*CHAPTER* **3**

# Appellate Practice


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## § 3.1 Introduction: Is the Supreme Court Pro-Business?

The business cases before the United States Supreme Court often do not attract as much attention as the cases that feed the popular culture wars, but they are no less significant. As one commentator noted in a 2008 analysis of the Court's recent opinions,

> Business cases at the Supreme Court typically receive less attention than cases concerning issues like affirmative action, abortion or the death penalty. The disputes tend to be harder to follow: the legal arguments are more technical, the underlying stories less emotional. But these cases—which include shareholder suits, antitrust challenges to corporate mergers, patent disputes and efforts to reduce punitive-damage awards and prevent product-liability suits—are no less important. They involve billions of dollars, have huge consequences for the economy and can have a greater effect on people's daily lives than the often symbolic battles of the culture wars.[1]

Many commentators have characterized the Roberts court as business-friendly.[2] Observers have noted, for example, the U.S. Chamber of Commerce's impressive success at the Court in recent years through direct litigation and amicus

1. Jeffrey Rosen, *Supreme Court Inc*., N.Y. TIMES MAGAZINE (Mar. 16, 2008), *available at* http://www.nytimes.com/2008/03/16/magazine/16supreme-t.html.

2. *See* Tony Mauro, *Is the Supreme Court Pro-Business? It depends how you define that*, CORPORATE COUNSEL (Oct. 1, 2010) ("Ever since the State of the Union message in January, the most persistent criticism of the U.S. Supreme Court from the left has been that it's pro-business."); Tony Mauro, *Supreme Court Continues Pro-Business Stance*, LEGAL TIMES (Feb. 21, 2008); Greg Stohr, *Alito Champions Business Causes in First Full High-Court Term*, BLOOMBERG (June 26, 2007) (referring to the 2006-2007 Supreme Court term as "what may have been the most pro-business U.S. Supreme Court term in decades"); Robert Barnes & Carrie Johnson, *Pro-Business Decision Hews To Pattern of Roberts Court*, THE WASHINGTON POST (June 22, 2007) (describing a case as another "victory for business in what has been a resoundingly successful year before the nation's highest court").

filings.[3] One 2010 study by the Constitutional Accountability Center reported that the Court's five conservative justices side with the Chamber of Commerce at least two-thirds of the time, while the four liberal justices disagree with the Chamber's position more than half the time.[4] In the Court's 2009-10 term, for example, the Chamber of Commerce at least partially prevailed in 13 of the 16 cases in which it filed a brief.

An independent study released at the end of 2010 by two law professors and Judge Richard Posner of the Seventh Circuit Court of Appeals concurs with this view.[5] The study is described as noting that "[t]he chamber's success rate is but one indication of the Roberts court's leanings on business issues."[6] Analyzing data since the 1950s, the study concludes that during Chief Justice Roberts's brief tenure, the percentage of business cases on the Court's docket has increased along with the percentage of cases won by business interests.[7] "The Roberts court, which has completed five terms, ruled for business interests 61 percent of the time, compared with 46 percent in the last five years of the court led by Chief Justice William H. Rehnquist, who died in 2005, and 42 percent by all courts since 1953."[8] At least some commentators have connected the success of business interests at the Court with the rise of the highly specialized Supreme Court bar that brings the cases to the Court.[9]

The seemingly widespread perception that the Roberts court is pro-business is not, however, universally held. Justice Breyer—who often differs with Chief Justice Roberts and Justice Alito—takes issue with the pro-business description. In a 2010 interview with Bloomberg Television, Justice Breyer rejected the notion that the Court has a pro-business slant, and asserted that the Court does not rule in favor of companies any more frequently now than it has historical-

3. David L. Franklin, *What Kind of Business-Friendly Court? Explaining the Chamber of Commerce's Success at the Roberts Court*, 49 Santa Clara L. Rev. 1019 (2009) (arguing that the Court's recent decisions are less about "pro-business" or "pro-defendant" jurisprudence, and more about "a broadly shared skepticism among the justices about litigation as a mode of regulation").

4. *The Roberts Court and Corporations: The Numbers Tell the Story*, Constitutional Accountability Center (June 2010), *available at* http://theusconstitution.org/blog.history/wp-content/uploads/2010/10/Chamber-Win-Statistics-formatted-end-of-term-6-25-final.pdf; *see also A Tale of Two Courts: Comparing Corporate Rulings by the Roberts and Burger Courts*, Constitutional Accountability Center (Oct. 25, 2010), *available at* http://theusconstitution.org/blog.history/wp-content/uploads/2010/10/Burger-Chamber-Report-10-25-10-FINAL1.pdf.

5. Lee Epstein, William M. Landes & Richard A. Posner, *Is the Roberts Court Pro-Business* (Dec. 17, 2010), *available at* http://epstein.law.northwestern.edu/research/RobertsBusiness.pdf.

6. Adam Liptak, *Justices Offer Receptive Ear to Business Interests*, N.Y. Times (Dec. 18, 2010), *available at* http://www.nytimes.com/2010/12/19/us/19roberts.html?_r=1&partner=rss&emc=rss.

7. *Id.*

8. *Id.*

9. *Id.*

ly.[10] Rather, in his view, businesses have "always done pretty well."[11] At least some Supreme Court practitioners concur with Justice Breyer's skepticism of popular sentiment:

> I don't think it makes sense to talk about a pro-business or anti-business court. . . . Two-thirds of the business decisions from last term cut in favor of business interests, but the justices often do not divide along ideological lines in business cases. In close cases, their votes come down to their judicial philosophies and not to any pro-business or anti-business bias.[12]

Indeed, as the cases discussed in this chapter illustrate, the Court often divides in ways that do not comport with popular notions of liberal or conservative, pro-business or pro-plaintiff—and the Justices do not shy away from issuing opinions that surprise or disappoint the business community.

