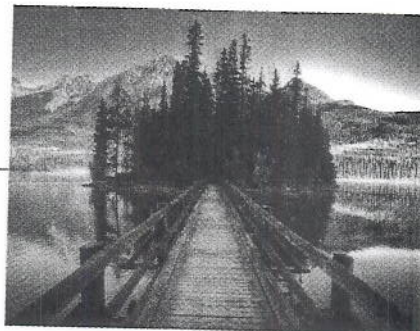


CASE 3

The American Red Cross

Daryl Benson



The American Red Cross (ARC) is an independent organization, supported by public financial donations and volunteerism. Its mission is to “provide relief to victims of disaster and help people prevent, prepare for and respond to emergencies.” The ARC responds to more than 70,000 disasters annually. However, the ways in which it handled 9/11 in 2001 and Hurricane Katrina in 2005 were widely criticized as being inadequate and poorly managed. The ARC has had to address allegations of fraud, bribery, and even theft on the part of volunteers and employees working for the organization. The ARC also has faced a number of internal challenges due to high turnover, as well as charges of overcompensation and possible corruption among its board of directors and upper management.

A BRIEF HISTORY

Clara Barton initially founded the ARC in 1881. She was inspired by the work of the International Red Cross while on a trip to Europe during the Franco-Prussian War of 1870–1871. Barton brought the model back to the United States, and subsequently led the organization through its first domestic and international relief missions, including assisting the U.S. military during the Spanish-American War in 1898. The ARC is one of a handful of organizations chartered by the U.S. government, receiving its first federal charter in 1900.

As a member of the International Federation of Red Cross and Red Crescent Societies, the ARC joins more than 175 other national societies in bringing aid to victims of disasters throughout the world. The ARC follows the seven fundamental bylaws to which all Red Cross societies must conform: humanity, impartiality, neutrality, independence, voluntary service, unity, and universality.

This case was prepared by Michelle Watkins and John-Paul Schilling under the direction of O.C. Ferrell and the development of Jennifer Jackson. This case was prepared for classroom discussion, rather than to illustrate either effective or ineffective handling of an administrative, ethical, or legal decision by management. All sources used for this case were obtained through publicly available material.

ORGANIZATIONAL STRUCTURE

Today the American Red Cross consists of roughly half a million volunteers and 35,000 employees. For many years the ARC has had a fifty-member, all-volunteer board of governors. The president of the United States is the honorary chair of the Red Cross and appoints eight governors, including the chair of the board. The chair nominates and the board elects the president of the ARC, who is responsible for carrying into effect the policies and programs of the board. This arrangement is undergoing changes that will be discussed later in the case.

The ARC is made up of more than 700 local chapters across the country. These chapters receive funding from the national Red Cross. Directors of local chapters are authorized to run day-to-day operations. Representatives of the local chapters nominate members of the local boards of governors. In recent history, members of the local boards of directors have clashed with top national management.

ORGANIZATIONAL AND LEADERSHIP UPHEAVAL

Trouble at the Top: Executive Turnover

The constant change in leadership is debilitating and does nothing to address the real problem.

The first decade of the twenty-first century saw a high rate of turnover in the boardroom at the Red Cross. Since Elizabeth Dole's resignation as chair in 1999, the ARC has had seven different permanent or acting heads. President Bernadine Healy (1999–2001) was forced to resign following mismanagement of the response to the September 11 attacks. Similarly, president and chief executive officer Marsha J. Evans (2002–2005) was ousted after the ARC's botched handling of Hurricane Katrina, though the official reason for her departure was communication problems with the board. Mark W. Everson was president and CEO for the brief period between May 29 and November 27, 2007. He was forced to resign after an inappropriate sexual relationship with a subordinate came to light.

This frequent executive turnover has significantly weakened the organization's ability to carry out its federal mandate. Some blame the oversized board of directors. "The board seems to think it is a hiring and firing agency, and does not see its role as building a strong Red Cross," said Paul C. Light, a professor of public service at New York University. "The constant change in leadership is debilitating and does nothing to address the real problem, which is years and years of underinvestment in telecommunications, technology and other infrastructure to help the organization with its mission." In the cases of both Healy and Everson, the board spent a considerable amount of time and money conducting a search for the "right person," nearly two years and eighteen months, respectively.

