id.*

64. *See* CHILDREN'S COMM'R, *supra* note 57, at 6 (explaining the types of child data collected online includes "inferred" data and "data that is 'given off'").

metadata, geolocation, IP address, and browser data.[65] The programs capture user interactions within the application and automatically upload the data.[66] For example, Summit Learning's platform collects geolocations, IP addresses, and browsing behaviors.[67] Many companies are working on applications to capture students' eye movements to measure engagement, whether through sensors in classrooms or cameras on laptops.[68] The Paris School of Business is already utilizing laptop webcams to analyze student eye movements in its online program and alert students when interest decreases.[69]

Potentially the most valuable data within the EdTech industry is inferred data, which combines direct and indirect information to create predictive models based on algorithms.[70] By providing access to big data and applying predictive analytics, EdTech businesses capitalize on advancements in technology data-mining to present trends and patterns within student data.[71]

c. Safety Risks and Privacy Concerns for EdTech Data Collection

Schools generate a substantial amount of valuable data with more than fifty million students in public school each year, which can entice hackers to the EdTech industry's large collection of student data.[72] In September 2018, the Federal Bureau of Investigation ("FBI") issued a warning that the "rapid proliferation of education technologies in U.S. schools poses privacy and

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65. *Id.*

66. *See, e.g.*, *Privacy Policy*, SUMMIT LEARNING, https://www.summitlearning.org/privacy-center/privacy-policy (last updated June 22, 2020) (clarifying that Summit Learning automatically collects certain types of visitor information).

67. *See id.*

68. *See* Erika Gimbel, *Biometric Tech Can Track How Well Students Are Paying Attention*, EDTECH MAG. (Feb. 23, 2018), https://edtechmagazine.com/k12/article/2018/02/biometric-technology-tracks-students-attention (describing the potential uses of biometric tracking in education and predicting they will emerge in U.S. classrooms by the year 2028).

69. *See id.* (describing the program Nestor, an application that uses AI-software to analyze students' eye movements in remote learning classes and generate alerts and create custom quizzes based on a student's attentiveness to the online program).

70. *See* CHILDREN'S COMM'R, *supra* note 57, at 6.

71. *See* Samuel Greengard, *How Predictive Analytics Will Improve Learning*, EDTECH MAG. (Oct. 31, 2006), https://edtechmagazine.com/k12/article/2006/10/how-predictive-analytics-will-improve-learning (predicting the increase and impact of predictive modeling in education); *see also* CHILDREN'S COMM'R, *supra* note 57, at 6, 9 (explaining that privacy policies for inferred data are often the least transparent, with many parents and students often lacking awareness of the data collected).

72. *See Back to School Statistics*, NAT'L CTR. FOR EDUC. STATS., https://nces.ed.gov/fastfacts/display.asp?id=372 (last visited Aug. 16, 2020) (reporting that 50.7 million students would attend public schools for the 2019–2020 school year).

safety risks for children."[73] Cybercriminals find the education sector an appealing target because it presents a large amount of data, collected in disparate, often ill-managed systems.[74] Parents and privacy advocates fear EdTech companies are further placing student data at risk due to the high concentration of data aggregation, lack of transparency on data collection, and poor security protocols.[75]

Moreover, studies show that schools are often unprepared to protect student data collected in EdTech applications.[76] Research conducted by the Fordham Center on Law and Information Policy ("Fordham CLIP") in 2013 suggested schools are not prepared to adequately address data governance or protection when data collection is outsourced to third-party services.[77] Ninety-five percent of school districts in the study utilized cloud computing solutions for data mining, but fewer than seven percent of the school contracts restricted companies' use of student data for marketing purposes.[78] The study also found many schools are ill-prepared to support FERPA regulations related to contracts with online operators.[79] Unsecured services lead to potential data breaches, which place students' safety at risk.[80]

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73. Benjamin Herold, *FBI Raises Alarm on Ed Tech and Student Data Privacy, Security*, EDUC. WK. (Sept. 13, 2018, 11:18 AM) [hereinafter Herold, *FBI Raises Alarm on EdTech*], https://blogs.edweek.org/edweek/DigitalEducation/2018/09/fbi_raises_alarm_ed_tech_privacy.html; *see* Press Release, Fed. Bureau of Investigation, Education Technologies: Data Collection and Unsecured Systems Could Pose Risks to Students (Sept. 13, 2018), https://www.ic3.gov/media/2018/180913.aspx (warning of malicious use of sensitive PII after uncovering two large data breaches resulting in public access to millions of students' data in 2017).

74. *See* Herold, *FBI Raises Alarm on EdTech*, *supra* note 73 (warning that school districts were being targeted and that "most data disclosures are caused by human error"); *see also* Cortez, *supra* note 3 (characterizing universities as a "juicy target" for hackers due to the large quantity of users).

75. *See* Barbara Kurshan, *The Elephant in the Room with EdTech Data Privacy*, FORBES (June 22, 2017, 1:51 PM), https://www.forbes.com/sites/barbarakurshan/2017/06/22/the-elephant-in-the-room-with-edtech-data-privacy/#37d57d7e57a5 (arguing EdTech applications that consolidate data create security risks by "mak[ing] it possible for a single hacked administrator login to reveal a swath of student data").

76. *See* REIDENBERG ET AL., *supra* note 9, at 24 (finding many school districts in the study failed to have adequate data governance policies for outsourced data collection, twenty percent of which had no policies addressing teacher's use of these services).

77. *See id.* (noting that poor documentation of vendor contracts and limited access to the full terms, in some instances, has serious implications for student data protection).

78. *Id.* at 19, 51–52 (finding school districts are using cloud services for reporting, data analytics, and classroom functions).

79. *See id.* at 26–27 (finding sixty-six percent of schools surveyed did not include the ability to audit or inspect vendors' practices).

80. *See* CHILDREN'S COMM'R, *supra* note 57, at 12 (detailing security risks caused by data breaches, including identity theft, cyberbullying, online impersonation, and stranger danger of identifying physical locations of children through metadata).