In any event, predicting the Court's direction is often futile in light of the Court's changing composition and the nature of federal and state legislative action. For example, Justice Kagan's frequent recusal in the Court's 2009 and 2010 terms as a result of her prior position as Solicitor General could make a material difference in many cases where the Court is closely divided. Two significant and parallel preemption cases discussed in this Chapter illustrate the potential impact of Justice Kagan's recusal. Both preemption cases arise from the State of Arizona's recent and controversial immigration reforms. In *U.S. Chamber of Commerce v. Whiting*,[13] currently pending before the Court, Justice Kagan is recused and Justice Kennedy is expected to be the swing vote on the issue of whether the Arizona immigration law is preempted. If Justice Kennedy sides with the Chamber of Commerce in favor of preemption in *Whiting*, many observers anticipate that the Court will split 4-4. Such an even split would have the effect of summarily affirming the Ninth Circuit's holding that the Arizona law is not preempted, but it would not establish precedent beyond the *Whiting* case. This result would be particularly significant in light of a second very similar lawsuit pending in the Ninth Circuit—*United States*

10. Greg Stohr, *Breyer Says Supreme Court Doesn't Have Pro-Business Slant*, www.bloomberg.com (Oct. 7, 2010).

11. *Id.* (quoting Justice Breyer); *see also* Tony Mauro, *Is the Supreme Court Pro-Business? It depends how you define that*, Corporate Counsel (Oct. 1, 2010) (noting that some data indicates that the Court's docket of business cases has steadily remained at about 40 percent over the last 16 years).

12. Ashby Jones, Y*our Early Guide to the Big Business Cases of the High Court Term*, WSJ Law Blog (Sept. 30, 2010), *available at* http://blogs.wsj.com/law/2010/09/30/your-early-guide-to-the-big-business-cases-of-the-high-court-term/ (quoting Lauren Rosenblum Goldman, a partner in Mayer Brown's Supreme Court and Appellate practice in New York).

13. In *Whiting*, the Court is considering whether an Arizona law (the Legal Arizona Workers Act) that threatens employers with revocation of their licenses to do business in Arizona if they hire illegal aliens is preempted by federal immigration law. *Chicanos Por La Causa, Inc. v. Napolitano*, 544 F.3d 976 (9th Cir. 2008), *reprinted as amended*, 558 F.3d 856 (9th Cir. 2009), *cert. granted*, *Chamber of Commerce of the United States v. Candelaria*, No. 09-115, 130 S. Ct. 3498 (2010) (consolidating cases for review).

*v. Arizona*—in which the United States is challenging a different and equally controversial Arizona immigration law.[14] If Justice Kagan, who would not be recused in the *Arizona* case, were to vote in favor of preemption in *Arizona*, the Court could well have two virtually contemporaneous and yet inconsistent opinions on preemption in the field of immigration law.

However the Justices' individual leanings and the Court's decisions are described philosophically, there is no doubt that the Court has decided—and is currently considering—a great number of cases that will significantly impact business interests now and in the future. The Court's opinions from this year also give some insight into how the recent legislative packages on finance reform and healthcare may be viewed by the courts in the challenges that are sure to come.

The following subchapters discuss, by topic, the Supreme Court's business-related jurisprudence from the 2009-10 term, the key cases impacting the business community pending before the Court through the end of 2010, and existing circuit splits that may provoke Supreme Court resolution in short order. This chapter's coverage ends as of December 31, 2010, although any major developments in early 2011 may be noted, with the intent that they will be fully addressed in the 2011 Appellate Practice Chapter.

## § 3.2 Securities Fraud

As Madoff-related filings slowed and the credit crisis eased, securities class action filings appeared to be declining as of the middle of 2010.[15] By the end of the year, however, securities fraud filings set a record pace of 1196 suits filed—slightly higher than 2009, but 24 percent higher than 2008 and 71 percent higher than 2005.[16]

2010 proved a busy year for securities cases in the Supreme Court. Unlike opinions in previous years, which have earned the Roberts court a business-

14. The *Arizona* case involves a challenge to Arizona's Support Our Law Enforcement and Safe Neighborhoods Act, a controversial 2010 legislative enactment that makes it a crime for an alien to be present in Arizona without carrying required documents, and requires police "when practicable" to detain a person without a warrant if they reasonably suspect the person is in the country without authorization. *United States v. Arizona*, 703 F. Supp. 2d 980, 986 (D. Ariz. 2010) (interlocutory appeal of preliminary injunction pending in *United States v. Arizona*, No. 10-16645, in the United States Court of Appeals for the Ninth Circuit).

15. *See* Dr. Jordan Milev, *et al*., NERA Economic Consulting, Trends 2010 Mid-Year Study: Filings Decline as the Wave of Credit Crisis Cases Subsides, Median Settlement at Record High (2010), *available at* http://www.nera.com/nera-files/PUB_Mid_Year_Trends_0710(1).pdf.

16. *See* 2010 a Record Year for Securities Litigation, An Advisen Quarterly Report, 2010 Review, *available at* https://www.advisen.com/downloads/sec_lit_Q42010_report.pdf.

friendly reputation,[17] the Court's 2010 securities-related decisions reveal a somewhat more complicated picture.

## § 3.2.1 The limitations period for a securities fraud claim begins to run when a reasonably diligent plaintiff would discover the facts giving rise to the claim. *Merck & Co., Inc. v. Reynolds*

In its first major securities decision of the term, *Merck & Co., Inc. v. Reynolds*,[18] the Supreme Court held in a unanimous opinion written by Justice Breyer that the two-year statute of limitations applicable to Securities Exchange Act Section 10(b) fraud claims is not triggered until the plaintiff actually discovered, or a reasonably diligent plaintiff would have discovered, the facts giving rise to the violation (whichever comes first).[19] The Court held that such "facts" include the fact of scienter (or fraudulent intent), which is a necessary element of a § 10(b) claim, and emphasized that facts suggesting a statement's falsity are not always sufficient to show scienter. As Justice Breyer explained, because a plaintiff must allege facts giving rise to a *strong* inference of scienter merely to survive a motion to dismiss, a holding inconsistent with that standard would prevent plaintiffs from bringing their claims if the defendant could conceal for two years that it had any intent to deceive.

*Merck* involved a claim by Merck investors that the company knowingly misrepresented the risk of heart attacks associated with Vioxx, ultimately resulting in a stock price drop. Merck had released a study showing increased heart attacks among Vioxx users in 2000, but suggested that the results could be explained by other factors. In September 2001, the Food and Drug Administration (FDA) also issued a warning letter stating that Merck had issued misleading statements about Vioxx's safety profile. Merck did not withdraw Vioxx from the market until September 30, 2004. The plaintiff-investors filed suit on November 3, 2003, over two years after Merck released its initial study and the FDA had issued its warning letter.

