



10-1-1980

Managerial Restructuring: Prospects for a New Regulatory Tool

Lewis D. Solomon

Nancy Stein Nowak

Follow this and additional works at: <http://scholarship.law.nd.edu/ndlr>



Part of the [Law Commons](#)

Recommended Citation

Lewis D. Solomon & Nancy S. Nowak, *Managerial Restructuring: Prospects for a New Regulatory Tool*, 56 Notre Dame L. Rev. 120 (1980).

Available at: <http://scholarship.law.nd.edu/ndlr/vol56/iss1/4>

This Article is brought to you for free and open access by NDLScholarship. It has been accepted for inclusion in Notre Dame Law Review by an authorized administrator of NDLScholarship. For more information, please contact lawdr@nd.edu.

Managerial Restructuring: Prospects For A New Regulatory Tool

Lewis D. Solomon*
and
Nancy Stein Nowak**

I. Introduction

In his book *Where the Law Ends*, Professor Christopher D. Stone characterizes what he labels as the continuing “corporate problem” as a “legacy of the law’s failure to search out and take into account the unique features of business corporations as actors”¹ Traditional sanctions in response to corporate wrongdoing, he suggests, rely on legal theories of deterrence which envision the corporation as an individual.² Legal responsibility for a corporation’s misbehavior could be traced to particular persons while the corporation as a legal entity was still in its formative stages. However, the large, modern corporate entity is too complex for such treatment.³ Although corporations consist of individuals, organizational forces tend to weaken individual identity. “In this setting each man’s own wants, ideas—even his perceptions and emotions—are swayed and directed by an institutional structure”⁴ Legal sanctions that are based upon theories of individual motivation, therefore, are inappropriate tools for dealing with corporate behavior.⁵

Traditional strategies for controlling corporate activity are divisible into two categories.⁶ One is built upon the assumption that corporations respond like individuals to dollar penalties or “negative profits.”⁷ According to Stone, however, neither criminal fines nor civil judgments against the corporate entity have proven effective in changing corporate practices and attitudes.⁸ Stone suggests several reasons for this failure. First, legislatures are unwilling to provide appropriately large penalties for corporate criminal activities for fear of losing revenue and employment opportunities to more permissive jurisdictions.⁹ Second, courts rarely impose damage awards which are substantial enough to deter unlawful actions.¹⁰ Third, even comparatively “stiff” fines represent minor expenses to the corporation. Insurance can effectively shield

* Professor of Law, The George Washington University, National Law Center; B.A., 1963, Cornell University; J.D., 1966, Yale Law School.

** B.A., 1975, M.A., 1977, Drake University; J.D., 1980, The George Washington University, National Law Center.

1 C. STONE, *WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR* 1 (1975).

2 *Id.* at 8-10.

3 *Id.* at 93-110.

4 *Id.* at 7.

5 *Id.* at 93-110.

6 *Id.* at 29.

7 *Id.* at 35-57.

8 *Id.*

9 *Id.* at 50-51.

10 *Id.* at 40-46.

the corporation from actual financial responsibility.¹¹ Product “mistakes” pose a risk of much greater losses.¹² Finally, any stigma imposed by penalties assessed against a corporation is shared by the entire organization, thereby diffusing individual responsibility.¹³ Individuals actually responsible for corporate wrongdoing avoid blame and consequently have no incentive to halt or modify undesirable activity.¹⁴

The second strategy used to control corporate behavior focuses on the dominant individuals in the organization, threatening them with personal financial liability or imprisonment for illegal corporate actions.¹⁵ According to Stone, this strategy is also ineffective, since penalties are invoked against corporate officials only in unusual circumstances.¹⁶ The requirement that a particular corporate official have actual knowledge of the wrongdoing is a barrier both to the imposition of liability for corporate wrongdoing and to the transfer of information within a corporation.¹⁷ In the rare instances in which fines are actually imposed, the responsible official often is immune from personal financial liability because of either insurance or indemnification arrangements with the corporation.¹⁸ Lastly, Stone observes, no stigma attaches to the conviction of a corporate official. The ambiguity and inconsistent enforcement of laws aimed at corporate activity present no threat of shame and perform no deterrent function. Convicted individuals quite often return to the same position of responsibility and have little incentive to modify their behavior.¹⁹

Stone notes that these traditional strategies share other characteristics which contribute to their ineffectiveness. They are retrospective—functioning after the undesirable activity and injury have occurred—and intrusive—imposing upon the corporation from outside but leaving basic corporate structures and attitudes unchanged. They also are often counterproductive. Convicted officials and corporations adjudged liable may believe that the law is inconsistently applied. Instead of encouraging obedience to the law, the appearance of arbitrary enforcement fosters resentment and the channeling of energies into resourceful avoidance of legal responsibility for future conduct.

The inadequacy of traditional legal strategies has been underscored by the increasingly dominant role played by the corporation in American society. As corporations have grown in number, their political power has grown in sophistication. Their activities, consequently, have widespread ramifications and the social costs of those activities, unchecked by the outdated legal theories of corporate behavior, have multiplied.

In response to this bleak analysis of present deterrence theories, Professor Stone recommends that legal approaches be revamped and that upon a finding of corporate wrongdoing, forthright intrusions into the corporation structure be made. This restructuring involves, most importantly, the creation of an

11 *Id.*

12 *Id.*

13 *Id.* at 40.

14 *Id.* at 46-50.

15 *Id.* at 58-69.

16 *Id.*

17 *Id.* at 60-61.

18 *Id.* at 64-66.

19 *Id.*

“institutional analogue to the role that responsibility plays in human beings.”²⁰ Stone suggests that this will result in the prevention of wrongdoing, not through after-the-fact punishment but through the development of a “corporate consciousness.”²¹ Specifically, he recommends that management functions be reassigned and that internal informational channels be improved so as to assure that information is transferred upward to those key individuals whose responsibilities include the receipt of information. Combining these two measures, Stone suggests, will result in the introduction of a sense of social responsibility into the decision making process of the corporation.

Several cease and desist orders entered by the Federal Trade Commission (FTC) have reflected this approach. The orders include provisions mandating internal corporate restructuring in order to forestall future violations of the law. The Commission’s authority for these orders is based on section 5 of the Federal Trade Commission Act (FTC Act),²² which has been interpreted to give the agency a broad range of discretion when addressing unfair and deceptive trade practices.²³ Even orders which proscribe activities other than the specifically enumerated statutory violations have been upheld as long as findings and supporting analysis are presented and the orders themselves are reasonably specific.²⁴

The FTC has employed managerial remedies in response to violations of section 5 occurring in four different types of businesses. In addition to addressing the immediate problems caused by past deceptive advertising practices, the FTC orders have required the establishment of improved systems of information handling, the creation of separate management level positions with responsibility for receiving and transferring customer feedback, and the assignment of important duties to specific individuals in the corporate organization.

Had the orders been fully complied with, either visible improvements within the corporations would have resulted or Professor Stone’s proposals would have been proven as ineffective as the traditional approaches he criticizes. However, examination of the compliance with and the effects of these orders reveals uneven results. After the variables that undoubtedly skewed the ultimate effect of the orders have been discounted, it appears that although the results have been less than dramatic, the remedial schemes have been both responsive to the industry or corporate problems and effective in injecting a sense of “consciousness” into the organizations. This article discusses the orders, the intervening variables, and the orders’ effects as indicators of the validity of Professor Stone’s theories. The experience of the FTC in four groups of consent orders is examined: the basement waterproofing industry, an aircraft company, the foamed plastics industry, and the mobile home industry.

20 *Id.* at 120.

21 *Id.* at 217-27.

22 15 U.S.C. § 45 (1976).

23 *Jacob Siegal Co. v. FTC*, 327 U.S. 608 (1946).

24 *FTC v. Anheuser Busch*, 363 U.S. 536 (1960).

II. The Consent Orders

Case 1: Basement Waterproofing Companies

Three consent orders involving basement waterproofing companies contained managerial remedies which attempted to improve the flow of information within the corporate organization and direct information coming from outside the corporation to responsible management officials. The effects of these orders demonstrate both the inherent weaknesses of such attempts and their potential for changing corporate behavior.