Data breaches risk student safety, lead to cyber bullying, contribute to identity theft, and generate financial burdens on schools and parents.[81] Beyond physical safety for abduction or harm from disclosing a child's location, online identifiers expose children to cyberbullying and online impersonation.[82] Bullying and online impersonation harm a child's wellbeing, and statistics show almost a third of U.S. children experience cyberbullying.[83] More troubling is that children who experience cyberbullying are nine times more likely to become a victim of online scams.[84] Long-term impacts of data breaches like identity theft, may actualize years after the breach, when bad actors use the information to open accounts or steal the identity of a child when he or she reaches the age of eighteen.[85]

Beyond future repercussions of identity theft, data breaches cause significant financial hardships for schools and parents in the present.[86] Due to poor regulation and vendor agreements, schools pay a higher cost for security breaches than other industries.[87] In spite of warnings against it, school districts have admitted to paying cybercriminals thousands of dollars to regain control of student data in response to ransomware attacks.[88] Even parents are susceptible to financial extortion attempts from hackers. In 2018, school districts closed classes after parents received text messages

81. *See id.*; *see also, e.g.*, Mamaysky, *supra* note 8 (finding a majority of 6,000 popular children's Android apps reviewed potentially violate COPPA).

82. *See* CHILDREN'S COMM'R, *supra* note 57, at 5–6, 20 (explaining types of data being collected online).

83. *See* Christo Petrov, *47 Alarming Cyberbullying Statistics for 2020*, TECHJURY, https://techjury.net/stats-about/cyberbullying/#gref (last updated June 23, 2020) (detailing how online "threats, mean comments, identify theft, racism, or attacks based on their looks or religion" lead to depression, anxiety, and stress amongst children and young people).

84. *Id.* (finding a direct correlation between cyberbullying and the likelihood of falling victim to identity theft).

85. *See* Jessica Baron, *Posting About Your Kids Online Could Damage Their Futures*, FORBES (Dec. 16, 2018, 8:00 AM), https://www.forbes.com/sites/jessicabaron/2018/12/16/parents-who-post-about-their-kids-online-could-be-damaging-their-futures/#398a258127b7 (discussing Barclays's estimate that two-thirds of identity theft by 2030 will be a result of oversharing information online).

86. *See* Sullivan, *supra* note 5 (describing how hackers use stolen student data to extort parents or school districts).

87. Ramona Carr, *The Rise of Education Data Breaches*, ZETTASET, https://www.zettaset.com/blog/education-data-breaches/ (last visited Aug. 16, 2020) (detailing a Ponemon Institute study showing that schools pay a higher cost to remedy data breaches than other industries, averaging $200 per student record).

88. *See, e.g.*, Sullivan, *supra* note 5 (reporting "a Massachusetts school district paid cybercriminals $10,000 in bitcoin to regain control" after a 2019 ransomware attack).

threatening to expose their students' PII.[89]

In addition to criminal activity, privacy advocates are concerned with EdTech's impact on student privacy. In November 2018, high school students in Brooklyn walked out of school to protest the school's disclosure of student PII to the Summit Learning platform.[90] The student organizers published a letter written to Mark Zuckerberg, co-founder of Summit Learning, detailing concerns about the extent of PII collected by the EdTech, and Summit's policy of disclosing this information to corporations.[91] Similarly, privacy advocacy groups commissioned studies, published reports, and filed lawsuits to further expose the student privacy issues arising from schools' implementation of EdTech applications.[92]

d. How EdTech Passes Off Regulation Compliance to Schools

While there are EdTech applications or services that fall outside of FERPA's education record definition, both the FTC and the ED rely on schools to determine whether an online service meets the statute's standards.[93] The FTC further states that online operators are responsible for determining whether the collection and use of student data by third parties complies with FERPA.[94]

Perhaps following the FTC's lead, EdTech companies will often assign schools the responsibility of determining whether all services provided fully comply with FERPA through the company's contract.[95] To mitigate risk, EdTech companies often include a contract provision requiring schools to obtain verifiable consent from parents.[96] This provision is designed to

89. *See, e.g.*, *id.* (noting that school districts in Alabama, Montana, and Texas had to close schools after parents were texted "ominous, personalized messages").

90. Kronk, *supra* note 10 (detailing a walk out of almost 100 students from the Secondary School for Journalism in Brooklyn in protest of the school's disclosure of PII to Summit Learning).

91. *Id.* ("Summit also says on its website that they plan to track us after graduation through college and beyond. Summit collects too much of our personal information, and discloses this to 19 other corporations.").

92. *See* FEDER, *supra* note 12, at 6 (noting the legal challenges to the 2011 revised FERPA guidelines allowing schools to disclose student information to third-party companies).

93. *See id.* at 5–6.

94. FED. TRADE COMM'N, *Complying with COPPA*, *supra* note 9.

95. *See id.*

96. *See* Natasha Singer, *Privacy Concerns for ClassDojo and Other Tracking Apps for Schoolchildren*, N.Y. TIMES (Nov. 16, 2014), https://www.nytimes.com/2014/11/17/technology/privacy-concerns-for-classdojo-and-other-tracking-apps-for-schoolchildren.html (noting that commercial companies can offload COPPA compliance for parental consent to schools within their service contracts).

protect the online operator from COPPA violations and any resulting financial repercussions in the event that an application or service exceeds the educational context.[97]

In lieu of clear FERPA guidelines, parents and privacy advocates are leading the movement for increased transparency and security protocols for EdTech companies.[98] Following public outcry over their lack of transparency, EdTech company InBloom was forced to shut down due to revenue loss.[99] Similarly, Electronic Frontier Foundation, a privacy advocacy group, filed a lawsuit in 2014 forcing Google to acknowledge that it mined data from student accounts for core services outside of the Google Apps for Education.[100]

III. NO MAN'S LAND OF OVERSIGHT: HOW EDTECH IS OPERATING IN A REGULATION VACUUM

Due to outdated regulatory definitions and counteracting enforcement guidelines, the EdTech industry is exploiting a loophole in federal regulations to mine children's online data for financial gain.[101] By connecting with schools as authorized educational partners, EdTech companies' data collection is governed by FERPA's education record guidelines.[102] However, today's online operators collect and store information that far exceeds the traditional school records FERPA was designed to protect, specifically the expansion to indirect and inferred data.[103] Furthermore, the very personal nature of this data exceeds FERPA's directory definition and, therefore, should require parental consent prior to disclosure.[104]

In addition to running afoul of FERPA's legislative intent, EdTech companies' data practices place student information at far greater risk than

97. *See* REIDENBERG ET AL., *supra* note 9, at 61.

98. *See* Kurshan, *supra* note 75.