The agency's reputation has been further tarnished by the ARC's history of awarding large severance packages for ousted executives, no matter how short the term served. Bernadine Healy received \$1.9 million in salary and severance pay upon her departure in late 2001. Marsha Evans received a total of \$780,000 in 2005; this comprised eighteen months' severance pay and a \$36,495 unpaid bonus. Speaking of the damage to the

organization, Diana Aviv, president and chief executive of the Independent Sector, a nonprofit trade association, said, "The tragedy of this is that the American Red Cross is probably the best-known nonprofit organization in this country. When the stories about it are more about governance and management and less about how it saves lives, it's sad and not just for the Red Cross."

Leadership troubles have extended into the local chapters as well, indicating systemic problems. In a story on the ARC, CBS News cited a laundry list of misconduct: "the fundraiser in Louisiana caught padding her own bank account with donations; the manager in Pennsylvania who embezzled to support her crack cocaine habit; and the executive in Maryland who forged signatures on purchase orders meant for disaster victims." One of the biggest charity frauds in history occurred at the ARC's Hudson County chapter in New Jersey. Chief executive Joseph Lecowitch and bookkeeper Catalina Escoto stole well over \$1 million in Red Cross funds, squandering it on gambling and gifts to themselves. Escoto also gave herself at least \$75,000 in bonuses. Even after Congress mandated changes meant to do away with such problems, in 2007 an executive in Orange County pleaded guilty to federal charges that she embezzled at least \$110,000 of the organization's money.

The systemic problems at the American Red Cross have continued, with the nonprofit running about a \$200 million deficit and eliminating 1,000 jobs in 2008 alone. Management turmoil and a slow economy combined to dampen fundraising, and the new CEO, Gail McGovern, split the organization's number-two executive position into three separate president-level positions. McGovern filled two of these positions with former AT&T executives with whom she had worked. The ARC was forced to ask for a \$150 million appropriation, along with funding to help victims of wildfires, tornados, and floods.

Organizational Changes at the Top

In 2006 Congress took action to try to improve the ARC's effectiveness and efficiency after the scandals of September 11, Hurricane Katrina, and the myriad problems at local chapters when Senator Charles E. Grassley filed legislation to overhaul the organization. Grassley's legislation also forced the organization to become more transparent. In 2006 the ARC disclosed thousands of pages of documents that had not previously been available to the public. This marked the first time in almost sixty years that Congress had moved to amend the organization's charter. The legislation sought to assuage the difficulties in the board by cutting its numbers by more than half, to twenty members by the year 2012. It also restructured the role of the president of the United States in making board appointments. In the past, the president appointed the chair and eight board members, typically cabinet secretaries who rarely attended meetings. Under the legislation, the board nominates a chair for approval and appointment by the president. All other presidential appointments to the board were abolished. An independent ombudsman position was created to take charge of annually reporting to Congress as well as assisting whistle-blowers should agency misconduct be reported.

The American Red Cross Code of Business Ethics and Conduct was updated in January 2007. All employees and volunteers are required to read and sign the two-page document. The ARC offers a twenty-four-hour, confidential, anonymous hotline, the "Concern Connection Line," that provides American Red Cross staff, volunteers, and members of the public a way to report concerns or ask questions regarding potentially illegal, unsafe, or unethical conduct. The ARC also published an eight-page "Ethics

Rules and Policies,” which outlines how business funds, property, and time may be allocated, as well as addressing conflicts of interest, recordkeeping, and addressing media inquiries. By far the longest section of this document is the page addressing writings by employees and volunteers about September 11, 2001, which details a policy for “creating, marketing and selling books and other literary works relating to the events of September 11, 2001.”

The word *ethics* does not appear a single time in the main promotional document the ARC provides to governmental agencies. *Compliance* appears only in reference to the ARC’s requirements related to the collection of blood donations. No mention is made of employee or volunteer ethics training in any official ARC documents available at its website, making it clear that this is not a high priority for the organization.