The FTC issued the first of the three consent orders in July 1976.²⁵ Northerlin Company, Inc. of Flushing, New York (Northerlin), respondent to the order, operated under the name "Vulcan Basement Waterproofing" and had subsidiary operations in nine states. The FTC's complaint cited numerous misrepresentations and deceptive statements in Northerlin's advertising and sales program, concerning the performance and price of its products, the existence of service guarantees, and the size of its business facilities.²⁶ Noting that Northerlin's deceptive practices induced consumers to make payments and assume obligations which they would not have otherwise incurred, the Commission issued a comprehensive order designed to eliminate the specific violations and, further, to attack more pervasive ills in the corporation's managerial structure and information processing system.²⁷

To eliminate the particular instances of wrongdoing, the FTC ordered Northerlin, its subsidiaries, successors and assigns, officers, and employees to "cease and desist" from misrepresenting its products or services.²⁸ Specifically, Northerlin was enjoined from characterizing its process as exclusive, permanent, or completely effective in all basements, and from misrepresenting the ease and convenience with which it could perform its services.²⁹ Affirmatively, the Commission required Northerlin to disclose in all advertisements and sales materials the limited effectiveness of one of its two methods of waterproofing, and to advise the public that tests by qualified engineers were necessary to certify the effectiveness of this particular service.³⁰ The FTC also required respondents to clarify certain vague or inappropriate language in its promotional materials. The word "guarantee" could be used only when a full and complete guarantee was offered, and conditional guarantees were to be explicitly distinguished. In addition, to prevent misrepresentations of the size of the corporate business, the word "office" could only be used if the respondent had a fully staffed office in a particular community.³¹

The Commission also ordered Northerlin to provide customers with a three-day cooling-off period even though such a provision was unrelated to the specifically alleged violations of the FTC Act. When contracting for products or services, customers were to be afforded notice and an opportunity to cancel

²⁵ *In re Northerlin Co.*, 88 F.T.C. 38 (1976).

²⁶ *Id.* at 40-46.

²⁷ *Id.* at 46-51.

²⁸ *Id.* at 46-49.

²⁹ *Id.* at 47.

³⁰ *Id.* at 47-48.

³¹ *Id.* at 48-49.

any obligation within three days of their signing. If they so canceled, they were to receive a full refund within three days. Northerlin had the duty not only to provide notice of this right, but also to furnish the forms necessary to effectuate the termination.³²

To ensure Northerlin's compliance with the order, the Commission imposed a duty on the corporation to inform all employees of the details of the agreement, obtain their consent to be bound by its terms, and dismiss all who refused to comply.³³ Furthermore, the agency mandated the establishment of both a system of surveillance (to ensure future companywide compliance) and a recordkeeping system (for Commission review and verification of compliance).³⁴ To discourage future violations, the FTC ordered respondents to notify it thirty days prior to any proposed dissolution, assignment or sale of the corporation affecting its compliance obligations. In addition, the respondents were to provide a compliance report for the Commission's review within sixty days of service of the order.³⁵ Finally, the Commission ordered Northerlin to establish a "customer relations" department to ensure that contractual obligations were fulfilled and to improve the flow of information within the corporation.³⁶ Northerlin was ordered to give customers the location and telephone number of this department, to respond to complaints within seven days, and to maintain for Commission inspection records of customer requests and services rendered.

The consent order failed to have a significant effect on Northerlin. The company did not file the required sixty-day compliance report and a subsequent FTC investigation revealed that another waterproofing company, Vulcan Basement Waterproofing of Flushing, Inc. (Vulcan), had purchased Northerlin's equipment and office furniture and had occupied its former business offices.³⁷

Although the president of Vulcan denied that his company was required to comply with the FTC cease and desist order,³⁸ his correspondence with the FTC, as well as reports prepared by various consumer agencies, suggest that Vulcan is obeying the spirit if not the letter of the consent order.³⁹ Copies of customer service requests submitted to the Commission by Vulcan show the

32 *Id.* at 49-50.

33 *Id.* at 50-51.

34 *Id.* at 51.

35 *Id.*

36 *Id.* at 47.

37 Compliance File for FTC Investigation of Northerlin Co. The compliance file contains information from a series of interview reports and other documents. All compliance files referred to below are located in the Washington, D.C. central office of the FTC.

38 *Id.* The three consent orders directed at waterproofers were made binding on "successors and assigns" of the targeted companies. *In re* Everseal Waterproofing Corp., 89 F.T.C. 110, 125 (1977); *In re* National Meridian Services, 89 F.T.C. 192, 207 (1977); *In re* Northerlin, 88 F.T.C. 38, 51 (1976).

39 Vulcan has responded to service requests of former Northerlin customers while denying any legal obligation to do so. Compliance File, *supra* note 37.

New York Better Business Bureau files showed a satisfactory record of prompt consideration of consumer complaints, including providing additional treatment, extending the warranty service period, and offering refunds. *Id.* Furthermore, the FTC's Boston Regional Office has not received a significant number of complaints regarding Vulcan's work. According to Mr. William F. Connolly of that office, Vulcan and Everseal, the subject of another cease and desist order, have simply changed the way they do business. That change is due, not so much to literal compliance with the consent order or the creation of a customer relations department but to the discontinuance of the pressure pumping method of waterproofing and a change in advertising methods. Telephone Interview with William F. Connolly, Staff Attorney, FTC's Boston Regional Office (Nov. 26, 1979).

seven-day response required of Northerlin; the Vulcan contract contains the required three-day cancellation option; and Vulcan no longer offers the pressure pumping waterproofing method which was the subject of special disclosure requirements in the consent order.

Although Vulcan established neither the special customer service department nor the employee surveillance system which the Commission required of Northerlin, the new company is reportedly a "responsible" operation.⁴⁰ Its owners have found that the questioned practices and ineffective services resulted in no savings to the corporation. Although the new company has not established the customer complaint department required in the consent order, it nevertheless has promptly attended to service requests.⁴¹ Accordingly, it appears that at least a measure of corporate restructuring and subsequent consumer benefit has been brought about.

A similar assessment may be made regarding the effectiveness of a second consent order issued in February 1977 against Everseal Waterproofing Company (Everseal), a comparatively small basement waterproofing business operating in Massachusetts, New Hampshire and Maine.⁴² The FTC's complaint alleged violations of the FTC Act by Everseal in all three states. It varied from the Northerlin order in naming, in addition to the corporate respondents, a present and a former officer who were allegedly responsible for the deceptive practices of the company.⁴³ Beyond this distinction, the complaint and order contained provisions similar to those included in the Northerlin case.⁴⁴

The consent order in Everseal was about as effective as the consent order in Northerlin in changing corporate behavior. By the time Everseal filed its required compliance report in January 1978, only one of the three corporate defendants remained in existence.⁴⁵ In addition, one of the two individual respondents had terminated all connection with Everseal in February 1976.⁴⁶ Mr. William Epner, the other individual respondent and author of the compliance statement, reported that as sole representative of Everseal he had informed all customers that he alone was responsible for all sales and services, and had given them his own telephone number in case additional service became necessary.⁴⁷ Only nine of 107 contracts were revoked in 1977 as a result of the three-day cancellation option, and all nine customers received full refunds.⁴⁸ Misleading claims regarding Everseal's waterproofing services ceased, and the company virtually eliminated its advertising campaign. Customers were provided a five-year guarantee that Everseal would eliminate continuing seepage problems without charge. Mr. Epner also reported that all twenty customer service requests were satisfactorily answered.⁴⁹

As in Northerlin, perhaps the most dramatic change effected by the Everseal consent order was the de-emphasis of the pressure pumping method of

40 Compliance File, *supra* note 37.

41 *Id.*

42 *In re Everseal Waterproofing Corp.*, 89 F.T.C. 110 (1979).

43 *Id.* at 111.

44 88 F.T.C. at 39.