Merck moved to dismiss on limitations grounds, arguing that the plaintiffs should have filed their claim within two years of the FDA's warning letter. The plaintiffs responded that they could not have discovered Merck's scienter—one

17. Greg Stohr, *U.S. Supreme Court Increasingly Favors Business, Study Says*, Bloomberg Businessweek (Oct. 26, 2010), available at http://www.businessweek.com/news/2010-10-26/u-s-supreme-court-increasingly-favors-business-study-says.html; Jeffrey Rosen, *Supreme Court Inc.*, New York Times Magazine (Mar. 16, 2008), available at http://www.nytimes.com/2008/03/16/magazine/16supreme-t.html.

18. *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010).

19. Under the applicable statute of limitations, cases by private plaintiffs under § 10(b) must be brought no later than the earlier of "2 years after the discovery of the facts constituting the violation," or 5 years after the violation. 28 U.S.C. § 1658(b).

of the essential facts giving rise to the cause of action—more than two years before filing suit. The Supreme Court agreed. To hold otherwise, the Court noted, would allow fraud defendants to avoid liability simply by concealing facts showing their fraudulent intent.[20]

The Court also rejected Merck's argument that the investors were, at the very least, on "inquiry notice" of the alleged fraud, finding that "inquiry notice" is inconsistent with the statute's use of the word "discovery." The Court emphasized that the so-called "discovery rule," which has been applied in a variety of federal and state limitations contexts, was particularly important in the fraud context because deceptive conduct may prevent a plaintiff from knowing he has been defrauded. By overruling several long-standing federal court decisions that applied an "inquiry notice" standard,[21] the Court significantly limited the circumstances in which defendants may successfully assert a statute of limitations defense. Thus, *Merck* likely will reduce the number of securities fraud suits dismissed on limitations grounds.

However, the decision presents a double-edged sword for plaintiffs. While they may now have a longer period in which to assert their claims, the decision also reaffirms the steepness of plaintiffs' burden to allege scienter with sufficient specificity to survive a motion to dismiss by confirming that scienter cannot necessarily be inferred from a materially false statement.

*Merck* also may have broader implications. While the decision is limited to a specific statutory context (and thus should not directly impact the limitations period applicable to state law claims), courts may take it into account in fraud cases outside the securities arena. The discovery rule, and the accompanying "inquiry notice" principle, have been applied by both federal and state courts to bar not only § 10(b) cases, but also fraud and other cases brought under state statutes or the common law. It remains to be seen whether lower federal and state courts will adopt the *Merck* reasoning in other contexts.

## § 3.2.2 United States securities laws do not apply to securities traded on foreign exchanges. *Morrison v. National Australia Bank Ltd.*

While *Merck* was widely viewed as a win for § 10(b) plaintiffs, not all of the Supreme Court's securities rulings proved plaintiff-friendly. In June 2010, the Court issued a decidedly pro-defendant landmark decision in *Morrison v. National Australia Bank Ltd.*, spurring a rash of lower court decisions and legislative action.[22] In *Morrison*, the Court addressed the extraterritorial application of U.S. securities laws and struck a major blow to would-be fraud plaintiffs who purchase securities on foreign exchanges. Specifically, the Court held that foreign plaintiffs purchasing securities on foreign exchanges cannot bring

20. *See Ashcroft v. Iqbal*, 129 S. Ct. 1937 (U.S. 2009).
21. *See, e.g., Franze v. Equitable Assurance*, 296 F.3d 1250, 1254 (11th Cir. 2002).
22. *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010).

suit under § 10(b) (or Securities and Exchange Commission (SEC) Rule 10b-5, promulgated thereunder) for securities fraud.

Several Australian stockholders sued the National Australia Bank (in Australia) in New York over allegedly fraudulent conduct committed by a bank-owned mortgage-servicing company in Florida. The plaintiffs contended that U.S. courts had jurisdiction over the dispute because the alleged fraud was committed in the United States.

Justice Scalia, writing for a unanimous court, disagreed and wrote that "Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States," *even if the fraudulent conduct occurred in the United States*.[23] The Court further criticized the Second Circuit's "conduct" and "effects" test for establishing subject-matter jurisdiction and found that the authority to hear a securities fraud case involving foreign investors and securities raises questions of merit, not questions of subject-matter jurisdiction.[24] Said another way, the Court held that the relevant question is whether § 10(b) gives rise to a private cause of action for securities traded outside the United States. Applying a "transactional test," the Court held that it does not. Instead, "it is . . . only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which Section 10(b) applies."[25]

Particularly in the ever-expanding international business world, the *Morrison* decision has significant implications for investors and issuers trading on foreign exchanges. The holding eliminates the potential for securities fraud suits brought by foreign purchasers of foreign shares on a foreign exchange (so-called "f-cubed" or "foreign-cubed" suits). Perhaps more notable, though, is that lower courts have interpreted *Morrison* to bar even *domestic* plaintiffs from suing foreign issuers trading on foreign exchanges. For instance, in *Cornwell v. Credit Suisse Group*, the district court granted a motion to dismiss claims brought by domestic plaintiffs who had purchased Credit Suisse securities on the Swiss Stock Exchange.[26] Given these decisions, some observers anticipate a reduction in the number of securities class actions filed in the United States,

23. *Id.* at 2888.

24. *Id.* at 2878-79.

25. *Id.* at 2884.

26. *Cornwell v. Credit Suisse Group*, No. 270 F.R.D. 145 (S.D.N.Y. Aug. 20, 2010); *see also Stackhouse v. Toyota Motor Corp.*, cv-10-0922, 2010 U.S. Dist. LEXIS 79837 (C.D. Cal. July 16, 2010) (barring domestic plaintiffs holding Toyota stock from bringing a § 10(b) claim); *Sgalambo v. McKenzie*, No. 09 Civ. 10087, 2010 U.S. Dist. LEXIS 79688 (S.D.N.Y. Aug. 6, 2010) (plaintiff conceded that *Morrison* "forecloses any potential class members who purchased Canadian Superior common stock on a foreign exchange"); *Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada*, 732 F. Supp.2d 1345 (S.D. Fla. 2010) (parties' intent that closing of a transaction in securities was to occur in the United States did not render it a domestic transaction under *Morrison*); *In re Banco Santander Sec.-Optimal Litig.*, 732 F. Supp.2d 1305 (S.D. Fla. 2010) (rejecting § 10(b) claims brought against Bahamian investment fund when all activity related to purchases of securities occurred off-shore even though plaintiffs alleged they were aware the funds were invested with an American-based investment company).

and perhaps also a corresponding increase in foreign class actions. Foreign issuers also may begin declining to register on domestic stock exchanges to avoid potential liability under U.S. securities laws.