In light of the scandals that have plagued the ARC, stakeholders must be assured repeatedly of the genuine efforts the organization is making to institutionalize ethical best practices. It may be the ARC believes that because its mission is to respond to and assist people in need, organizational ethics will automatically occur. Perhaps the assumption is that all employees will be ethical without direction or training.

SEPTEMBER 11, 2001

Slow Response

After the September 11 attacks on New York City’s World Trade Center, the ARC was widely criticized for its response. The criticisms began the very day of the incident, as the Pentagon called the office of Red Cross President Bernadine Healy at noon to ask, “Where the hell are you guys? Where is the Red Cross?” The Virginia-based command center known as the Disaster Operations Center (DOC) had, for more than a day afterward, failed to activate the specialized teams normally sent out after a plane crash or similar disaster. The trouble did not stop there. In the days and weeks following the attacks, the ARC was continually criticized for its management of the financial donations from thousands of Americans.

Monetary Donation Mismanagement

After September 11, monetary donations poured in at an unprecedented rate. Healy set up a separate fund, the “Liberty Fund,” for donations earmarked for victims. By the end of October, the fund had received \$543 million in pledges. It had, however, distributed less than one third of those funds to 9/11 relief efforts. The ARC announced that more than half would be spent to increase the organization’s ability to prepare for and respond to future catastrophes instead.

Angry outcries prompted a U.S. congressional hearing in November 2001. Healy attempted to defend the use of the money, saying it was clear to donors that not all gifts would go directly to immediate relief efforts. To this Representative Billy Tauzin replied, “It was specially funded for this event, for September 11, and we’re also being told parenthetically, ‘by the way, we’re going to give two thirds of it away to other important Red Cross needs.’” The ethical issue of asking for funds for 9/11 relief efforts, and then appropriating those funds for other purposes, created an explosive debate. At the time of the hearing, Healy had already been forced to resign as ARC president. The ARC subsequently announced that all Liberty Funds monies would go to September 11 victims and their families.

HURRICANE KATRINA

ARC and FEMA Miscommunication

During August and September of 2005, the American Red Cross responded to the disastrous effects of Hurricanes Katrina and Rita, the largest national emergencies in the history of the organization. Katrina hit New Orleans on August 23 as a category 3 storm, making it the sixth strongest hurricane ever recorded in the Atlantic. It was also the costliest hurricane in history. Hurricane Rita hit the coast of Louisiana and Texas only a month later and was an even larger category 3 storm. The ARC raised more than \$2 billion in private donations to fund massive relief efforts for both these disasters.

Yet again, following this outpouring of charitable giving, the American public was left largely unsatisfied by the inadequate and untimely relief efforts depicted in the media. These subpar emergency responses were the outcome of a host of fraudulent, questionable, and inefficient decisions made by the ARC, as well as its federal, state, and local disaster relief counterparts. As a result of these faulty responses, and at the request of various congressional committees, the Government Accountability Office (GAO) wrote a report detailing the inadequacies of the ARC and the Federal Emergency Management Agency (FEMA).

The GAO found that the National Response Plan written by the Department of Homeland Security (DHS) in December 2004 was not properly followed and that coordination between the ARC and FEMA was not satisfactory. The DHS plan depicted the ARC as the primary agency responsible for coordinating federal mass care assistance in support of state and local governments and other voluntary organizations in charge of meeting needs such as shelter, food, and emergency first aid. During their disaster relief efforts, FEMA and ARC officials disagreed about their roles and responsibilities and failed to communicate appropriate points of contact for each agency. Additionally, ARC staff was criticized for rotating support positions every two to three weeks. This made it difficult for ARC staff to maintain working relationships with counterparts or to gain expertise in their job functions. Lastly, FEMA failed to implement a comprehensive system to track requests for assistance received from the ARC. One of the ARC's main objectives is properly categorizing and responding to requests for specific goods or necessary services by state and local governments as well as other voluntary organizations.

FEMA failed to implement a comprehensive system to track requests for assistance received from the ARC.