45 Compliance File for FTC Investigation of Everseal Waterproofing Corp.

46 *Id.*

47 *Id.*

48 *Id.*

49 *Id.*

waterproofing, previously the primary company service. As Mr. Epner noted in his report, "We have changed our operations considerably [and] . . . are now concentrating on doing floor (pressure relief) systems."⁵⁰ No doubt the cost of compliance—especially the disclosure and guarantee provisions—rendered pressure pumping an unprofitable company service.⁵¹

An FTC staff attorney responded to Everseal's compliance report in February 1978, noting certain minor deficiencies which required further attention. He noted that the company's yellow-page advertisement did not disclose that one of the two types of waterproofing services might not prevent leaks, and that the advertisement mentioned a "guarantee" without disclosing its conditions and exemptions.⁵² The staff attorney also complained that Everseal's contract form and yellow-page ads falsely implied that certain listed cities had fully staffed offices. He requested that contracts list only the Newton, Massachusetts home office, and that the company limit its yellow-page advertising to the Boston metropolitan area directories. Going to the heart of the consent order, the FTC attorney noted that the compliance report made no mention of a customer relations department and that the Commission had not been supplied with copies of customer verifications of satisfactory responses to service requests.⁵³ Everseal's president acknowledged these omissions by letter on March 28 and agreed to rectify the noncompliance. The FTC then accepted the compliance report in May 1978, and indicated that no action would commence against the respondents so long as they continued the promised compliance.⁵⁴

It appears that the FTC order was responsible for effecting some change in the way Everseal did business. By creating duties of disclosure beyond those otherwise imposed by law, and by threatening Everseal's president with individual liability for corporate wrongdoing, the FTC forced the company to abandon its most misleading promotional practices and most questionable waterproofing services. Although fundamental managerial restructuring was not achieved nor formal information handling systems established, Everseal was required to accept responsibility for its business conduct. Responding to complaints in a timely and satisfactory manner in turn brought the ineffectiveness of certain waterproofing methods to the company's attention. The lack of total compliance with the consent order's provisions did not obviate the order's success in bringing about significant, if not the intended, corporate restructuring.

In contrast to the orders employed in the Northerlin and Everseal cases, the third consent order was unsuccessful. That order involved Meridian Waterproofing Corporation (Meridian), a \$10-million-a-year company. Meridian operated waterproofing and termite control businesses from its principal of-

50 *Id.*

51 Telephone Interview with Connolly, *supra* note 39.

52 Compliance File, *supra* note 45.

53 *Id.*

54 *Id.* The Boston Regional Office reports that it has not received the number or kinds of complaints regarding the business practices of Everseal that it had received previously. With a decline in customer complaints and a change in the company's method of waterproofing, the FTC will not attempt to enforce the consent order to the letter. *Id.*

office in Mineola, New York.⁵⁵ In March 1975, the FTC issued a complaint against Meridian, its parent corporation, National Meridian Services (National Meridian), and two officers and directors of Meridian, Michael Pascucci and Austin Royle.⁵⁶ The Commission alleged violations of section 5 of the FTC Act similar to those alleged in the Everseal and Northerlin cases.⁵⁷ In addition, the complaint alleged that Meridian had misrepresented the education, training and experience of its employees; exaggerated the risk and immediacy of danger to potential customers from water and termite damage; failed to disclose to customers that financial obligations might be assigned to finance companies; and falsely claimed that such recognized publications as *Better Homes and Gardens* and *The New York Times* had endorsed its services.⁵⁸

In response to these violations, the Commission ordered the respondents to cease and desist making misrepresentations about (1) the size of the company, (2) the qualifications of its staff, (3) the uniqueness and permanence of its products and services, (4) the nature of guarantees and warranties offered, (5) the existence of special prices without reference to the dollar or percentage savings, and (6) the existence of endorsements by reputable publications.⁵⁹ The FTC also ordered respondents to cease the use of scare tactics to induce purchases, to disclose the assignment of financial obligations to third parties, and to make all other disclosures required by federal law. The Commission further directed respondents to inform customers of the three-day cooling off period during which they could cancel their obligations without penalty.⁶⁰

To effectuate and monitor compliance, the Commission directed Meridian to:

- (1) disclose in all advertising that it did not always provide prompt service, unless it established an address and phone number for submitting service requests and complaints and responded to those requests within seven days;⁶¹
- (2) create a recordkeeping system documenting the claimed performance characteristics of respondents' products and services, and the nature of consumer complaints and company responses;⁶²
- (3) notify all employees of the order and of their obligation to comply with its terms;
- (4) design a system of surveillance to monitor compliance and employee violations; and
- (5) report to the FTC changes in the corporation which might affect com-

55 In 1975, corporate revenues totalled \$9,800,000 and assets were estimated at \$3,700,000. National Meridian maintained offices in 19 cities with 1,000 employees and 100 salesmen. Compliance File for FTC Investigation of National Meridian Services, Inc.

The Wall Street Journal, on October 1, 1976, reported a net income for the company in fiscal 1976 at \$314,915. Wall St. J., Oct. 1, 1976, at 21, col. 2. On October 4, 1977 the same publication reported that figure had dropped to a net loss of \$735,863. Wall St. J., Oct. 1, 1977, at 37, col. 2.

56 *In re National Meridian Services, Inc.*, 89 F.T.C. 192 (1977). Michael Pascucci was president and a director of National Meridian as well as principal shareholder and responsible for advertising. Austin Royle was vice-president and a director of National Meridian, an officer of Meridian, and in charge of personnel training. Compliance File, *supra* note 55.

57 89 F.T.C. at 198-99.

58 *Id.* at 193-99.

59 89 F.T.C. at 200-05.

60 *Id.* at 203-04.

61 *Id.* at 200-01.

62 *Id.* at 201.

pliance obligations, and changes in the affiliation or responsibilities of the individual respondents.⁶³

Like the respondents in Northerlin and Everseal, Meridian avoided full compliance with the consent order obligations. Meridian filed its compliance report in June 1977 as required by the consent order. In August, before correcting the deficiencies, National Meridian advised the FTC of its intention to sell its waterproofing and termite control businesses to Ruthra Services.⁶⁴ The sale took place one month later, and was intended to represent the "complete disposition" of the corporate and individual respondents' involvement in waterproofing and termite control services.⁶⁵

Following this sale, National Meridian changed its name to Trexar Corporation and became involved in "the origination of property modernization loans for various lenders," with respondent Pascucci president and director of the company.⁶⁶ Respondent Royle left National Meridian and became vice-president of a "light construction business," Spruce Management Services (Spruce), with duties as financial consultant and construction manager.⁶⁷ Although Spruce may have provided some waterproofing and termite control services, the corporation prohibited Royle from participating in those activities.⁶⁸ In April 1978, Royle left Spruce after the company's financial condition worsened.⁶⁹

Meanwhile, Ruthra Services, which had agreed to be bound by the consent order in its purchase agreement with National Meridian, filed for bankruptcy in February 1978.⁷⁰ With Pascucci and Royle out of the waterproofing business and the successor company in receivership, the FTC formally announced in June 1979 its determination that no further compliance action was warranted, reserving the right to renew investigation if circumstances warranted.⁷¹

The history of noncompliance in the Meridian case illustrates the effectiveness of "structural remedies." Although it fails to reinforce Professor Stone's theories unequivocally, Meridian's history demonstrates that a corporation engaging in deceptive business practices, including misrepresentation of product performance and purposeful ignorance of product or service quality, may be forced into dissolution by regulatory intervention.

The compliance histories in all three of the waterproofing cases indicate that the FTC's consent orders effectuated some modifications in corporate behavior. However, these modifications may have been stimulated by other factors. The present widespread industry acceptance of the three-day cooling

63 *Id.* at 205-06.

64 Letter from Jack Lipson (Counsel for National Meridian, now Trexar Corp.) to William S. Sanger (Staff Attorney, FTC's Washington Regional Office) (Mar. 8, 1978).