99. *Id.*

100. *Id.*

101. *See* Kronk, *supra* note 10 (describing the loophole in FERPA regulation that permits schools to disclose student PII to EdTech companies without parental or student consent by considering the company an authorized school official).

102. *See* 20 U.S.C. § 1232g(a)(1) (2018); 34 C.F.R. § 99.31(a)(1)(i)(A) (2020) (expanding FERPA's permitted disclosure of education records to third-party entities if they are authorized educational partners).

103. *See* CHILDREN'S COMM'R, *supra* note 57, at 5–8 (describing the expansive list of data used today, including vast amounts of data collected automatically from online applications).

104. *See* 34 C.F.R. § 99.30(a) (requiring written parental consent prior to disclosing information). *But see* Drake, *supra* note 61 (providing scenarios where schools' online interactions would not be considered education records regulated under FERPA).

traditional education records housed and maintained by individual schools.[105] The large-scale data collected online feeds into the datafication of children, placing their safety and online identities at risk of improper mining, use, or theft.[106] Neither individual schools nor the ED are adequately prepared to oversee FERPA compliance within the EdTech industry.[107] Unlike schools, commercial companies are not subject to financial repercussions or disciplinary actions by ED for violating FERPA.[108] Subsequently, FERPA provides no regulatory incentive for EdTech companies to provide adequate transparency and privacy protection.[109] Outside of school education records, COPPA governs the data collection for children by online operators.[110] COPPA is well-positioned for oversight enforcement because the FTC investigates complaints and can impose financial penalties and business restrictions upon companies found to be in violation of the Act.[111]

a. EdTech's Expansive Collection of Student Data Transcends the Realm of FERPA's Education Records

EdTech companies exploit FERPA's overly broad definition of education records to mine enormous amounts of children's online data, largely without notice and absent parental consent.[112] FERPA limits school disclosure

105. *See* Sullivan, *supra* note 5 (comparing traditional and digital files to advocate for heightened EdTech security).

106. *See id.* (relaying events where student PII was stolen and used for extortion); *see also* FEDER, *supra* note 12, at 5–6 (noting that privacy advocates are concerned about the risks to student privacy that data sharing poses).

107. *See* 34 C.F.R. § 99.1(a) (limiting FERPA enforcement to educational institutions that receive federal funds administered by the Secretary of Education).

108. *See* Brandon Wong, *FERPA: The Joke with No Punchline*, AM. ENTER. INST.: BLOG (Feb. 23, 2015), https://www.aei.org/education/ferpa-joke-punchline/ (noting that FERPA only applies to institutions that are recipients of federal funds, not for-profit EdTech companies).

109. *See* 34 C.F.R. § 99.1 (indicating that FERPA regulations are limited to educational institutions receiving federal funding).

110. 15 U.S.C. § 6502(a)(1) (2018); 16 C.F.R. § 312.3 (2020).

111. *See, e.g.*, Alexi Pfeffer-Gillett, *Peeling Back the Student Privacy Pledge*, 16 DUKE L. & TECH. REV. 100, 130 (2018) (discussing how the FTC's investigations and consumer oversight align with consumers' right to accurate information, and the FTC has the ability to hold companies accountable with financial and procedural remedies); *see also* Mamaysky, *supra* note 8 (predicting increased investigation of online operators' adherence to COPPA is signaled by the FTC's record-setting 2019 YouTube settlement for COPPA violations).

112. *See* Kronk, *supra* note 10 (describing the loophole in FERPA regulation that permits schools to disclose PII to EdTech companies without parental or student consent by considering the commercial entity an authorized school official).

policies to information directly linked to a student, related to their education, and maintained by the school as an education record.[113] However, EdTech applications often fail to meet all of these FERPA requirements for education records.[114] EdTech companies are indiscriminately gathering information not directly linked to students' education.[115]

First, the technological advancements of online applications have negated the protections of limiting FERPA to records directly linked to a student.[116] If a student's image is captured incidentally or as part of the background at a school event, the ED does not consider the image to be directly related to a student and, therefore, not an education record.[117] In that instance, schools can still publish or share the image without obtaining the consent of the student by reasoning that the inadvertent peripheral image contained no PII data beyond directory information.[118] There is little risk of harm or invasion of privacy for a student if he appeared anonymously in the background of a photo printed in a newspaper.[119]

However, unlike the traditional directory information disclosed by a school, online operators present more tangible risks to a student's privacy if caught in the background of an image due to the technological advancements of the application.[120] EdTech companies place student privacy at risk because they make student PII more obtainable when online applications can use machine learning and AI algorithms to identify individuals in the

113. 20 U.S.C. § 1232g(b) (2018).

114. *See* Jackie Gharapour Wernz, *Are Emails, Texts, Tweets, and Other Digital Communications Student Records Under FERPA and State Law?*, JD SUPRA (Feb. 20, 2013), https://www.jdsupra.com/legalnews/are-emails-texts-tweets-and-other-dig-60950/ (discussing the ambiguous area of applying FERPA to digital communication records when the files are not considered education records under the Act).

115. *See* ALIM ET AL., *supra* note 54, at 5 (detailing how EdTech applications data-gathering goes beyond traditional PII to include behavioral information, search terms, contact lists, location data, and browsing history).

116. *See id.* (highlighting the exponential increase in data as a result of technology applications' ability to generate new data).

117. *See* FAQS ON PHOTOS, *supra* note 21 (describing how images are not directly linked to students captured in the background, but the school still must obtain parental consent to disclose the photo or alternatively classify the image as directory information).

118. *See id.*

119. *See id.*

120. *See* Kashmir Hill, *The Secretive Company that Might End Privacy as We Know It*, N.Y. TIMES (Jan. 18, 2020), https://www.nytimes.com/2020/01/18/technology/clearview-privacy-facial-recognition.html (last updated Feb. 10, 2020) (explaining the ability for computer programming to collect images online and then use algorithms to convert the images into vectors, mathematical formulas, that are grouped together to identify individuals; a technology being used to eliminate anonymity of faces in background or surveillance images by more than 600 law enforcement agencies with Clearview AI).

background or tag the image's geolocation to expose the child's location.[121] Applications such as Google Photos also use AI technology to scan images to identify any faces captured in photos, even faces in the background or indirect focus of the image.[122]

In those instances, there is an equivalent risk of privacy invasion for both the directly linked student and any children incidentally captured because the online application is equally collecting and tracking student PII.[123] Due to these technological advancements, FERPA's guidelines to determine direct linkage to a student in traditional media are incompatible with the enormous capabilities of online applications.[124]

Second, EdTech companies' capability to capture and generate new types of data is testing the limits of educational context required under FERPA.[125] Data simply obtained by an educational institution or agent is not automatically considered to be within the educational context of FERPA regulation.[126] Under the Act, education records are limited only to

121. *See, e.g.*, Matthew Lynch, *U.S. PreK-12 Schools Explore Adopting Facial Recognition Software*, TECH EDVOCATE (Sept. 6, 2019), https://www.thetechedvocate.org/u-s-prek-12-schools-explore-adopting-facial-recognition-software/ (highlighting EdTech applications' use of facial recognition, including measuring student engagement in China by scanning faces to determine if a student is engaged, tired, or distracted).