Mismanagement of Funds and Volunteers

Along with the failures in communication between FEMA and the ARC, there have been numerous accusations about the improper management of donated funds and of volunteers following Hurricanes Katrina and Rita. A *New York Times* article summarizes these actions as follows: "The accusations include the improper diversion of relief supplies, failure to follow Red Cross procedures in tracking and distributing supplies, and use of felons as volunteers in the disaster area in violation of Red Cross rules."

Numerous Katrina volunteers reported the disappearance of rented cars, electricity generators, and even some 3,000 air mattresses. During the relief efforts, the ARC had

more than 235,000 volunteers working in the hurricane disaster areas, more than five times the previous peak of 40,000 volunteers for other relief efforts. It was reported that several of these volunteers had arrest warrants or other felony charges in their backgrounds. The ARC has a screening process that normally would detect potential volunteers with criminal backgrounds, but during Katrina, the organization was so overwhelmed with people seeking to volunteer that it dropped its usual standards.

Other volunteers complained of unauthorized possession and use of Red Cross computer equipment by staff and volunteers. This equipment was equipped with software to add donated money to debit cards for immediate use by hurricane victims and could easily be misused by unscrupulous volunteers. Other incidents included an ARC call center employee writing money orders in the names of various relief victims and fraudulently cashing them herself.

The ARC launched an investigation into claims that, as an organization, it had virtually no cost controls, little oversight of inventory, and no mechanism for basic background checks on volunteers that were given substantial responsibilities. These examples of mismanagement of charitable funds and volunteers pose questions regarding the ARC's ability to prevent fraud and protect resources amid the chaos of major national disasters.

As a nonprofit organization, the ARC should always take steps to ensure impartiality.

Encouragement of Corporate Partnerships

Another story that emerged from relief efforts for Hurricane Katrina victims regards the ARC's acceptance and choice of corporate partnerships. During the national emergency situation, many corporations were eager to help. Corporate donations not only help victims, but they also cast companies in a good light as the companies demonstrate their compassion and concern for stakeholders. As a nonprofit organization, and the lead agency in charge of various aspects of the disaster relief, the ARC had a duty to scrutinize the corporate donations. Examples of corporate partnerships during the Katrina disaster relief efforts included Coca-Cola donating water, Anheuser Busch canning and delivering water in Anheuser Busch cans, Master Card and J.P. Morgan issuing ATM cards with access to ARC-donated funds for relief victims, and the Southwest Drycleaners Association (SDA) donations of funds that were intended to help the SDA portray themselves as a compassionate and community-involved industry.

In a national emergency, these corporate partnerships help to provide access to resources that otherwise may not be available. The ARC deserves praise for incorporating the generosity of private corporations effectively into its overall disaster relief strategy. However, it should be noted that in the future a more active approach to monitoring private firms' donations would benefit the transparency and overall goals of keeping the ARC apolitical and independent from large businesses. The danger of large corporate donations is that they could make the ARC appear to be in collusion with or biased toward certain corporations. As a nonprofit organization, the ARC should always take steps to ensure impartiality. A greater level of transparency would allow the ARC to assure regular citizens that their charitable donations will not be affected or misused, regardless of corporate involvement. The ARC must be especially careful with whom it is willing to partner during times of national disaster so as not to appear to be using a disaster as a means to promote corporate products.

An article published in the *Harvard Business Review* states that entities such as the ARC would benefit from greater cooperation and partnerships with private businesses. "It's a good thing when companies pitch in after natural or other calamities. It would be a

far better thing if they partnered with aid agencies to make plans before disaster struck." As an example, the authors use the agreement for a partnership between Abbott Laboratories and the ARC to supply blood-screening equipment to prove their point that preplanned private partnerships with aid agencies could expedite relief efforts to disaster victims. Through this agreement, Abbott Laboratories will donate a variety of pharmaceutical products ranging from antibiotics to baby food.

Donation Acceptance and Insufficient Capacity

The last point worth mentioning in this analysis of the ARC's donation management involves the organization's capacity to electronically accept donations. The ARC's website has become the main source for receiving individual charitable donations. After September 11, 2001, the organization had to expand its Web-based infrastructure to accommodate additional web traffic. After the tsunami in Southeast Asia, the ARC found itself once again overwhelmed with Internet traffic to donate money. Internet technology staff was forced to offload some of the expansion capabilities work to contractors in the technology processing industry.