*Morrison* also has implications outside of the securities world. For instance, the Second Circuit recently applied *Morrison* in a RICO case, holding that a shareholder in a Russia oil company could not pursue RICO claims against foreign persons and entities that allegedly conspired to take over the company.[27]

However, in light of recent (and possible future) legislation, *Morrison*'s long-term consequences are unclear. The decision relied on the absence of § 10(b) language explicitly extending its reach to foreign investors and exchanges. It also failed to carve out an exception for SEC and DOJ actions, and could thus be construed as placing the same limitations on criminal cases. *Morrison*, therefore, may have played a part in prompting President Obama to sign the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) on July 21, 2010. This sweepingly broad legislation significantly expands the SEC's authority and, among other things, purports to expand federal jurisdiction over securities actions brought by the SEC or the Justice Department against certain foreign issuers.

## § 3.2.3 The Supreme Court will consider whether reports that are "not statistically significant" are sufficient to state an allegation of materiality in a securities fraud claim. *Siracusano v. Matrixx Initiatives, Inc.*

Securities law practitioners can expect more significant developments in the Supreme Court's 2011 term. In June 2010, the Court granted certiorari in *Siracusano v. Matrixx Initiatives, Inc.*, a class action brought by investors involving the claim that Matrixx, a pharmaceutical company, failed to disclose material information regarding the cold remedy Zicam (specifically, that Zicam causes a condition called anosmia, which is a loss of the sense of smell, in its users).[28] Matrixx argued to the district court that the plaintiffs could not establish materiality[29] of the information because the reports about anosmia were "not statistically significant." The district court agreed, and dismissed the plaintiffs' claims.[30]

27. *Norex Petrol. Ltd. v. Access Industries Inc.*, 622 F.3d 148 (2d Cir. 2010).

28. *Siracusano v. Mattrixx Initiatives, Inc.*, 585 F.3d 1167 (9th Cir. 2009), *cert. granted*, 130 S. Ct. 3411 (2010).

29. "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

30. *Siracusano v. Matrixx Initiatives, Inc.*, No. CIV-04-0886-PHX-MHM, No. CIV-04-1012-PHX-MHM, 2005 U.S. Dist. LEXIS 41102 (D. Ariz. Dec. 15, 2005), *rev'd*, 585 F.3d 1167 (9th Cir. 2009), *cert. granted*, 130 S. Ct. 3411 (2010).

The Ninth Circuit reversed, holding that materiality was a fact-specific inquiry that should have been left to the fact finder.[31] In its holding, the Ninth Circuit relied on Supreme Court precedent for the proposition that "the Supreme Court has rejected the adoption of a bright-line rule to determine materiality because '[t]he determination [of materiality] requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him.'"[32] With this holding, the Ninth Circuit split with the First, Second, and Third Circuits, which have each held that drug companies have no duty to disclose until reports show statistically significant evidence that the adverse events may be caused by a drug's use.[33]

A number of amicus curiae briefs were filed with the Court, including a brief filed by the U.S. Solicitor General in favor of the Respondent, which argued that the pleadings were adequate because information suggesting an adverse effect may be "material"—and thus mislead investors—even absent statistical significance.[34] Matrixx argues that if information that qualifies as not statistically significant qualifies as material information that must be disclosed, there will be a flood of relatively useless and potentially misleading information that will only confuse investors. The Court granted the Solicitor General's motion to appear at argument, which was scheduled for January 10, 2011.[35] It remains to be seen whether the Supreme Court agrees with this analysis. Whatever the decision, it is clear that *Matrixx* may have wide-reaching effects for manufacturers of drugs and medical devices.

## § 3.2.4 The Supreme Court will address the scope of secondary liability in private securities-fraud actions. *Wiggins v. Janus Capital Group, Inc.*

Although it is settled that there is no aiding and abetting liability in private securities-fraud actions,[36] some plaintiffs have sought to circumvent this rule by asserting direct claims against third parties for assisting in the preparation of misleading disclosures. In one of these cases, *Wiggins v. Janus Capital Group, Inc.*, the Supreme Court will determine whether victims who relied on

31. *Siracusano*, 585 F.3d at 1178-79.

32. *Id.* at 1178 (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 236 (1988)).

33. *See N.J. Carpenters Pension & Annuity Funds v. Biogen IDEC Inc.*, 537 F.3d 35, 50 (1st Cir. 2008); *Oran v. Stafford*, 226 F.3d 275, 284 (3d Cir. 2000); *In re Carter-Wallace, Inc. Securities Litigation*, 220 F.3d 36, 41-42 (2d Cir. 2000).

34. Brief of the United States as Amicus Curiae Supporting Respondents, No. 09-1156, filed in the U.S. Supreme Court (Nov. 12, 2010), *available at* http://sblog.s3.amazonaws.com/wp-content/uploads/2010/11/AmicusUS.09-1156.pdf.

35. *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 812 (2010).

36. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

false statements in a company's prospectus can sue an investment adviser that helped prepare the prospectus.[37]

In *Janus*, First Derivatives Traders filed suit individually and on behalf of individual shareholders against Janus Capital Group (JCG) and its wholly owned subsidiary Janus Capital Management (JCM) for investment losses alleged to result from JCM's "market-timing" scheme with hedge funds. JCM managed and was the investment adviser for various mutual funds under the Janus name, but the shareholder plaintiffs actually owned shares in JCG. When JCM's scheme was disclosed, investors reacted by pulling $14 billion out of JCM-managed funds. Because JCG derives 90 percent of its revenues from its subsidiary JCM, the disclosure also caused a precipitous decline in JCG's share price as investors cashed out (including a 12 percent drop the day after the disclosure).

The district court dismissed the complaint, holding that JCM had not actually prepared the prospectuses, nor had it directly made the allegedly misleading statements.[38] The Fourth Circuit reversed and allowed the suit to proceed, holding that a service provider may be liable for securities fraud. In reaching this holding, the Fourth Circuit held that "given the publicly disclosed responsibilities of JCM, interested investors would infer that JCM played a role in preparing or approving the content of the Janus fund prospectuses."[39]

After JCM filed a petition for writ of certiorari, the Supreme Court solicited an amicus brief from the U.S. Solicitor General to express the views of the United States.[40] The Obama Administration filed an amicus brief urging the Court not to take the case but, on June 28, 2010, the Supreme Court granted review.[41]

The appeal raises two issues for the Court's review: (1) whether the service provider "made the misleading statements" in another company's prospectuses "by participating in the writing and dissemination of [the] prospectuses," and (2) whether the service provider can be held liable for a statement in a different company's prospectus "even if the statement on its face is not directly attributed" to the service provider.