122. *How Google Uses Pattern Recognition to Make Sense of Images*, GOOGLE, https://policies.google.com/technologies/pattern-recognition?hl=en (last visited Aug. 11, 2020) (describing how computers use pattern recognition to identify faces in photos); *see* Dale Smith, *Google Knows What You Look Like. Here's What it Means and How to Opt Out,* CNET (Feb. 4, 2020, 5:00 AM), https://www.cnet.com/how-to/google-knows-what-you-look-like-heres-what-it-means-and-how-to-opt-out/ (explaining ways Google is acquiring, storing, and using facial data).

123. *Compare* 34 C.F.R. § 99.1 (2020) (requiring FERPA education records to be directly linked to the student and maintained by the school), *with* FAQS ON PHOTOS, *supra* note 21 (describing how incidental images are not regulated by FERPA).

124. *See* Thomas Germain, *How a Photo's Hidden 'Exif' Data Exposes Your Personal Information*, CONSUMER REPS., https://www.consumerreports.org/privacy/what-can-you-tell-from-photo-exif-data/ (last updated Dec. 6, 2019) (describing how images capture location through GPS data). *Compare* FAQS ON PHOTOS, *supra* note 21 (arguing children included in the background of an image are not covered under FERPA because there is little likelihood of an invasion of privacy), *with* Lily Hay Newman, *AI Can Recognize Your Face Even if You're Pixelated*, WIRED (Sept. 12, 2016, 11:54 AM), https://www.wired.com/2016/09/machine-learning-can-identify-pixelated-faces-researchers-show/ (describing how machine learning can be used to defeat privacy protection technologies by identifying pixelated or obfuscated faces in images and videos).

125. *See* ALIM ET AL., *supra* note 54, at 24 (explaining how EdTech applications are gathering indirect and inferred information found solely in online applications).

126. *See What Records Are Exempted from FERPA?*, U.S. DEP'T OF EDUC., https://studentprivacy.ed.gov/faq/what-records-are-exempted-ferpa (last visited Aug. 11, 2020) (listing files that are not considered education records collected by schools).

information collected relating to a student's education.[127] However, a feature that distinguishes online applications from traditional school records is the ability to collect vast amounts of engagement data that schools did not collect previously.[128]

The indirect and inferred data EdTech applications collect often exceeds the traditional PII found within the permanent student file directly maintained by the school.[129] Online applications collect geolocations of users, IP addresses, and biometric data such as heart rate or activity levels.[130] Additionally, many online applications retain information generated from online messaging, file sharing, and email communication between users.[131] The expanding universe of indirect data EdTech companies are amassing is then compiled with direct information disclosed by schools, such as grades, attendance, or test scores, to predict behavior or develop learning strategies.[132] Unlike grades or attendance, the relationship between browser preferences, geolocation, or social communications with other users in web chats is, at best, tenuously related to a student's education.[133]

Third, schools can fail to maintain the data collected by EdTech companies as required by FERPA. The ED requires documents to be

127. 20 U.S.C. § 1232g(a)(4)(A) (2018).

128. *See* CHILDREN'S COMM'R, *supra* note 57, at 6 (distinguishing the various types of data collected online, specifically new data "given off" unknowingly by users online, such as cookies). *Compare* 20 U.S.C. § 1232g(a)(5)(A) (defining traditional directory information such as name, address, and school activities), *with* 16 C.F.R. § 312.2 (2020) (tailoring the personal identifiers for COPPA regulation to online services and applications by including online contact, persistent identifiers, and geolocations).

129. *See* ALIM ET AL., *supra* note 54, at 24.

130. *See* CHILDREN'S COMM'R, *supra* note 57, at 3 (arguing the data collected on children through connected devices, monitoring equipment, and social media is exponentially expanding the amount of data harvested compared to previous generations).

131. *See, e.g.*, CLASSDOJO, HOW DOES CLASSDOJO BUILD A POSITIVE SCHOOL COMMUNITY? 1–2 (n.d.), https://static.classdojo.com/docs/TeacherResources/SchoolLeaderPack/ClassDojo-SchoolLeaderPack.pdf (last visited Aug. 11, 2020) (highlighting application features that allow for officials to share stories, images, and messages with parents); Jeff Knutson, *Essential Tips and Tools to Improve the Parent-Teacher Communication Loop*, COMMONSENSE EDUC. (Aug. 23, 2016), https://www.commonsense.org/education/articles/6-tech-tools-that-boost-teacher-parent-communication (promoting EdTech messaging applications that increase communication between students, teachers, and parents).

132. *See* CHILDREN'S COMM'R, *supra* note 57, at 6 (defining inferred data as an analysis combining direct and indirect information to then form a prediction).

133. *Compare* 20 U.S.C. § 1232g(a)(4)(A) (limiting education records to files that contain information directly linked to a student and are maintained by the educational agency or institution), *with* Wernz, *supra* note 114 (discussing the ambiguous area of applying FERPA to digital communication when the files are not considered education records).

maintained and stored by a school, or its agent to be regulated by FERPA.[134] In addition to storing data, schools must demonstrate the file was retained with some degree of permanency to be considered an education record, such as retaining the record in a filing cabinet or permanent secure database.[135] Even while EdTech companies collect information as agents for schools, there is still a requirement to show an intent to hold the data as part of a permanent record.[136] Otherwise, the electronic data can be considered temporary in nature and outside FERPA regulation.[137] Guidelines for demonstrating a deliberate action to retain, such as attaching an email to a permanent file, also apply to agents of schools.[138] However, the limitless availability of storage nullifies the permanency requirement as previously presented to schools.[139] By transitioning education records from physical mediums to digital files offsite in cloud servers, schools have virtually unlimited storage space and digital data is being captured at exponentially higher rates due to ease.[140]

Without physical constraints, vast amounts of data collected through EdTech applications fail to meet FERPA requirements because they are generated and shared between users instead of with schools.[141] User-provided information such as profile submissions and webchat discussions between classmates are more closely analogous to peer-graded assignments, classmate feedback, or group projects than school records because the data originates outside of the educational context.[142] The ED has determined that peer-graded assignments are not considered education records under FERPA

134. 34 C.F.R. § 99.3 (2020); *see* 20 U.S.C. § 1232g(a)(4)(A).