The magnitude of donations for Hurricane Katrina victims was unprecedented in the ARC's history. Internet donors immediately overwhelmed the ARC website's capacity. More than fifty Internet technology staff members worked around-the-clock to expand capacity sixfold. The ARC once again outsourced some of the workload to Akamai Technologies, Inc.

There is a lesson to be learned from these continued action-and-reaction scenarios regarding online donation acceptance capacity. The lesson is that the ARC would benefit greatly from a plan outlining how to deal with the next crisis of insufficient capacity. Dave Clark, the chief technology officer at the ARC, believes that it would be a good idea to install a collaboration system. This would consist of a plan to effectively partner with various Internet technology firms to alleviate long-term problems regarding online capacity needs, as well as to deter the ARC from dealing with each disaster on a case-by-case basis, thus better serving the increasingly large online donor community.

MARKETING CHALLENGES AT THE RED CROSS

After much bad press, the ARC faces many challenges in marketing itself as a prominent, ethical, and transparent nonprofit organization. The ARC must effectively reduce perceived risk associated with giving to it, and must carefully choose partnerships with private corporations that will continue to encourage blood donations. The organization also must overcome any frivolous lawsuits that might damage its reputation. Lastly, the ARC must focus on marketing the positive impacts the organization has on society, including the vital role it plays in disaster relief. These marketing efforts will ideally translate into increased positive exposure and enhanced support for the organization.

Perceived Risks of Charitable Giving

Unfortunately for the ARC, many donors have been irritated by the numerous reports of fraudulent use of donations. Donors now associate a degree of uncertainty with giving to

the ARC, as they question whether the funds will be used properly. The ARC has increased competition for funding as well. The number of nonprofit organizations searching for donor funds has increased dramatically in the past twenty years. In 1987 there were 422,000 nonprofit organizations in the United States; by 2005 the number had nearly doubled to 800,000. This growth obviously increases competition for charitable donations, especially in tough economic times. In order to maintain a strong donor base and continue to increase the monetary amount of donations, the ARC must increase transparency to assure donors that their money is being used responsibly.

Partnerships and the Red Cross Symbol

In 2004 the ARC joined in a unique marketing partnership with the independent film studio Lionsgate to co-market the release of a horror film entitled *Saw IV* while promoting blood collection services. The *Saw* “Give Till It Hurts” blood drive was a key element of the marketing campaign for the fourth installment of the most successful horror franchise of all time. Due in large part to promotions like the *Saw* blood drive in 2004, filmgoers’ blood donations increased from 4,200 pints to 41,000 pints by 2007. In 2008, the *Saw* franchise again held a nationwide blood drive to draw attention to the release of *Saw V*. Marketing efforts such as these benefit both the film producers and the ARC by adding to the ARC’s main goal of increasing blood supplies while also promoting the film. Many marketers believe that this sort of age-specific marketing strategy, accompanied by word-of-mouth advertising, is the best way to reach a new pool of potential volunteers.

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Lastly, the ARC benefits from brand recognition in the form of its internationally recognized Red Cross symbol, although this symbol also has generated controversy in the form of a lawsuit filed by Johnson & Johnson Company regarding licensing the Red Cross icon for use on commercial products. In 1887, Johnson & Johnson began using a red cross symbol on its surgical packages and registered the trademark for commercial use with the U.S. Patent Office in 1906. The ARC, on the other hand, cites its federal charter from the year 1900 as the adoption date for its emblem, and further points out that the image was developed in Switzerland in 1863 by the International Committee of the Red Cross, where the group decided that “volunteer nurses braving battlefields shall wear in all countries, as a uniform distinctive sign, a white armband with a red cross.”

In total, the ARC has sold first aid kits, preparedness kits, and related products that have generated over \$2 million in revenue. Johnson & Johnson believed that the ARC was benefiting from consumers confusing the ARC packages for those of Johnson & Johnson which has very similar packaging. The lawsuit was resolved in 2008, with both parties dismissing their suits and countersuits.