65 *Id.*

66 Letter from Stephen M. Sacks (Counsel for National Meridian, now Trexar Corp.) to Lester G. Grey (Staff Attorney, FTC's New York Regional Office) (Oct. 13, 1978).

67 Letter from Jack Lipson (Counsel for National Meridian, now Trexar Corp.) to Lester G. Grey (Staff Attorney, FTC's New York Regional Office) (Oct. 13, 1978).

68 *Id.*

69 *Id.*

70 Compliance File, *supra* note 55.

71 *Id.*

off period, for example, should be traced not to these consent orders but to state statutes and the FTC's regulation of door-to-door sales.⁷² Moreover, the consent orders alone cannot account for the industry's abandonment of the pressure pumping method of waterproofing, since this technique had never been offered by other than very large or fraudulent companies. Industrywide changes have also altered business practices. Firms engaged in basement waterproofing no longer make outlandish product claims, a change which parallels a shift in ownership of these firms.⁷³ As the industry has become more competitive, companies have been forced to respond to service requests and to drop unsuccessful waterproofing techniques in order to survive. Thus, the impact of these three consent orders on corporate behavior must be evaluated in light of the total context in which the changes in corporate behavior occurred.

Case 2: Bede Aircraft

The FTC used managerial remedies to a greater extent in response to an unusual situation involving Bede Aircraft, Inc. (Bede).⁷⁴ Unfortunately, the remedial scheme was not put to a fair test because of the corporation's precarious financial position and the FTC's delays in effectuating the required corporate restructuring.

Bede was a Kansas manufacturer of sport aircraft which advertised and accepted orders for both factory and "do-it-yourself" kit-built versions of one, two and four seat airplanes.⁷⁵ The price of the airplanes started at \$1800 in 1971 and ranged from \$3600 to \$4000 in 1978.⁷⁶ The planes, which could be easily disassembled and loaded into trailers for transport and storage, were

72 Telephone Interview with James Dyson, Chief Investigator of the Home Improvement Industry Section, Montgomery County Consumer Affairs Office (Nov. 3, 1978).

73 Telephone Interview with Connolly, *supra* note 39.

Attempting to gauge the "effectiveness" of these orders, several strategies were pursued by this author. The results are inconclusive.

Comparisons of consumer reaction to Washington area waterproofing companies failed to establish any industry response to the orders. Numbers of complaints in waterproofing are consistent, agreed Dyson, Cynthia Levy of *The Washington Post* Real Estate News Section, and Carrie Ellis of the Better Business Bureau, due to the nature of the business (service oriented) and the type of soil in the region. Telephone Interview with Dyson, *supra* note 72; Telephone Interview with Cynthia Levy (Nov. 3, 1978); Telephone Interviews with Carrie Ellis (Nov. 3 and Nov. 6, 1978). Ms. Ellis also noted that all 22 complaints received by her office in 1977 involving waterproofing companies were of a routine nature, none involving advertising or sales practices of the businesses.

Other industry observers believe FTC activities were ineffective. As discussed above, Dyson of the Montgomery County Consumer Affairs Office explained that inherent industry features were responsible. Les Blattner of the National Association of Home Builders' Consumer Affairs Office agreed with the assessment of ineffectiveness and characterized the consent order as a particularly ineffective tool for bringing about industrywide change. Telephone Interview with Dyson, *supra* note 72. Hugh Barndollar, former Vulcan employee, said the orders were ineffective but put blame on public ignorance of FTC rulings, the failure of area consumer agencies in educating consumers, and widespread public acceptance of the inevitability of "getting taken," especially by service industries such as waterproofing. Telephone Interview Hugh Barndollar, Owner of Accredited Waterproofing (Nov. 6, 1978). Taking the other position, Michael Mpras felt that the consent orders were somewhat effective, pointing to evidence that the targeted companies have had to make drastic changes in the way they do business. Telephone Interview with Michael Mpras, Staff Attorney, FTC's Washington Regional Office (Nov. 2, 1978).

74 Also joined as respondents were Bede Wing and Bede General Corporation, merely "paper corporations" according to Kenneth Bennington, formerly with the FTC and responsible for negotiating the consent order on behalf of the Commission. Telephone interview with Kenneth Bennington, Staff Attorney, FTC's Denver Regional Office (Dec. 3, 1979).

75 *In re Bede Aircraft, Inc.*, 92 F.T.C. 449 (1978).

76 Marsh, *FTC Moves to Assist Bede Customers*, *AV. WEEK & SPACE TECHNOLOGY*, June 19, 1978, at 32.

reputed to be "good product[s]"⁷⁷ and were highly attractive to consumers because of their unusual design and low cost.⁷⁸

However attractive the products, the company suffered from "lousy management."⁷⁹ Bede solicited orders and collected deposits, representing that its products were available for delivery. In fact, the company used the deposits to fund research and development.⁸⁰ The firm actually delivered few aircraft. By the summer of 1978, Bede had received deposits totalling \$6.3 million and accumulated about 9500 unfilled orders.⁸¹

Meanwhile, consumer complaints to the FTC regarding Bede's delayed and incomplete shipments of ordered products were more numerous than any other in Commission history.⁸² In response to these complaints, the FTC began an investigation into Bede's business practices.⁸³ Although complaints began pouring into the Kansas City regional office in 1974, the closing of that office stalled the FTC's inquiry, as did the Commission's belief that Bede might cure its financial and management woes on its own. Bede had come "tantalizingly close" to being able to pull itself out of trouble on several occasions, a solution which the Commission much preferred.⁸⁴ The Commission was also mindful of the continued desire of the great majority of customers for the product as ordered and not for a mere refund of their deposits. By mid-1978, however, it appeared that without Commission intervention Bede would collapse and consumers would be left without recourse. The situation demanded that the FTC act boldly.

To this end, the FTC filed a complaint against Bede which revealed the pervasive nature of the corporation's deceptive practices.⁸⁵ The complaint alleged that Bede had violated section 5 of the FTC Act by misrepresenting that: (1) aircraft kits were available for sale and ready to ship; (2) complete delivery of the kits could be accomplished in logical sequence and at reasonable intervals; (3) the planes could be easily assembled in 800 hours using simple hand tools; and (4) engines and drive system subassemblies were available with the kits.⁸⁶ The Commission also alleged that Bede had circulated misleading financial statements, failed to issue refunds when requested, neglected to remedy its precarious financial condition, and used advance payments for research and product development without disclosing such use to customers.⁸⁷

77 *FTC Settles Case that Involves Kits for Building Planes*, Wall St. J., June 13, 1978, at 14, col. 4 (quoting M. Pertschuk, FTC Chairman).

The United States Air Force reportedly considered purchasing several BD-5J's, the jet-powered version of the single seat BD-5, in 1975. At that time the assembled craft, for which there was a backlog of sixty orders, cost \$29,000; the kit version cost \$24,000. *USAF Views BD-5J as Transition Trainer*, Av. WEEK & SPACE TECHNOLOGY, Mar. 3, 1975, at 40 (1975).

78 In addition to its disassembly feature, the BD-5 sported a unique rear propeller. Telephone Interview with Lt. Joseph Wallace, Public Works Officer, United States Navy (Dec. 2, 1979).

79 *FTC Settles Case that Involves Kits for Building Planes*, *supra* note 77.

80 Factory built models which were shipped had not yet received the required FAA certification. Marsh, *supra* note 76.

81 *Id.*

82 Telephone Interview with Kenneth Bennington, Assistant Regional Director, FTC's Denver Regional Office (Dec. 3, 1979).

83 *Id.* Public response to the consent order also generated record-setting interest. Over 100 public comments were received by the Commission—an unprecedented number.

84 *Id.*

85 92 F.T.C. at 450-59 (1978).

86 *Id.* at 454-55.

87 *Id.* at 457-59.