Many critics of the Fourth Circuit's opinion—including the Chamber of Commerce (which filed an amicus)—argue that allowing secondary actor liability is essentially an end-run around the rule that there can be no aiding and abetting liability, and that it will give rise to a flood of litigation. Given that this issue could arise for any number of service providers, including accountants, lawyers, and other advisers, the Court's answer to these questions may well have far-reaching implications.

Indeed, at the December 9, 2010 oral argument, the Justices wrestled with the role such advisors play in drafting statements on behalf of mutual funds—

37. *Wiggins v. Janus Capital Group, Inc. (In re Mut. Funds Inv. Litig.)*, 566 F.3d 111, 127 (4th Cir. 2009), *cert. granted*, 130 S. Ct. 3499 (2010).

38. *Wiggins v. Janus Capital Group Inc. (In re Mut. Funds Inv. Litig.)*, 487 F. Supp. 2d 618 (D. Md. 2007), *rev'd*, 566 F.3d 111, 127 (4th Cir. 2009), *cert. granted*, 130 S. Ct. 3499 (2010).

39. *Wiggins*, 566 F.3d at 127.

40. *Janus Capital Group, Inc. v. First Derivative Traders*, 130 S. Ct. 1117 (2010).

41. *Janus Capital Group, Inc. v. First Derivative Traders*, 130 S. Ct. 3499 (2010).

i.e., whether they are primary or secondary actors, agents or principals. For example, Justice Sotomayor asked Janus's counsel, "Do you mean to tell me that puppets become a legal defense for someone who intentionally manipulates the market information?"[42] How the Court will ultimately decide the issue will be one of the more anticipated events in the coming year.

## § 3.2.5 The Supreme Court is asked to consider whether loss causation must be proven at the class certification stage in a securities-fraud class action. *Erica P. John Fund, Inc. v. Halliburton Co.*

On October 4, 2010, the Court signaled its interest in yet another securities fraud suit by seeking the Solicitor General's advice as to whether to grant certiorari in *Erica P. John Fund, Inc. v. Halliburton Co.*[43] If the Supreme Court opts to hear the case, it will consider whether and to what extent a securities fraud plaintiff must not only satisfy the requirements to trigger a rebuttable presumption of fraud-on-the-market, but must also establish loss causation at class certification stage by a preponderance of admissible evidence without discovery or jury consideration.

The fraud-on-the-market theory generally refers to the idea that stock prices reflect all material information about the company and its business, as long as the relevant market is "efficient."[44] As a result, when a company makes a material misrepresentation about its business, courts will presume that a person who purchased the company's stock relied on the false information and was injured when the stock subsequently lost value. This presumption makes it easier for plaintiffs to make a prima facie fraud case that will survive dismissal. Clearly, without the presumption, class certification would be much more difficult.

The *Halliburton* case asks whether the fraud-on-the-market presumption may be relied upon when seeking certification of a class of plaintiffs in a securities fraud case. The plaintiff filed a class action against Halliburton and its former Chief Executive Officer Dick Cheney alleging they violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 by falsifying financial results and misleading the public about facts related to asbestos liability, accounting practices, and the benefits of the company's merger with Dresser Industries.

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42. The official transcript of the oral argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-525.pdf.

43. *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330 (5th Cir. 2010) (petition for certiorari pending); *see also Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 380 (2010) (inviting brief from the U.S. Solicitor General).

44. *See Basic v. Levinson*, 485 U.S. 224, 248 (1988) ("Requiring proof of individual reliance from each member of the proposed plaintiff class" would often "prevent[] [plaintiffs] from proceeding with a class action, since individual issues would then . . . overwhelm[] the common ones").

The plaintiff moved to certify as a class all Halliburton investors during the years 1999 and 2001. The district court denied the motion to certify a class on the ground that the plaintiff was required to prove loss causation, i.e., that the corrected truth of the former falsehoods actually caused the stock price to fall and resulted in the losses.[45]

The plaintiff appealed the decision to the Fifth Circuit, arguing that the district court's requirement that it prove loss causation misapplied the Fifth Circuit's precedent, exceeded a plaintiff's burden as set forth in *Basic v. Levinson*,[46] and was inconsistent with other circuit court decisions.

Affirming, the Fifth Circuit held that the district court correctly required the plaintiffs to prove loss causation before allowing them to rely on the fraud-on-the-market presumption of reliance.[47] The plaintiff was required to show that "'(1) the defendant made public material misrepresentations, (2) the defendant's shares were traded in an efficient market, and (3) the plaintiffs traded shares between the time the misrepresentations were made and the time the truth was revealed.'"[48] Only the first required element was disputed—the defendant did not challenge the second two.

Addressing the first element, the Fifth Circuit held that the plaintiff must do more than show a drop in stock price; he must show that the complained-of misrepresentation or omission "materially affected the market price of that security,"—in other words, that it "actually moved the market."[49] This showing must also be made at the "class certification stage by a preponderance of all admissible evidence."[50] The plaintiff has the "added burden" of showing not just that there was a drop in stock price after a corrective disclosure, but that the plaintiff's loss "resulted directly *because* of the correction."[51] For example, if the company released a variety of negative information in one day, the plaintiff must show that the alleged harm did not result from the unrelated negative information.

> As articulated by the Fifth Circuit, its holding means that where a plaintiff presents "no evidence that a false, non-confirmatory positive statement caused a positive effect on the stock price, [he] would have to show '(1) that an alleged corrective disclosure causing the decrease in price is related to the false, non-confirmatory positive statement made earlier, and (2) that it is more probable than not that it was this related corrective

45. *Archdiocese of Milwaukee Supporting Fund, Inc., v. Halliburton Co.*, 2008 U.S. Dist. LEXIS 89598, at *9a (N.D. Tex. Nov. 4, 2008), *aff'd*, 597 F.3d 330 (5th Cir. 2010), *cert. granted*, 131 S. Ct. 380 (2010) (denying class certification) (citing *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261, 269 (5th Cir. 2007)).

46. *Basic v. Levinson*, 485 U.S. 224 (1988).

47. *Halliburton*, 597 F.3d at 335.

48. *Id.* (quoting *Greenberg v. Crossroads Sys., Inc*. 364 F.3d 657, 661 (5th Cir. 2004)).