Focusing on Positive International Effects

From a marketing perspective, the greatest strength the ARC possesses is its ability to focus on the positive doings of its sister international organizations. The International Federation of Red Cross and Red Crescent Societies (IFRC) wrote a report discussing discrimination against women, the elderly, and the disabled in disasters. The IFRC concluded in this report that these situations, as well as sexual violence, can be prevented

with an improvement in disaster-preparedness programs. This conclusion states that with stronger support by charitable organizations, such harsh discriminations can be reduced or eliminated in the future.

Even in incidents where the International Committee of the Red Cross (ICRC) is forced to evacuate a country, such as the case of Myanmar in 2006, the ARC has gained publicity from write-ups on the international association. An article in *The Economist*, for example, summarized Myanmar's decision regarding removal of the ICRC: "Last year the organization paid individual visits to more than 3,000 prisoners in 55 places. It has also been providing aid—foods, medicines, help with sanitation, and so on—to villages on the border." The article went on to state that "the ICRC announced that the ruling junta last month ordered it to close its five field offices in the country." Thus, even in negative circumstances, the positive coverage on the ICRC has benefitted the overall marketability of the ARC.

ETHICAL RISKS AND CHALLENGES

The American Red Cross faces many ethical risks and challenges. Some are common challenges for any organization of its size, such as executive compensation, preventing and handling employee misconduct, and considering all stakeholders in its operating model. Other risks are unique to the Red Cross, such as transparent and accurate representation of the organization's need for, and use of, monetary donations, volunteer time, and blood donations. Also, the ARC has the ethical challenges of maintaining effective and efficient operations to respond to disasters and transparently reporting the organization's accomplishments, failures, and opportunities for improvement in disaster response activities.

The executive turnover experienced by the ARC has brought to light the compensation awarded top executives. Bernadine Healy was given \$1.9 million in salary and severance pay when she left in 2001. Marsha Evans was given \$780,000 when she left in 2005. Much time and money was also spent in the search for and training of these top executives.

Employee misconduct also has been an issue, from the discrimination in disbursing relief after disasters to employee embezzlement. Such misconduct has occurred from New Orleans to Maryland and New Jersey, indicating a systemic problem. Addressing stakeholder needs, particularly those of the ARC's thousands of donors, is an ongoing challenge. Donors have a multitude of choices among nonprofits to support with their money and their time. They need open, honest, and transparent communication about how their resources are allocated and why such decisions are made. Issues like misrepresenting the use of the "Liberty Fund" collected after September 11 must be prevented if the ARC wishes to continue to be relevant.

The ARC must also address the specific ethical risks with its disaster response duties. Clear and efficient communications with federal and local government agencies is a challenge, as shown by the breakdown of communications in the aftermath of Hurricane Katrina. The ARC must develop strategic plans to better accomplish disaster response goals. These plans must include how to respond to organizational missteps and failures. Transparent, honest reporting of the ARC's goals, accomplishments, opportunities for improvement, and mistakes would go a long way to restoring the country's trust in the organization.

CONCLUSION

In short, the American Red Cross has a stakeholder obligation to fulfill its charter's expectations and deliver these promises effectively and efficiently. Charitable donations fund the nonprofit's operations and volunteers comprise 95 percent of its workers. The ARC staff and volunteers need to be well managed by capable directors and executives within ARC. Improvements to the ARC as an organization must begin with executive leadership and flow downward to every level of the group. Congressional oversight and interaction with federal, state, and local organizations must continue to be reviewed and modified to suit current needs.

Disaster relief cooperation in the form of partnering with private corporations to provide efficient and effective responses to victims of disasters should be continued. Joint marketing practices between the ARC and private businesses should also continue, as long as unethical interactions or associations do not compromise the mission of the ARC. Close monitoring must be carried out by the many stakeholders of the ARC, including donors, staff, volunteers, and society in general.

QUESTIONS

1. Explain the possible problems in the ethical culture of the Red Cross that created the issues discussed in this case.
2. Name some of the problems the ARC has encountered with handling donation money.
3. What are some of the reasons for the ARC's ethical dilemmas, and how can the organization guarantee that these problems will not recur in the future?
4. What effect does organizational structure and compensation have on ethical behavior among chief executives at ARC?

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