In June 1978, Bede and its sole shareholder, James R. Bede, signed a consent order which the FTC accepted after an unusual and unfortunate four month delay.⁸⁸ The order required, first, that the respondents cease and desist from the misrepresentations and unfair practices enumerated above.⁸⁹ Second, it established a system of priorities among consumer creditors according to the kind of airplane each had ordered and what method of reimbursement each had selected.⁹⁰ Third, the order required respondents to enter into an escrow agreement with a financial institution which would act in a fiduciary capacity, holding and disbursing corporate assets in a manner consistent with the consent agreement.⁹¹ Finally, the order provided for the appointment of an independent, third-party trustee to control Bede's stock and to oversee the company's operations.⁹² The trustee was empowered to remove and replace directors who appeared to be acting in violation of the consent order and, if "no other reasonable alternative exists for the successful operation of the company consistent with the spirit" of the order, to initiate bankruptcy proceedings.⁹³ The trustee was also responsible for the appointment of "authorized officials" who would in turn be responsible for operations at each of the respondent's business sites.⁹⁴

Although the FTC exercised its full authority in drafting the Bede order, events beyond the Commission's control assumed primary significance by the time the order was finally accepted.⁹⁵ Because Bede was in a precarious financial position by the fall of 1978, the success of the consent decree and the trustee arrangement depended on the company's ability to stall its creditors and obtain working capital. A loan agreement was negotiated with a Virginia bank which would have been used to build a new production facility in Virginia. The loan, however, was conditioned on Bede's obtaining a loan guarantee from the Farmers' Home Administration.⁹⁶ Although the possibility of obtaining the guarantee seemed promising when the Commission accepted the consent order, the Farmers' Home Administration eventually refused to extend the guarantee as hoped.

In addition to this setback, business creditors secured judgments against Bede prior to the Commission's acceptance of the consent agreement.⁹⁷ Execu-

88 92 F.T.C. at 449. The Commissioners did not react with unanimous or immediate approval toward the Bede consent order in the summer of 1978. The question of its appropriateness from a policy standpoint was not resolved until October of that year. However, after its acceptance, it was publicly endorsed by even the vigorous Commission opponents. Telephone Interview with Bennington, *supra* note 74.

89 *Id.* at 462-63.

90 *Id.* at 469-75. Those options included: rescission of the purchase contract and refund of advance payment or deposit plus interest; rescission and refund on all uncompleted kits returned to respondent; reaffirmance of the order at the price paid by dealers 90 days prior to the date such customer paid the purchase price in full; or, if the purchase price had been paid in full, reaffirmance plus interest to be paid by Bede on that amount.

91 *Id.* at 466-69.

92 *Id.* at 462.

93 *Id.* at 485-86.

94 *Id.* at 479-80.

95 Telephone Interview with Bennington, *supra* note 74. Bennington suggested that "politics finally killed" the loan, noting the "strange timing" of that decision. He also explained that many people disliked James Bede's flamboyant style and technological ingenuity and that his aircraft posed a significant threat to established competitors.

96 *FTC Settles Case that Involves Kits for Building Planes*, *supra* note 77; Marsh, *supra* note 76.

97 Telephone Interview with Tom Lyons, Staff Attorney, FTC's Denver Regional Office (Nov. 26, 1979).

tion of those judgments was temporarily stayed in August 1978 by the filing of a Chapter X bankruptcy petition by Mr. Bede. However, a Chapter XI petition was filed after the withdrawal of the Chapter X petition. By the summer of 1979, Bede's few remaining assets were sold and distributed among its business creditors.⁹⁸

The Commission selected a trustee shortly after its formal acceptance of the consent order in late 1978. Despite the sweeping powers given the trustee, the momentum of the events described above proved irreversible. The overlapping jurisdictions of the bankruptcy court and the Commission posed one problem. In addition, the FTC had designed the order to forestall insolvency, primarily through the prudent management of the corporation's assets by the trustee and the escrow agent. However, bankruptcy occurred too quickly after the appointment of the trustee for him to have an opportunity to exercise his powers.⁹⁹ As of the fall of 1980, the 9500 customers had not received either kits or refunds, and the Commission remained "very skeptical" that they ever would.¹⁰⁰

The managerial remedies contained in Bede's consent order differ little in theory from those found in the waterproofing company orders. The order restructured the company's mode of doing business by providing for the appointment of outsiders—primarily a trustee—to oversee compliance, coordinate permanent restructuring, and institute changes in the day-to-day operations of the corporation. The trustee, along with the escrow agent, would have ensured that Bede's business activities would comport with the interests of its creditors and customers, and would have sought to place Bede's future operations on a secure footing.

The Commission was mindful that although Bede suffered from pervasive managerial problems, it also offered an attractive product and possessed the technological capabilities to have produced it as promised. The Commission tailored its order to address these specific inadequacies and strengths. However, the corporation's financial woes had progressed to such a point that a fair test of the order and its theoretical basis was precluded. Furthermore, without the loan guarantee the restructuring had no hope of success.¹⁰¹ The consent decree's failure to provide the desired consumer redress and corporate revitalization merely underscores the importance of timing in the success of administrative intervention.

Case 3: Foamed Plastics Industry

Events beyond the control of a regulatory agency may also serve to enhance the effect of managerial remedies. Such was the case in a consent

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.* Mr. Bennington cautioned that something could still come out of the consent order. Although there are no definite possibilities that a loan could yet be negotiated or the bankruptcy court could force execution of the outstanding judgment liens, "drain Mr. Bede of every penny" and creditors thenceforth would stop suing him. Telephone Interview with Bennington, *supra* note 74.

¹⁰¹ The Commission's reluctance to exercise its authority to insert a third party into a private corporation delayed acceptance of the order. However, according to Bennington, there was nothing more that the Commission could have done to save Bede and insure consumer redress: only the speed of the Commission's intervention could have helped. *Id.*

order in which the FTC sought to inject a greater sense of responsibility into the foamed plastics industry.

The FTC's investigation of the plastics industry grew out of complaints regarding inaccurate or deceptive descriptions by plastics manufacturers of the flammability characteristics of cellular or foamed plastics.¹⁰² The investigation, which was formally announced in 1972, culminated in November 1974 in a complaint lodged against the Society of Plastics, a trade association, and twenty-six individual manufacturers of cellular plastics.¹⁰³ The complaint alleged that respondents violated section 5 of the FTC Act by disseminating results of flammability tests performed on various cellular plastic products which misrepresented the fire hazards posed by those products.¹⁰⁴ Specification sheets and promotional materials described products' responses to fire on the basis of small-scale laboratory tests, and used such labels as "self-extinguishing," "non-burning," and "non-combustible" to describe the products.¹⁰⁵ However, the tests did not accurately measure, nor the labels accurately describe, the dangers inherent in actual fire situations.¹⁰⁶ Furthermore, the Commission charged that the lay persons interpreted these test results in their ordinary descriptive sense, rather than in narrow technical sense.¹⁰⁷ The complaint also asserted that widespread consumer ignorance of the actual risk of fire contributed to the danger of serious harm to person and property presented by cellular plastics.¹⁰⁸

On November 4, 1974, the FTC accepted a consent order requiring respondents to cease and desist from using expressions such as "non-burning," "self-extinguishing," or "non-combustible" in the marketing of products.¹⁰⁹ The firms were permitted to use numerical flame spread rates, the most common measure of comparative inflammability for building materials, only if they warned consumers that the rating was "not intended to reflect hazards presented by the material under actual fire conditions."¹¹⁰ In addition, the FTC ordered the respondents to cure the lingering effects of past deceptive advertising practices by notifying purchasers of the products since 1968 of the serious fire hazards posed by the products. In-

102 Show and Gillette, *Urethane: A Deadly and Pervasive Peril*, L.A. Times, Jan. 21, 1979, § 1, at 14, col. 2.

103 *In re Society of Plastics Industry*, 84 F.T.C. 1253 (1974). The 26 manufacturers and respondents were: Allied Chemical, ARCO Polymers, BASF Wyandotte, Baychem, Cook Paint and Varnish, Dow Chemical, E.I. duPont de Nemours, Flintkote, Foster Grant, General Tire and Rubber, W.R. Grace, Hooker Chemical, Jefferson Chemical, Millmaster Onyx, Mine Safety Appliances, Monsanto, Olin, Owens-Corning, Fiberglass, PPG Industries, Tenneco Chemicals, Union Carbide, United States Steel, Uniroyal, Upjohn, and Witco Chemical. *Id.* at 1255-58.