135. *See* Owasso Indep. Sch. Dist. No. I-011 v. Falvo, 534 U.S. 426, 432–33 (2002) (holding that FERPA suggests a method of permanency or intent to retain files as a statutory requirement).

136. *See* S.A. v. Tulare Cty. Office of Educ., No. CV F 08-1215 LJO GSA, 2009 U.S. Dist. LEXIS 93170, at *9–10 (E.D. Cal. Oct. 5, 2009) (holding emails are temporary and only education records if printed and placed in a student file).

137. *See* Drake, *supra* note 61 (discussing when email communications can be education records governed by FERPA).

138. 34 C.F.R. § 99.31 (a)(1)(i)(B); *see also* Kronk, *supra* note 10 (describing risks associated with FERPA's extension of authorized school officials to third-party commercial companies).

139. *See* CHILDREN'S COMM'R, *supra* note 57, at 11 (describing the increase of connected devices gathering information, paired with advancements in data processing to generate predictive inferred data, which means online data is exponentially growing).

140. *See* REIDENBERG ET AL., *supra* note 9, at 1–2.

141. *See* Owasso Indep. Sch. Dist. No. I-011 v. Falvo, 534 U.S. 426, 433–35 (finding peer grades are not education records because school officials did not capture the data or create it with the intent of retaining in a permanent file).

142. *See* Wernz, *supra* note 114 (highlighting the ambiguous area of applying FERPA to classroom applications, specifically the characteristics of user-submitted information).

because the documents originate outside of school officials.[143] Similarly, online communication between peers should not be considered education records protected by FERPA.[144] Furthermore, the records must be maintained by FERPA standards, preventing disclosure to non-authorized parties.[145] While offsite servers may still be considered secure by enlisting password authentication, many applications feature the ability for end users to view other users' accounts, activity, and records.[146]

Further compounding the issue of maintaining records, many EdTech companies disclose student data to additional third parties to capture, store, and process the collected data.[147] The vast network created through EdTech services is multi-layered and far more complex than schools' traditional record keeping practices.[148] As a result, EdTech operators are comingling traditional educational information, such as attendance and grades, with data generated from social features such as peer messaging or photo sharing.[149] Information generated from social features in the online applications is more analogous to temporary email communications that are not considered education records.[150]

Finally, even if information meets FERPA's education record standards,

143. *See* 20 U.S.C. § 1232g(a)(4)(B)(ii) (2018) (limiting FERPA education records to files "maintained" by a school); 534 U.S. at 434–35 (confirming that the ED interpretation of "maintained" education records to be "kept by a single central custodian" through "describing a 'school official' and 'his assistants' as the personnel responsible for the custody of the records").

144. 534 U.S. at 432–33 (explaining that education records are not "maintained" when students grade their peers' work because student graders are not acting on behalf of an educational institution).

145. 34 C.F.R. § 99.31(a)(6) (2020).

146. *See* Erin Klein, *5 Apps to Share Class Work Beyond the Classroom!*, SCHOLASTIC: TOP TEACHING BLOG (Mar. 25, 2014), https://www.scholastic.com/teachers/blog-posts/erin-klein/5-apps-share-class-work-beyond-classroom/ (describing online applications that can be used to share classroom and student information with parents).

147. *See* REIDENBERG ET AL., *supra* note 9, at 17 (reporting that ninety-five percent of selected school districts shared student information with third parties through cloud computing arrangements).

148. *See* GIRARD KELLY ET AL., COMMON SENSE MEDIA, 2019 STATE OF EDTECH PRIVACY REPORT 47 (2019), https://www.commonsensemedia.org/sites/default/files/uploads/research/2019-state-of-edtech-privacy-report.pdf (finding that seventy-nine percent of EdTech applications or services share student information with third parties for analytics and data tracking).

149. *See id.* at 50 (discussing that more than half of surveyed applications risk data being shared through social or federated logins on third-party sites such as Facebook).

150. *See* S.A. v. Tulare Cty. Office of Educ., No. CV F 08-1215 LJO GSA, 2009 U.S. Dist. LEXIS 93170, at *9–10 (E.D. Cal. Oct. 5, 2009) (holding that because emails have a "fleeting nature," they are only education records if printed and placed in a student file).

EdTech companies are collecting metadata, behavioral observations, and predictive classifications that exceed student directory information.[151] Like disclosing non-directory information, such as social security numbers, schools are required to obtain parental consent prior to using EdTech applications to generate and disclose a student's non-directory information.[152] A grounding principle of FERPA is the strong foundation in promoting parental transparency.[153]

b. Disclosure of Student Information to EdTech Runs Afoul of FERPA's Intent

Congress enacted FERPA to protect the process for disclosing students' education records.[154] As emphasized in a letter from the cosponsors, FERPA's intent is to protect student data by regulating how schools release records and promote transparency through parental access.[155] The ED erred by loosening the guidelines for schools to release student education records to authorized third parties because this extension does not align with the original intent of the statute.[156]

First, the 2011 Amendments decrease transparency for students and parents regarding school records.[157] FERPA originally limited disclosure to educational institutions and agencies for financial aid, but the 2011 Amendments permit disclosure to commercial companies in the tech industry.[158] Additionally, many tech companies rely on several third-party applications or services to run analytics, store data, or partner services.[159]

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151. *See* REIDENBERG ET AL., *supra* note 9, at 24 (finding that several school districts inadvertently entered contractual agreements that permitted the outsourcing of student information to third parties).

152. 34 C.F.R. § 99.30 (2020).

153. *See* ELEC. PRIVACY INFO. CTR., *supra* note 31 (clarifying that schools must notify parents of their rights under FERPA annually, including their right to review their children's education records).

154. *See* STUDENT PRESS L. CTR., *supra* note 15.