49. *Id.* (internal quotes and citation omitted).

50. *Id.* (internal quotes and citation omitted).

51. *Id.* at 336 (emphasis in opinion).

> disclosure, and not any other unrelated negative statement, that caused the stock price decline.'"[52]

The plaintiff filed a petition for a writ of certiorari, asking the Supreme Court to reverse what it called the Fifth Circuit's "substantial and unprecedented burden" on class action plaintiffs.[53] The plaintiff argued that the Fifth Circuit's holding directly conflicted with cases from eight other circuits[54] as well as with the Supreme Court's holding in *Basic v. Levinson*, which adopted the fraud-on-the-market theory as a method of establishing reliance in securities fraud class actions. On December 3, 2010, the Solicitor General filed a brief supporting review, arguing that the Fifth Circuit's holding erroneously "requires plaintiffs to prove a significant element of their case at the class-certification stage, without the benefit of full discovery and without consideration of their claims by a jury."[55] Whether or not the Court grants review in the *Halliburton* case, the Fifth Circuit's departure from other circuit courts ensures this issue will be oft-litigated, and may dramatically impact class action securities fraud cases.

*Update: the Supreme Court granted the petition for writ of certiorari in Erica P. John Fund, Inc. v. Halliburton on January 7, 2011.*[56] *Oral argument has been set for April 25, 2011.*

52. *Id.* at 337 (quoting the district court's opinion).

53. *See* Petition for Writ of Certiorari, filed in Cause No. 09-1403, in the U.S. Supreme Court, *available at* http://www.scotusblog.com/wp-content/uploads/2010/07/09-1403_pet.pdf.

54. *See In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2nd Cir. 2008); *In re PolyMedica Corp. Sec. Litig.*, 432 F3d 1, 7 (1st Cir. 2005); *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1419 n.8 (3rd Cir. 1997); *In re The Mills Corp. Sec. Litig.*, 257 F.R.D. 101, 108 (E.D. Va. 2009); *Ross v. Abercrombie & Fitch Co.*, 257 F.R.D. 435, 454 (S.D. Ohio 2009); *Schleicher v. Wendt*, No. 1:02-cv-1332-DFH-TAB (S.D. Ind. Mar. 20, 2009); *In re Nature's Sunshine Prods. Inc. Sec. Litig.*, 251 F.R.D. 656, 665 (D. Utah 2008); *In re Netbank, Inc. Sec. Litig.*, 259 F.R.D. 656, 676 n. 14 (N.D. Ga. 2009).

55. Amicus Brief of the U.S. Solicitor General, filed in Cause No. 09-1403, in the U.S. Supreme Court, at 5, *available at* http://sblog.s3.amazonaws.com/wp-content/uploads/2010/12/AmicusUS.09-1403.pdf.

56. *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 856 (2011).

# § 3.3 Racketeering and Honest Services Fraud

## § 3.3.1 The Supreme Court narrows the scope of honest services fraud. *Skilling v. United States*

In the closely watched case of *Skilling v. United States*,[57] the Supreme Court significantly limited the type of conduct the government may prosecute as criminal under 18 U.S.C. § 1346, which addresses "honest-services" fraud. Section 1346 makes it illegal to fraudulently "deprive another of the intangible right of honest services," by narrowly interpreting the concept of "honest services" to apply only to schemes involving actual bribes or kickbacks.

Jeff Skilling, the CEO of the famously defunct Enron, was charged with employing fraudulent accounting practices for purposes of increasing Enron's share price and, ultimately, his compensation.[58] At trial, Skilling was convicted of conspiracy to commit honest-services wire fraud (among 18 other charges) and was sentenced to 292 months' imprisonment, three years' supervised release, and $45 million in restitution.[59] The Fifth Circuit affirmed the conviction, holding that § 1346 requires only a material breach of a fiduciary duty that results in a detriment to the employer.[60] The Supreme Court granted certiorari to determine whether § 1346 requires a showing of private gain to the defendant that is inconsistent with the employer's interests.[61]

"Theft of honest services" under 18 U.S.C. § 1346, also known as "honest-services fraud," is a subset of mail fraud and wire fraud under 18 U.S.C. §§ 1341 and 1343.[62] Enacted in 1872, the first mail fraud statute prohibited the use of the mails in furtherance of "any scheme or artifice to defraud."[63] In 1909, however, Congress amended the statute to read "any scheme or artifice to defraud, *or for obtaining money or property by means of false or fraudulent pretenses*."[64] While this amendment clarified that the statute proscribed future schemes to defraud, the disjunctive "or" suggested that a scheme need not result in the loss

57. *Skilling v. United States*, 130 S. Ct. 2896 (2010).

58. *Skilling* Brief for Petitioner at 3-4, *available at* http://www.scotusblog.com/wp-content/uploads/ 2009/12/Skilling-merits-brief.pdf.

59. *United States v. Skilling*, 554 F.3d 529, 542 (5th Cir. 2009).

60. *Id.* at 547.

61. *Skilling*, 130 S. Ct. at 2902-03.

62. *See id.* at *3 n.1; *United States v. Redzic*, 569 F.3d 841, 845 (8th Cir. 2009) ("Section 1346 does not create a separate offense but expands the definition of scheme or artifice to defraud for both mail and wire fraud.").

63. Act of June 8, 1872, ch. 335, § 301, 17 Stat. 283, 323.

64. Act of Mar. 4, 1909, ch. 321, § 215, 35 Stat. 1088, 1130 (emphasis added).

of money or property to be criminal, prompting some to argue that the statute was broad enough to encompass a deprivation of "intangible rights."[65]

In the 1970s, the Department of Justice (DOJ) began using the intangible-rights theory to indict public officials for depriving citizens of their right to "good government."[66] Because no federal laws expressly prohibited state or local officials from receiving bribes or kickbacks, the mail and wire fraud statutes were often the only way for federal prosecutors to address government corruption at the local level.[67] Traditional "money-or-property" fraud was not always useful because the tangible thing (money or property) obtained by a dishonest official was willingly provided by a third party (the briber) rather than stolen from a defrauded victim. With honest-services fraud, prosecutors were able to allege that the victim (the citizenry) was deprived of something other than money or property.[68] Over time, prosecutors began to allege, and courts began to accept, honest-services claims in the private sector based not only on bribes and kickbacks, but on a range of conduct inconsistent with a defendant's fiduciary obligations.[69] By 1982, all courts of appeal had embraced the notion of honest-services fraud.[70]