104 Cellular or foamed plastics are defined in Appendix A of the consent order, *Id.* at 1277-78.

105 *Id.* at 1267.

106 *But see* Kline, *The Facts Behind the "Conspiracy" in Flammability Test Terminology*, MOD. PLASTICS, June, 1976, at 64-66, wherein the author, who had participated in the development and refinement of these tests, quoted at length from test reports which warned that flame spread and burning rates were not the only indicators of the actual fire hazard posed.

107 84 F.T.C. at 1261.

108 *Id.* at 1262.

109 *Id.* at 1271.

110 *Id.* Using the American Society of Tests and Materials' Steiner tunnel test, a "25 flame spread" rating was assigned to most cellular plastics. That score classified the material as "noncombustible" under a number of building codes throughout the United States. *Id.* at 1262. While the test was a useful measure of flammability for traditional building products, it did not accurately register the more unusual burning characteristics of plastics. *See* Show and Gillette, *supra* note 102.

dividual notices were to be supplemented by publication of similar disclosures in selected periodicals.¹¹¹

The order also established a research program with three specific objectives: (1) to determine the most effective manner for employing cellular plastics and systems containing such products to minimize fire hazards in the final intended uses; (2) to develop guidelines for the safe and effective use of such cellular plastics; and (3) to develop accurate tests and standards for measuring the behavior of cellular plastics in various burning conditions.¹¹² The research program was to be managed by the Product Research Committee, composed of nine members of proven technical competence.¹¹³ Four members selected by the companies were to represent the industry; the remaining five members were to be selected by the FTC and could not represent any competing industry. The nine members were to share responsibilities and powers equally.¹¹⁴ The FTC was authorized to designate one of the members to serve as chairperson.¹¹⁵ The committee was to keep minutes of all meetings and make them available to the FTC upon request.¹¹⁶ In addition, it was to submit an annual report summarizing its activities to the Commission and all the respondent companies.¹¹⁷ Funding of the \$5 million program was to be provided chiefly by the Society of Plastics, with the balance supplied by the corporate respondents.¹¹⁸ The Society of Plastics could be credited with up to \$2.5 million of program funds for money spent on independent research unless the Product Research Committee had evaluated the expenditure and determined that the research did not further the objectives of the research program.¹¹⁹ The order also directed companies to provide up to \$25,000 per year of administrative support.¹²⁰

An examination of industry promotional material circulated after the FTC order suggests that the respondents have conscientiously attempted to comply with the order's requirements.¹²¹ Clearly, the order has helped purge prohibited expressions from industry promotional material.¹²² References to flame spread ratings in industry advertisements are now accompanied by the required warnings which caution against their accuracy.¹²³

More significantly, the Product Research Committee has begun to carry out its responsibilities under the consent order. Early in its history, the committee sponsored seminars designed to gauge the informational needs of the industry. It then focused its activities in the areas of fundamental research, small-

111 84 F.T.C. at 1271-72.

112 *Id.* at 1272.

113 *Id.* at 1272-73.

114 *Id.* at 1272-74.

115 *Id.* at 1272-73.

116 *Id.*

117 *Id.*

118 *Id.* at 1273.

119 *Id.* at 1273-74.

120 *Id.*

121 *Id.* at 1277. The consent order requires respondents to supply the FTC with copies of all advertising materials relative to cellular plastics. These materials are available for review at the FTC's Washington office.

122 Compliance File for FTC Investigation of Society of Plastics Industry.

123 For a critical account of the "woefully" inadequate government regulation of the marketing and usage of plastics, see Show and Gillette, *supra* note 102, at 13, col. 4. This series of articles demonstrates the scope of the inflammability problem.

scale tests, large-scale tests, and toxicity of combustible products.¹²⁴ During its first year, the committee sponsored eight meetings on various topics relevant to the inflammability problems of industry products. The meetings included discussions of the widely used ASTM E-84 tunnel (flame spread) test and the toxicology of combustion products.¹²⁵

The committee's work has been carried out "primarily through a series of contracts and grants to various research laboratories."¹²⁶ In soliciting research bids, the committee has emphasized its interest in research which develops fire tests on a large and small scale, measures characteristics of individual products in various fire situations, and synthesizes results into an overall estimate of the hazard presented.¹²⁷ This is the kind of information the industry had carefully avoided developing in the previous decades.¹²⁸

The Fourth Annual Report of the Product Research Committee shows that the group has retained its focus and structure.¹²⁹ The committee appears to have continued its interest in developing reliable indicators of product flammability in actual fire situations—the intended purpose of the committee's creation in 1974.¹³⁰

Any assessment of the effectiveness of the consent order must take into account other circumstances affecting the plastics industry. First, the Society of Plastics had begun its own research program shortly before it accepted the FTC's consent decree.¹³¹ Second, other government agencies besides the FTC have directed their attention to the industry in the intervening years.¹³² Third, building codes, which previously incorporated the problematic tunnel test as a measure of combustibility, have been updated to assess more accurately the dangers of plastics in the building construction industry.¹³³ Fourth, the insurance industry has refused to insure structures insulated with urethane, thereby contributing to the widespread rejection of small-scale test results as reliable indicators of flammability.¹³⁴ Finally, private damage suits have spawned damaging publicity and have resulted in large awards for personal and property damage against manufacturers who misrepresented or failed to warn of the fire hazards presented by cellular plastics.¹³⁵ The combined

124 Products Research Comm., First Annual Report (January, 1976) at 1.

125 *Id.* at 1-2.

126 *Id.* at 7.

127 *Id.* at 7-8.

128 See Show and Gillette, *supra* note 102 at 13, col. 3.

129 Products Research Comm., Fourth Annual Report (May, 1979). Six of the eight members of the Committee were still serving as of May, 1979.

130 Cf. *Testing Plastics for Fire Behavior: The Smoke is Beginning to Clear Away*, MOD. PLASTICS, Mar., 1976, at 46 ("intense research" is going on into the behavior of plastics in real-fire situations).

131 An industry attorney reportedly addressed a gathering of plastics manufacturers, in 1974, and warned of the "disastrous" results of government interference unless steps were quickly taken to remedy critical problems in testing. Show and Gillette, *supra* note 102, at 14, col. 2.

The consent order provision which allows the crediting of expenditures for independent research in subjects of interest to the committee anticipates and encourages this industry activity.

See Kline, *supra* note 56, at 66. That observer had been involved in pre-consent order fire testing of plastics and praised the order as accelerating the progress of various public and private efforts to improve testing methods.

132 For instance, mattress fires in prisons and hospitals have drawn significant attention and study from HEW, state agencies, and the Bureau of Prisons. See Show and Gillette, *supra* note 102, at 12, col. 1.

133 Show, *Fire Went "Wshoosh"—And Two Youths Were Dead*, L.A. Times, Jan. 21, 1979, 31, at 13, col. 3.

134 *Id.*

135 Telephone Interview with Eric Rubin, Staff Attorney, FTC's Washington Regional Office (Dec. 11, 1979). See also Heckman, *Legal Exchange*, MOD. PLASTICS, Feb. 1976, at 108, which included a warning of the

pressures of the press, government agencies, and successful plaintiffs rendered unprofitable the continued ignorance of managers regarding the fire hazards presented by their products.¹³⁶

The FTC's consent order was flawed in several respects. First, according to FTC officials, the committee's \$5 million funding base was insufficient to remedy the industry's ignorance regarding the combustibility of its products. Second, the order contained no provision explicitly requiring management to digest and assimilate information generated by the Product Research Committee, and gave the FTC no powers to discern whether indirect assimilation had taken place. Nevertheless, the consent order set in motion—or at least was a part of—a series of events which compelled the plastics industry to accept responsibility for its defective products and thereby provided it with an incentive to disseminate complete and accurate product information and to improve product quality.