155. *See id.*; Greenberg, *supra* note 15.

156. *See, e.g.*, Kronk, *supra* note 10 (describing that the expansion of FERPA permits schools to disclose student PII to EdTech companies without parental or student consent); *see also* STUDENT PRESS L. CTR., *supra* note 15 (describing that the driving factors for Sen. James Buckley in coauthoring the FERPA legislation were the lack of parental access to student records and a lack of consistency in schools' policies governing disclosure of student records).

157. 34 C.F.R. § 99.31(a)(1)(i)(B).

158. *Id.*

159. *See* REIDENBERG ET AL., *supra* note 9, at 24 ("Fordham CLIP's research revealed . . . [that] many [district schools] did not seem to understand the nature of the services that they outsourced to third-party providers.").

Schools are not required to notify parents if disclosing student information that does not require prior parental consent, including data disclosed to third-party commercial companies acting as authorized educational partners.[160] As a result, the amendments expose student data to a wide range of entities beyond educational institutions, including commercial technology companies such as Google, Amazon Web Services, and Apple.[161]

Second, by not limiting approved authorized third parties to educational institutions or non-profit companies, schools can release information to commercial companies who provide a service or product.[162] The 2011 Amendments permit schools to release records to commercial companies who may then profit from the monetization of student data.[163] However, the penalty for violating FERPA regulations is limited to the withholding of federal funding to schools or educational institutions, and does not extend to any financial penalty for commercial companies.[164] The ED has no oversight or enforcement power over commercial companies.[165] Data collected through online applications from individual consumers instead of schools face stricter regulations under COPPA.[166] However, the FTC's decision to not investigate online applications receiving information from schools permits commercial companies to effectively operate without oversight.[167] Under this gap, EdTech companies can collect and use data disclosed from student accounts, obtained without parental consent, that the ED may determine were not in fact education records and thus should instead require

160. *See* DEP'T OF EDUC., THE FAMILY EDUCATIONAL RIGHTS AND PRIVACY ACT GUIDANCE FOR ELIGIBLE STUDENTS 3 (2011) [hereinafter DEP'T OF EDUC., FERPA GUIDANCE], https://www2.ed.gov/policy/gen/guid/fpco/ferpa/for-eligible-students.pdf (describing schools' notification obligations for data disclosed without parental consent).

161. *See* Greenberg, *supra* note 15 (discussing how FERPA guidelines do not limit the type of entity a school can authorize as an educational partner and receive student data).

162. *See* Kurshan, *supra* note 75 (warning conflicts can arise when commercial companies that rely on data mining and advertising to raise revenue have access to vast amounts of student information).

163. 34 C.F.R. § 99.31(a)(1)(i)(B).

164. *See* Wong, *supra* note 108 (positing that FERPA creates no mechanism for enforcement on companies because the law's drafters did not envision commercial purposes for disclosing student data).

165. *See id.*

166. *Compare* 34 C.F.R. § 99.67(a) (listing the remedies available to the ED to enforce FERPA that are all tied to withholding or prohibiting federal funding for school programs), *with* 16 C.F.R. § 312.9 (2020) (stating the remedies available to the FTC for COPPA violations include financial penalties to commercial companies).

167. *See* 20 U.S.C. § 1232g(b)(1)(F) (2018); *see also* REIDENBERG ET AL., *supra* note 9, at 11 (explaining that COPPA does not apply to information about a child that is obtained directly from a school).

parental consent as governed under COPPA.[168] The exception allowing schools to grant consent, on behalf of parents, under the assumption that the information pertains to education records, regardless of its actual nature, makes this analysis only retrospective with the result that EdTech companies receive such information to use at will without constraint or oversight. [169]

As a result of the 2011 Amendments, school guidelines have reinstated the wide disparity in school disclosure policies for releasing student records.[170] Congress enacted FERPA to address school disclosure policies that were inconsistent and unregulated.[171] However, the ED's decision to expand authorized disclosure to include third-party commercial companies, such as EdTech companies, as authorized educational partners creates a wide range of data exposure and enforcement concerns.[172] The original FERPA guidelines limited the release of student records to educational institutions, parties for financial aid, and governments.[173] Today, schools can release information to EdTech companies who, in turn, share the information with additional partners.[174] Since the 2011 Amendments to FERPA, EdTech companies collect and use children's PII without prior parental consent.[175] FERPA, created in response to school's inconsistent and irregular practices of disclosing information, now authorizes schools wide latitude in disclosure of student PII.[176]

168. REIDENBERG ET AL., *supra* note 9, at 2; *see* Kronk, *supra* note 10 (explaining that EdTech programs collect unlimited personal information and disclose it to other third parties).

169. 34 C.F.R. § 99.31(a) (limiting FERPA violation investigations by the ED to educational institutions receiving federal funding, which does not include commercial EdTech companies).

170. *See* Carr, *supra* note 87 (highlighting the disparity within school systems and the challenge it poses for implementing security protocols in school systems); *see also* REIDENBERG ET AL., *supra* note 9, at 21.

171. *See* Greenberg, *supra* note 15 (discussing FERPA's intent to increase transparency and parental oversight of student data).

172. Kronk, *supra* note 10.

173. 34 C.F.R. § 99.1(a); *see also* Kronk, *supra* note 10.

174. *See* 34 C.F.R. § 99.31(a) (allowing schools and educational partners to share student data with third parties).

175. *See id.* (noting that schools may disclose information without prior parental consent to third parties if a school has outsourced institutional services to the company).

176. *Compare* ELEC. PRIVACY INFO. CTR., *supra* note 31 (discussing Sen. James Buckley's and Sen. Claiborne Pell's intent for FERPA), *with* FEDER, *supra* note 12, at 5–6 (noting the impact of the 2011 FERPA amendment, which allows schools to disclose student information to third-party companies).

c. Schools and the Department of Education Are Ill-Equipped to Enforce FERPA Compliance in EdTech

The wide latitude in school data policies, combined with the ED's inability to enforce FERPA regulations on commercial companies, creates a zone of unaccountability.[177] Schools are ill-equipped to oversee data mining by EdTech companies.[178] Consequently, EdTech companies exploit the gap in oversight created by the combination of the ED's inability to enforce FERPA violation penalties against commercial companies and the FTC's refusal to oversee student data disclosed by schools.[179]

Given the proliferation of data generated by online services, it is unreasonable for schools to complete a case-by-case determination on whether inferred or indirect data meets the education record definition.[180] Direct information is shared with EdTech applications and online operators daily by school administrators, teachers, and students.[181] Beyond the direct information, online applications are collecting vast amounts of indirect and inferred data that schools, parents, and users are simply unaware of.[182] However, the ED relies on the individual context of each record to determine if FERPA applies.[183] Because many schools are implementing third-party applications due to lack of resources, it follows then that schools with limited resources do not have the bandwidth to oversee educational partners' FERPA compliance.[184] Thus, there is little to no oversight of data collection,

177. *See* Kronk, *supra* note 10 (explaining a gap in FERPA regulation created by expanding disclosures to third parties).