The honest-services fraud theory developed under the common law discussed above lasted until 1987. The Supreme Court struck down the theory of honest-services fraud in *McNally v. United States*,[71] rejecting the idea that the way the 1909 amendment was drafted created the offense of honest-services fraud separate from traditional money-or-property fraud.[72] The Court in *McNally* acknowledged that the mail and wire fraud statutes were ambiguous, but under the Court's reading there must be a showing that the defrauded victim lost money or property, and that "if Congress desires to go further, it must speak more clearly than it has."[73]

Congress responded swiftly to *McNally* by enacting 18 U.S.C. § 1346 the following year. The new version of § 1346 defined the term "scheme or artifice to defraud" for the purposes of the wire and mail fraud statutes[74] to "include[] a scheme or artifice to deprive another of the intangible right of honest services."[75]

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65. *See Skilling*, 130 S. Ct. at 2911. The first use of the "intangible rights" theory is credited to *Shushan v. United States*, 117 F.2d 110 (5th Cir. 1941) ("A scheme to get a public contract on more favorable terms than would likely be got otherwise by bribing a public official would not only be a plan to commit the crime of bribery, but would also be a scheme to defraud the public.").

66. *See McNally v. United States*, 483 U.S. 350, 356 (1987).

67. 18 U.S.C. § 666 was not enacted until 1984.

68. *See Skilling*, 130 S. Ct. at 2911-12.

69. *Id.* at 2911-12; 2938-42 (Scalia, J., concurring).

70. *Id.* at 2912.

71. *McNally v. United States*, 483 U.S. 350 (1987).

72. 483 U.S. 350 (1987).

73. *Id.* at 360.

74. 18 U.S.C. §§ 1341, 1343.

75. 18 U.S.C. § 1346 (eff. 1988) (added by Pub. L. 100-690, Title VII, § 7603(a), Nov. 18, 1988, 102 Stat. 4508).

The amended version of § 1346 overturned *McNally* and explicitly expanded the reach of the mail and wire fraud statutes to include the theft of honest services. It did not, however, define "honest services" or establish any limits as to the conduct it covered.[76] As such, upon enactment, § 1346 was used liberally to prosecute an ever-expanding range of conduct.[77] This expanded treatment often led to disparate results among the circuit courts.[78] Throughout this period, however, the Supreme Court repeatedly declined to address the limits of honest-services fraud or the evolving differences among the circuit courts on what qualified as such.

Importantly, in a dissent to a 2009 denial of certiorari, Justice Scalia captured the frustration of many observers when he wrote that § 1346 "invites abuse by headline-grabbing prosecutors in pursuit of local officials, state legislators, and corporate CEOs who engage in any manner of unappealing or ethically

76. In his concurring opinion, Justice Scalia noted that even the *McNally* opinion did not consistently define the theory of fraud it rejected. *Skilling*, 130 S. Ct. at 2936 (Scalia, J., concurring).

77. Public officials were indicted for not disclosing actual or potential conflicts of interest, even if they received no financial benefit or there was no clear duty to disclose. For example, Chicago city officials were convicted for handing out jobs to politically favored individuals even though the officials received nothing tangible in return and the city still received competent workers. *United States v. Sorich*, 523 F.3d 702, 709-11 (7th Cir. 2008) (finding that gain appreciated by any individual—even an individual unaware of the fraud—suffices for the private gain limiting principle). Similarly, in the private sector, fiduciaries faced the threat of prosecution when they acted in a manner inconsistent with their employer's interests. Three basketball coaches, for example, were convicted of honest-services fraud for helping prospective transfer students cheat on their exams in violation of NCAA rules. *United States v. Gray*, 96 F.3d 769 (5th Cir. 1996).

78. In some circuits, § 1346 itself (or an indistinct notion of an "inherent" duty of honest services) provided the source of the prosecution. *See, e.g.*, *United States v. Weyhrauch*, 548 F.3d 1237, 1248 (9th Cir. 2008) ("We hold that 18 U.S.C. § 1346 establishes a uniform standard."); *United States v. DeVegter*, 198 F.3d 1324, 1328 (11th Cir. 1999) ("Public officials inherently owe a fiduciary duty to the public to make governmental decisions in the public's best interest."). Other circuits, however, required an independent violation of state or federal law. *See, e.g.*, *United States v. Brumley*, 116 F.3d 728, 734-35 (5th Cir. 1997) (requiring violation of a state law); *United States v. Murphy*, 323 F.3d 102, 116-17 (3d Cir. 2003) (requiring violation of a state *or* federal law). Circuits also took different views as to whether there must be harm to the victim or, inversely, some gain by the defendant before there could be a deprivation of honest services. *See, e.g.*, *United States v. Black*, 530 F.3d 596, 600 (7th Cir. 2008) (finding a private gain to the defendant was all that was required); *United States v. Frost*, 125 F.3d 346, 368 (6th Cir. 1997) (requiring that the employee foresaw or reasonably should have foreseen that his employer might suffer an economic harm as a result of the breach); *see also United States v. Spano*, 421 F.3d 599, 603 (7th Cir. 2005) ("A participant in a scheme to defraud is guilty even if he is an altruist and all the benefits of the fraud accrue to other participants."). Related to this split, other courts asked only whether the breach was "material" enough to be capable of causing an employer to change position irrespective of whether the defendant gained anything or the victim was harmed. *See, e.g.*, *United States v. Rybicki*, 354 F.3d 124, 145 (2d Cir. 2003) (holding that "the misrepresentation or omission at issue for an 'honest services' fraud conviction must be 'material,' such that the misinformation or omission would naturally tend to lead or is capable of leading a reasonable employer to change its conduct").

questionable conduct."[79] Eight months later, the Supreme Court accepted three cases raising questions about the scope and constitutionality of § 1346: *Black v. United States*,[80] *Weyhrauch v. United States*,[81] and *Skilling v. United States*.[82] Of the three, *Skilling* was the only case in which the constitutionality of § 1346 was at issue.