Case 4: Mobile Home Industry

Probably the most far-reaching attempt at managerial restructuring occurred within the mobile home industry. The successful results of that effort are not only visible but have been acknowledged by the targeted companies. Their experiences suggest the potential of these remedies.

The FTC began an investigation of the mobile home manufacturing industry in August 1972, focusing on warranty performance and warranty service systems.¹³⁷ The Commission selected sixteen representative companies for close scrutiny,¹³⁸ and eventually named the four largest of these companies, which were also the subjects of a majority of the consumer complaints, as respondents in consent order proceedings.¹³⁹

The FTC's investigation continued until 1974, and revealed the need for improvements in warranty performance systems and for government intervention to effectuate those changes. Studies revealed that the typical purchasers of mobile homes were blue-collar workers and retirees, whose income level was below that of the general population.¹⁴⁰ An FTC report described these purchasers as "tend[ing] not to pursue their rights when defects or problems do occur [and] rely[ing] totally on the expertise of both the dealer and the manufacturer to handle the sometimes complicated details of the entire transaction."¹⁴¹

The complexity of mobile homes aggravated these purchasers' com-

dangers of exaggerated product claims for creating either a cause of action for negligence or breach of warranty.

¹³⁶ See Show and Gillette, *supra* note 102, at 12, col. 2. The most serious problems are presented by these plastics products purchased several years ago by consumers who continue to be unaware of their deadly flammability characteristics.

¹³⁷ FTC REPORT OF THE PRESIDING OFFICER ON PROPOSED TRADE REGULATION RULE: MOBILE HOME SALES AND SERVICE 19 (1979) [hereinafter cited as REPORT OF THE PRESIDING OFFICER].

¹³⁸ Interview with Randolph Tritell, Staff Attorney, FTC's Washington Regional Office, in Washington, D.C. (Nov. 28, 1979). He explained that the consent order proceeding was used to obtain prompt results for a large number of consumers while the lengthy rulemaking procedure continued.

¹³⁹ 1977 Subpoena Returns, Mobile Home TRR Proceeding, R8 22188-4235 [hereinafter cited as 1977 Subpoena Returns]. The proposed trade regulation rule was in turn modeled after the consent order provisions. The experiences of the four respondent companies under the consent order were of special interest to participants in the later proceedings.

¹⁴⁰ REPORT OF THE PRESIDING OFFICER, *supra* note 137, at 29-34.

¹⁴¹ *Id.* at 33.

parative lack of sophistication. Mobile homes consist of a package of products and services,¹⁴² all susceptible to defects which may impair the safety and habitability of the home.¹⁴³ Because the mobile home distribution chain is complex and the distances between manufacturer, dealer and consumer are often great, defects often are not detected before the final anchoring of the home. When defects appear, purchasers turn to the dealer for the promised warranty service. However, dealers may be unable or unwilling to answer those complaints. Manufacturers select dealers primarily because of their ability to sell, secondarily because of their credit history, and only incidentally because of their ability to perform warranty services and home anchorings.¹⁴⁴ Even if capable of repairing defects, dealers may be reluctant to do so because of the difficulty of securing reimbursement from manufacturers.¹⁴⁵

The mobile home industry itself also contributed to the problems in warranty performance. Rapid industry expansion in the late 1960's and early 1970's resulted in the creation of a number of large firms with perilously decentralized and informal management systems.¹⁴⁶ Communication in these firms between plant and management officials, and between dealer and manufacturer, regarding product defects and customer service requests was inadequate.¹⁴⁷

The FTC's investigation revealed that the mobile home manufacturers breached their warranty obligations. In some areas of the country, up to forty percent of all purchasers were unable to obtain warranty service.¹⁴⁸ The ambiguity, informality or nonexistence of systems for handling service requests resulted in an unacceptable juggling of service responsibilities between dealers and manufacturers.¹⁴⁹ The reluctance of these parties to accept responsibility for defects resulted in repairs being greatly delayed, which in turn resulted in customers undertaking the repairs themselves or living with the inconvenience.¹⁵⁰

In March 1975, the FTC accepted four consent orders which attempt to redress this situation.¹⁵¹ The orders require the respondent companies to create

142 *Id.* at 103 n. 52.

143 Safety features of mobile homes are covered by the National Mobile Home Construction and Safety Standards Act of 1974, 42 U.S.C. § 5401-26 (1976 & Supp. II 1978). These standards only attempt to deal with defects which render a home uninhabitable and therefore do not address warranty performance systems. See REPORT OF THE PRESIDING OFFICER, *supra* note 137, at 228.

144 REPORT OF THE PRESIDING OFFICER, *supra* note 137, at 65 (quoting Lee Posey, President of Redman Industries, testifying before the TRR proceeding on March 29, 1973).

145 "Too often in the past the manufacturer/dealer relationship has been an adversary relationship. We feel this must change: the relationship must become more of a partnership." *Manufactured Housing Dealer* 56, 60 (Nov., 1978) (quoting Fleetwood President William Weide in an interview).

146 According to Eric Rubin, the extent of the manufacturers' ignorance of their own operation in the early 1970's was incredible. Several companies even had inadequate records of the extent of their assets. Telephone Interview with Rubin, *supra* note 135. Pam Stewart reiterated this view and described the FTC investigation as offering the respondents the benefits of a very expensive management consulting evaluation at the public's expense. Telephone Interview with Pam Stewart, Staff Attorney, FTC's Washington Regional Office (Jan. 18, 1980).

147 REPORT OF THE PRESIDING OFFICER, *supra* note 137, at 171-72.

148 Mobile Homes Sales and Services Trade Regulation Rule, 44 Fed. Reg. 68,330 (1979).

149 REPORT OF THE PRESIDING OFFICER, *supra* note 137, at 73.

150 *Id.* at 185.

151 *In re Redman Industries, Inc.*, 85 F.T.C. 309 (1975); *In re Fleetwood Enterprises, Inc.*, 85 F.T.C. 414 (1975); *In re Skyline Corp.*, 85 F.T.C. 444 (1975); *In Re Commodore Corp.*, 85 F.T.C. 472 (1975).

Commodore Corporation, one of the four consent order companies, suffered severe financial setbacks just prior to the Commission's acceptance, by which time it had dropped from an operation of 23 plants to

channels for the communication of service requests from purchasers to dealers to manufacturers, and to establish a "uniform procedure for the systematic receipt and analysis and fair disposition of all complaints."¹⁵² Each firm's customer service manager is required to review periodically both service records and the results of questionnaires sent by the firm to mobile home purchasers.¹⁵³ The customer service manager must send summaries of that information each month to responsible corporate officers.¹⁵⁴

The consent orders also create certain service responsibilities and clarify the service obligations of both dealer and manufacturer. The order requires the manufacturer to inspect the mobile home both before and after occupancy.¹⁵⁵ Each manufacturer must also review regularly its dealers' qualifications to perform home anchorings and warranty repairs,¹⁵⁶ and assign responsibility for repairs in detailed, written agreements with the dealers.¹⁵⁷ Responsibility for the entire warranty service program is centralized in a corporate level official.¹⁵⁸ The consent orders are also intended to serve as a model for, and a reliable indicator of, the potential for success of a trade regulation rule under consideration for possible adoption on an industrywide scale.

The contemporaneous rulemaking injects a measure of uncertainty into any evaluation of the effect of the consent orders. Anxious to avoid further government regulation, industry officials may be inclined to deny that the provisions are necessary, or that they result in noticeable consumer benefits.¹⁵⁹ Fueling their skepticism is the mounting rhetoric attacking government regulation in general and the FTC in particular.¹⁶⁰ In addition, according to FTC files, the four targeted companies have recently become uncooperative with compliance efforts and are complaining of being subjected to special regulatory requirements which, they claim, place them at a competitive disadvantage.¹⁶¹

These factors make it difficult to assess accurately the degree to which the consent orders have affected the behavior of the targeted companies. Nevertheless, improvements are visible. For example, the consent orders require that each company's customer service manager synthesize information generated

five. For this reason, the Commission modified that consent order substantially on April 22, 1975. Compliance File for FTC Investigation of Commodore Corp.