178. *See id.*; *see also* REIDENBERG ET AL., *supra* note 9, at 24 (finding many districts had inadequate data governance policies for outsourced data collection, including twenty percent of study respondents with no policies addressing teacher's use of services).

179. *See* Kronk, *supra* note 10.

180. *See* FAQS ON PHOTOS, *supra* note 21 (explaining the case-by-case process by which the ED reviews whether a photo or video is an education record governed by FERPA).

181. *See* DELOITTE, 2016 DIGITAL EDUCATION SURVEY 4 (2016), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/technology-media-telecommunications/us-tmt-digital-education-survey.pdf (finding that more than fifty percent of teachers use three digital devices every week in their classrooms, with forty-two percent of teachers reporting they use at least one device daily).

182. *See* ALIM ET AL., *supra* note 54, at 15; *see also, e.g.*, Singer, *How Google Took Over*, *supra* note 11 (reporting that Google declines to disclose details for how it gathers and uses student data, and whether student data is comingled with commercial applications).

183. *See* Drake, *supra* note 61 (explaining the various ways digital data on social media may be considered education records).

184. *See* Sullivan, *supra* note 5 (noting that schools lack funds and resources to provide the latest security technology).

retention, and use by third-party companies partnering with schools.[185]

Furthermore, while schools may own the data EdTech companies collect from students, these records are metadata, behavioral observations, and predictive classifications; none of these categories are considered directory information under FERPA.[186] Similar to disclosing non-directory information such as social security numbers, schools should obtain parental consent prior to using EdTech applications to generate non-directory information on students.[187] The adoption of third-party commercial companies as authorized educational partners is alarming because of the widespread use of EdTech applications in schools and the lack of transparency companies provide about their data practices.[188] This lack of transparency and lax oversight ultimately result in increased risks to student privacy and risk of data breach.[189]

Another flaw with FERPA regulating school disclosure to EdTech companies is the non-existent threat of enforcement.[190] During the forty-five years since FERPA's enactment, ED has never withheld federal funding from a school in violation of the statute.[191] Without an actual risk of funding loss, there is little incentive for schools to diligently verify that commercial partners, and any third-party commercial companies they share information with, are FERPA compliant.[192]

By implementing a case-by-case approach instead of clearly defining the education record parameters, the ED creates a self-serving opportunity for schools to assert a broad application of FERPA to student data collected through authorized EdTech applications.[193] Schools avoid the logistics of

185. *See* FEDER, *supra* note 12, at 5–6 (noting the response to the ED's 2011 revised FERPA guidelines and the impact of expanding access of personal information to third parties allowed schools to disclose PII without parental consent).

186. *See* REIDENBERG ET AL., *supra* note 9, at 4 (defining directory information to include details such as the "student's name, address . . . date and place of birth, major field of study," and attendance information).

187. *See* 20 U.S.C. § 1232g(b)(1) (2018) (requiring parental consent prior to disclosure of non-directory information).

188. *See* FEDER, *supra* note 12, at 2.

189. *See* Kurshan, *supra* note 75 (describing threats to student privacy from EdTech applications, recommending EdTech products require more monitoring, and emphasizing the need for clarity regarding when companies should be allowed in classrooms).

190. *See* PARENT COAL., *supra* note 38 (stating that as of 2019, the ED has never rescinded funding or issued a financial penalty against a school for violating FERPA regulations).

191. *Id.*

192. *See* 34 C.F.R. § 99.31(a)(1)(i)(B) (2020) (requiring schools to verify that third-party vendors are FERPA compliant).

193. *Id.*; *see also* STUDENT PRESS L. CTR., *supra* note 15 (arguing the lack of guidance

obtaining parental consent, and online operators avoid FTC oversight for COPPA compliance by painting a broad education record umbrella.[194]

This circular logic leaves parents and students with little recourse for privacy violations resulting from schools granting consent on an individual's behalf and sharing student data with an EdTech company.[195] Without a private right of action to sue in courts, parents can only file complaints with the ED.[196] To further complicate the matter, the ED only investigates education record determinations after a valid complaint is filed, and the ED requires parents to specify what records they are seeking for review from the school.[197]

IV. HOW TO CLOSE THE SCHOOL CONSENT LOOPHOLE GRANTING EDTECH ACCESS TO CHILDREN'S PII

The gap in oversight of the EdTech industry's collection and use of student data can be addressed by amending FERPA guidelines to narrowly tailor the disclosure of student data to non-commercial companies or requiring notification and clear parental consent.[198] Alternatively, the loophole can be closed by revoking the school exemption to COPPA enforcement and empowering the FTC to address commercial company violations with monetary fines and remedial efforts.[199]

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by the ED has led to a pattern of abuse by schools using FERPA's individual review of education records definition to avoid requests for records).

194. *See* REIDENBERG ET AL., *supra* note 9, at 24–25 (summarizing studies showing that school contracts with cloud services often lack compliance and have weak data governance).

195. *See* Greenberg, *supra* note 15 ("The U.S. Supreme Court held . . . that individuals and organizations cannot sue to enforce F[ERPA]. The flawed decision effectively closed the courts to students [and] parents . . . harmed by F[ERPA] fouls."); *see also* Tarka v. Franklin, 891 F.2d 102, 104 (5th Cir. 1989) (noting that there is no language in the statute or legislative history indicating congressional intent for a private right of action); Slovinec v. DePaul Univ., 222 F. Supp. 2d 1058, 1060–61 (N.D. Ill. 2002) (affirming that there is no congressional intent to create private right of action under FERPA).

196. *See* Ashford v. Edmond Pub. Sch. Dist., 822 F. Supp. 2d 1189, 1200 (W.D. Okla. 2011) (upholding dismissal of student claim because FERPA fails to confer individually enforceable rights).