152 Redman Industries, Inc., 85 F.T.C. at 325.

153 Redman Industries, Inc., 85 F.T.C. at 316; Fleetwood Enterprises, Inc., 85 F.T.C. at 420; Skyline Corp., 85 F.T.C. at 451; Commodore Corp., 85 F.T.C. at 478.

154 Redman Industries, Inc., 85 F.T.C. at 316; Fleetwood Enterprises, Inc., 85 F.T.C. at 421; Skyline Corp., 85 F.T.C. at 451; Commodore Corp., 85 F.T.C. at 479.

155 Redman Industries, Inc., 85 F.T.C. at 321; Fleetwood Enterprises, Inc., 85 F.T.C. at 425-26; Skyline Corp., 85 F.T.C. at 456; Commodore Corp., 85 F.T.C. at 484.

156 Redman Industries, Inc., 85 F.T.C. at 318; Fleetwood Enterprises, Inc., 85 F.T.C. at 422; Skyline Corp., 85 F.T.C. at 452; Commodore Corp., 85 F.T.C. at 480.

157 Redman Industries, Inc., 85 F.T.C. at 319; Fleetwood Enterprises, Inc., 85 F.T.C. at 424; Skyline Corp., 85 F.T.C. at 454; Commodore Corp., 85 F.T.C. at 482.

158 The job description of Skyline's Director of Consumer Services reads: "to establish, maintain and analyze service records so as to provide reports and recommendations to management as to how to maximize cost effectiveness and how consumer satisfaction may be achieved in the company's service activities, to maximize both short- and long-term profits." 1977 Subpoena Returns, *supra* note 139, at R8 22622.

159 If the final TRR is less stringent the consent order companies may petition to modify the orders, which technically are permanently binding on them, and subject themselves to the less burdensome industry rule. Interview with Tritell, *supra* note 138.

160 See, e.g., Kennedy, *Delegalizing Society* 2 WHITTIER L. REV. 469 (1980); Gellhorn, *The Commission's Deregulatory Philosophy*, 48 ANTITRUST L.J. 541 (1980).

161 In March of 1979, the FTC voted to commence an investigation into the possible noncompliance of the four companies. FTC public files document the unwillingness of the companies to cooperate with the investigation. Telephone Interview with Stewart, *supra* note 146.

by the inspections and questionnaires and present it to the appropriate corporate officials.¹⁶² Soon after the consent orders were signed, corporate officials began reviewing the information, noting recurrent problems with particular plants and suppliers, and investigating possible solutions to those problems.¹⁶³ Close surveillance of the problem plants has resulted in a decrease in defects.¹⁶⁴ Moreover, several companies appear to have borrowed the idea of having one figure within the corporate organization, the customer service manager, responsible for warranty performance.¹⁶⁵

Less clear, however, is the effect of the consent orders' provisions concerning the respective responsibilities of dealers and manufacturers in performing warranty obligations. The four manufacturers have terminated very few dealer relationships as a result of inadequate service capability or performance,¹⁶⁶ and the manufacturers' inquiries into dealer experience, skills and equipment remain superficial.¹⁶⁷ On the other hand, the decline in the number of consumer lawsuits and complaints to the FTC may indicate that these provisions have improved warranty service.¹⁶⁸

The clearest sign of the legitimacy of Professor Stone's theories lies in the target firms' own assessments of the benefits derived from managerial remedies—assessments made after two years of experience under the consent order and before the rulemaking proceeding, deregulation and anti-FTC rhetoric had brought about a polarization of attitudes. One of the respondent companies reported that it had changed its quality control procedures, construction materials and manufacturing techniques "in order to reduce the number and cost of repairs necessary to comply" with the order's warranty service requirements.¹⁶⁹ The company stated that "the cost of the[se] changes was less than the benefit received in the form of savings in repair costs and increased good will. . . ."¹⁷⁰ Another respondent similarly reported that the cost of the warranty service program was nominal and that "some" savings resulted.¹⁷¹ The company stated that by bringing problems to light early in the warranty period, the inspections and questionnaires tended "to reduce the cumulative costs of warranty service."¹⁷² It also noted that "early attention tends to reduce the incidence and duration of homeowner dissatisfaction . . . thus aiding long term sales."¹⁷³

The experiences of the four mobile home manufacturers reflect more than

162 Redman Industries, Inc., 85 F.T.C. at 324-26, Fleetwood Enterprises, Inc., 85 F.T.C. at 429-30; Skyline Corp., 85 F.T.C. at 460-61; Commodore Corp., 85 F.T.C. at 487-88.

163 1977 Subpoena Returns, *supra* note 139, at R8 22137-4235.

164 *Id.*

165 Telephone Interview with Stewart, *supra* note 146.

166 Fleetwood and Redman reported dropping no more than five percent of their dealers and Skyline only 26 of its 2206 dealers. 1977 Subpoena Returns, *supra* note 139, at R8 22137-4235.

167 Manufacturer "evaluation" amounts to dealer self-evaluation of their own service and set-up capability. See 1977 Subpoena Returns, *supra* note 139, at R8 22137-4235.

168 Interview with Tritell, *supra* note 138; Telephone Interview with Stewart, *supra* note 146.

169 1977 Subpoena Returns, *supra* note 139, at R8 22137-4235.

170 *Id.*

171 *Id.*

172 The additional costs incurred as a result of the consent order provisions were of interest in the rulemaking proceeding and are the most visible consequences of the FTC intervention. Administrative costs experienced by each individual respondent were included in the responses to the 1977 subpoenas. Those figures, however, were extended confidential treatment and are not available for public review. *Id.*

173 *Id.*

the applicability of Professor Stone's theories. The current position of the four companies again demonstrates the importance of the entire context surrounding government intervention and managerial restructuring. The prospect of industrywide regulation of mobile home manufacturers has dampened the receptivity of the targeted companies to the potential benefits of compliance with the consent order provisions. Instead, the companies have retreated to an adversarial position, certain that no good can come out of administrative intervention.

III. Conclusion

Evaluation of these four sets of consent orders must end with an assessment of the cost of their implementation and maintenance. The costs of the orders include (1) the FTC's investigative and enforcement costs, (2) the costs to the respondents of compliance, and (3) the eventual price paid by the public for the eradication of the misbehavior. Unfortunately, accurate financial data concerning these costs are neither presently available nor easily compiled. The Commission's costs are certainly high, given the lengthy investigations preceding three of the four sets of orders. The costs to the corporations elude approximation. The only figures available concerning costs borne by consumers involve the mobile home consent orders. A complete and impartial study of these costs was produced by the United States Regulatory Council, which concluded that compliance had added approximately fifty dollars to the cost of the average mobile home. However, the cost to purchasers of waterproofing services or foamed plastic products is probably much less.

Because these orders appear to have produced success at relatively insignificant costs, they constitute attractive regulatory tools which can be used by other federal or state agencies. Nothing in the above examination suggests that these positive results are limited to FTC implementation or consent order application. Nor does the size of company or type of industry appear to be a factor affecting success. Perhaps the most important variables are extraneous to the order actually entered—for example, the timing delays experienced in the Bede Aircraft case, the contemporaneous industrywide rulemaking in the mobile home case, the change in corporate attitudes among waterproofers, and the universal criticism of the plastics industry.

It is clear, then, that not all situations are ripe for managerial restructuring attempts, and that surrounding circumstances must be scrutinized before such attempts are made. The Bede Aircraft and National Meridian cases suggest that managerial remedies may be inadequate to eradicate pervasive corporate problems and deliberate corporate misconduct. The mobile home cases suggest that attempts to trigger "spillover" effects may be counterproductive if the targeted corporations see themselves as victims of regulations not imposed upon their competitors. Nevertheless, managerial remedies hold forth promise of becoming effective means of deterring corporate wrongdoing. If their implementation is tempered by an appreciation of their inherent limitations, such remedies may offer the potential of success in restructuring corporate organizations.