197. *See* DEP'T OF EDUC., FERPA GUIDANCE, *supra* note 160, at 6 (describing the ED investigation process of valid FERPA complaints); *see also* Wernz, *supra* note 114 (referencing ED instructions clarifying parent's responsibility to specify the records he is seeking access to).

198. *See* Kronk, *supra* note 10 (describing the loophole in FERPA regulation permitting schools to disclose student PII to EdTech companies without parental or student consent).

199. *See* Pfeffer-Gillett, *supra* note 111, at 134 (discussing the FTC's ability to hold EdTech companies accountable with financial and procedural remedies).

a. Limit the Reach of FERPA by Narrowly Tailoring Disclosure of Education Records

The ED can amend FERPA guidelines to narrow the definition of education records. By tailoring the definition of education records to data necessary for education, the ED can release more oversight of PII back to the FTC for COPPA enforcement. Today's broad definition of education records permits EdTech companies to collect and store all data captured through school contracts by stating the service or application is used for an educational context, including new types of indirect and inferred data generated and stored only within the application.[200] By narrowing the scope of education records, EdTech companies and schools will be required to notify and obtain parental consent for collection and use of student data that exceeds an educational context, such as geolocation or IP addresses.[201]

The ED could further decrease safety risks to students by limiting the information shared without parental consent. Recognizing the increased risk of disclosing sensitive online information such as images and location identifiers, the ED could limit the information shared with online operators to traditional directory information.[202] Requiring parental consent for non-directory information may increase awareness about student privacy concerns, promote parent engagement, and increase corporate accountability.[203]

b. Eliminate the FTC's School Exemption for COPPA Compliance

To create accountability for the EdTech industry, the FTC can amend the COPPA school exemption to apply strictly to educational institutions. Today, commercial EdTech businesses can collect student information with only the consent of the school when acting as authorized educational partners.[204] However, even when acting as an agent of a school, EdTech companies remain commercial online operators.[205] By revoking the FTC

200. *See* 34 C.F.R. § 99.31(a)(1)(B)(1) (2020) (allowing EdTech applications to capture student PII if the company asserts that the information is part of the service or function the company was contracted to provide as a school official).

201. *See* 20 U.S.C. § 1232g(b)(1) (2018) (allowing the disclosure of education records to a broad range of entities, including other educational institutions, courts, and consultants acting on behalf of the school).

202. *See id*. § 1232g(a)(5) (defining traditional directory information such as name, address, and school activities).

203. *See* REIDENBERG ET AL., *supra* note 9, at 30 (suggesting that requiring parental consent could improve data compliance with FERPA).

204. 34 C.F.R. § 99.31(a).

205. *See* 15 U.S.C. § 6501(2)(A) (2018) (limiting operators regulated under COPPA to services "operated for commercial purposes").

school exception or, at a minimum, narrowing the restriction to non-commercial online operators, the FTC can ensure the privacy protection safeguards of COPPA remain intact for all online businesses.[206]

To ensure COPPA compliance, the FTC encourages adherence by providing guidance through rules, statements, and settlements for violations.[207] Unlike FERPA's vaguely defined education record standards, COPPA provides detailed categories of the types of data that fall within the legislation.[208] COPPA also recognizes the evolving nature of technology and prescribes to regular reviews to keep the legislation current.[209]

Finally, the potentially most effective tool to increase security of student data would be to have the FTC enforce COPPA compliance to all commercial companies collecting and using children's PII.[210] Regardless if EdTech companies contract directly with schools, if the company is providing a commercial service, it should be COPPA compliant. The FTC is better suited to review data violations by online operators because it can consistently apply the same investigation and analysis processes for potential COPPA violations, regardless of whether the online operator receives consent from a school or parent.

Moreover, remedies available for COPPA violations are not limited to federal funding restrictions, which do not apply to commercial companies.[211] In addition to applying financial penalties, the FTC can affect industry change through remedial requirements as part of a settlement.[212] Currently, the lack of financial penalties in FERPA's history provide little deterrence for malfeasance or bad actors in the EdTech industry.[213] Paired with the lack

206. *See* FED. TRADE COMM'N, *Complying with COPPA*, *supra* note 9 (describing how companies are not required to obtain parental consent for student PII obtained from a school district if the information is for "use and benefit of the school" because school districts are governed by FERPA).

207. *See* 15 U.S.C. § 6505(b) (listing relevant provisions for compliance enforcement).

208. *See id.* § 6501(8) (outlining personal information covered by COPPA).

209. *See FTC Strengthens Kids' Privacy, Gives Parents Greater Control Over Their Information By Amending Childrens Online Privacy Protection Rule*, FED. TRADE COMM'N (Dec. 19, 2012), https://www.ftc.gov/news-events/press-releases/2012/12/ftc-strengthens-kids-privacy-gives-parents-greater-control-over (noting the FTC's 2010 review of COPPA and the subsequent 2012 amendment to reflect the changes in technology).

210. *See* Pfeffer-Gillett, *supra* note 111, at 130 (arguing that the FTC can hold educational service providers accountable).

211. *See id.* at 134 (noting two examples of FTC remedies for COPPA violations).

212. *See* Press Release, Fed. Trade Comm'n, *supra* note 51 (discussing FTC's settlement with TRUSTe Inc.).

213. *See* PARENT COAL., *supra* note 38 (suggesting the lack of financial penalties for FERPA violations do not promote compliance but instead invite lackluster oversight).

of access to an individual right of action, FERPA gives little recourse for individuals. By revoking the school exception to COPPA enforcement, the FTC can ensure adequate oversight of online operators in the EdTech industry by holding all commercial online operators to the same standards for collection and use of student data.[214]

V. CONCLUSION

By expanding disclosure of student records to third-party commercial companies, the current FERPA guidelines decrease transparency, place student data at risk, and are askew with the legislative intent. To close the loophole, the ED can amend FERPA guidelines to limit schools' disclosure of student data to non-commercial third parties or require parental consent. Alternatively, the FTC can amend the school exemption to investigate and enforce COPPA violations of commercial companies that receive student data from schools. The FTC is better equipped to classify and enforce data privacy protections for online operators and provide effective deterrence measures against commercial EdTech companies.

214. FED. TRADE COMM'N, *Complying with COPPA*, *supra* note 9 (discussing online operators' requirements to meet COPPA and FTC enforcement regulations).

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