In *Skilling*, Justice Ginsberg delivered the unanimous opinion of the Court. After reviewing the history of honest-services fraud, the Court concluded that "[i]n the main, the pre-*McNally* cases involved fraudulent schemes to deprive another of honest services through bribes or kickbacks supplied by a third party who had not been deceived."[83] With that background, the Court reasoned that when Congress enacted § 1346 in response to *McNally*, it intended to reach "at least" bribes and kickbacks.[84] Therefore, rather than strike down § 1346 as unconstitutionally vague, the Court elected to limit § 1346's reach by construing it in a fashion consistent with Congress's intent. When § 1346 is limited to schemes involving bribes and kickbacks, the Court held the statute is not unconstitutionally vague (thus avoiding a constitutional ruling, as the Court does when possible).[85] As Justice Ginsberg wrote: "Reading § 1346 to proscribe bribes and kickbacks—and nothing more—satisfies Congress' undoubted aim to reverse *McNally* on its facts."[86] In so holding, the Court rejected the Government's argument that § 1346 should also encompass undisclosed self-dealing by a public official or private employee.[87]

Because the Government did not allege that Skilling's fraud included side payments from a third party, the Court ruled that, under its construction of § 1346, "Skilling did not commit honest-services fraud."[88] The Court vacated the Fifth Circuit's ruling on that conviction and remanded the case for further proceedings. The Supreme Court applied its holding in *Skilling* to its companion cases *Black* and *Weyhrauch*.

When the Supreme Court issued its *Skilling* opinion on June 24, 2010, it was front-page news across the country. Many commentators already have questioned what the future holds for fraud prosecutions in light of *Skilling*, particularly as high-profile defendants seek release on bail citing *Skilling*. At the outset, however, it is important to remember what *Skilling* does *not* do. As interesting as it is, the decision does not apply to allegations that a defendant engaged in traditional "money-or-property" mail or wire fraud. Schemes to obtain money or property through false pretenses still will be prosecuted as mail

79. *Sorich v. United States*, 129 S. Ct. 1308, 1309 (2009) (Scalia, J., dissenting from denial of certiorari).
80. 130 S. Ct. 2963 (2010).
81. 130 S. Ct. 2971 (2010).
82. 130 S. Ct. 2896 (2010).
83. *Skilling*, 130 S. Ct. at 2902-03.
84. *Id.* at 2914.
85. *Id.* at 2915-16.
86. *Id.* at 2915.
87. *Id.*
88. *Id.* at 2916.

and wire fraud, and as practitioners in this area are already well aware, those statutes are powerful weapons in cases where the victim has suffered direct harm. As one prosecutor vividly stated:

> To federal prosecutors of white collar crime, the mail fraud statute is our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart—and our true love. We may flirt with RICO, show off with 10b-5, and call the conspiracy law "darling," but we always come home to the virtues of 18 U.S.C. § 1341, with its simplicity, adaptability, and comfortable familiarity.[89]

Beyond the confines of traditional mail and wire fraud, *Skilling* certainly will affect honest-services cases predicated *only* on an "undisclosed conflict of interest" theory. Pending charges will be dropped,[90] those serving sentences will be able to seek review,[91] and even those who have completed a sentence may get relief.[92] In reality, though, much of pre-*Skilling* criticism of § 1346 focused on the law's potential application to everyday low-level employees rather than on its particular application to high-level executives such as Jeff Skilling. In oral arguments for *Skilling*, *Black*, and *Weyhrauch*, several Justices expressed this concern by asking hypothetical questions in which ordinary workers could be prosecuted under the statute for relatively innocuous acts. One example often cited was the worker who calls in sick in order to catch a game at the ballpark.[93] Before *Skilling*, the only thing that theoretically stood between a healthy worker in the upper deck and jail time was prosecutorial discretion. Now it seems clear that such minor ethical violations cannot be prosecuted under § 1346.

Of course, Congress has the option of speaking more clearly (as it did in response to *McNally*) by again amending § 1346. Indeed, pending legislation proposed by Senator Leahy, entitled the *Honest Services Restoration Act* seeks

89. Jed S. Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 DUQ. L. REV. 771, 771 (1980).

90. *See, e.g.*, Katie Durio, *United States Asks Court to Dismiss Charges in Poverty Point Reservoir Fraud Case*, KATC.COM, July 6, 2010, http://www.katc.com/news/united-states-asks-court-to-dismiss-charges-in-poverty-point-reservoir-fraud-case/ (last visited July 8, 2010).

91. Many lower courts in the aftermath of *McNally* agreed the ruling was entitled to retroactive application under *Davis v. United States*, 417 U.S. 333 (1974). However, this occurred prior to the Court's retooling of the retroactivity doctrine in regard to subsequent procedural changes. *See Teague v. Lane*, 489 U.S. 288 (1989). It remains to be seen how courts will characterize the retroactive effect of *Skilling*.

92. *See* Diane M. Duszak, Note, *Post*-McNally *Review of Invalid Convictions Through the Writ of Coram Nobis*, 58 FORDHAM L. REV. 979 (1990) (discussing the availability of the writ to those whose sentences had already been served).

93. *See* Transcript of Oral Argument at 36, 38-39, 41, 55, *Black v. United States*, No. 08-876 (June 24, 2010), *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/08-876.pdf.

to restore pre-*Skilling* law.[94] Indeed, some states are already taking up this challenge by considering laws that would expand the reach of honest-services fraud beyond bribes and kickbacks.[95] In any case, the federal prosecutor's trusty "Louisville Slugger"—traditional mail and wire fraud—still has plenty of heft to address the most serious ethical breaches, and if those breaches involve bribes or kickbacks, the indictment will almost certainly include theft of honest services.

As a final note, the *Skilling* opinion is also significant for its thorough analysis of the question of whether pretrial publicity and community prejudice in Houston, Texas—where Enron had been located—prevented Skilling from receiving a fair trial. The Court rejected this argument, holding that the district court was not required to change venue for Skilling's trial, and that Skilling suffered no prejudice by remaining in Houston. In dissent, Justice Sotomayor, joined by Justices Breyer and Stevens, expressed concern about the fairness of a Houston trial:

> The majority understates the breadth and depth of community hostility toward Skilling and overlooks significant deficiencies in the District Court's jury selection process. The failure of Enron wounded Houston deeply. Virtually overnight, what had been the city's "largest, most visible, and most prosperous company," its "foremost social and charitable force," and "a source of civic pride" was reduced to a "shattered shell."[96]

The Court's analysis on this subject will no doubt be invoked in any case involving high-profile defendants or controversial issues engendering public outrage.

94. Honest Services Restoration Act, S. 3854, 111th Congress (2010); *see also* Wagoner, Nicholas J., *Honest-Services Fraud: The Supreme Court Defuses the Government's Weapon of Mass Discretion in* Skilling v. United States (Jan. 3, 2011), 51 S. Tex. L. Rev. 1121, 2010 (Spring 2010), *available at* SSRN: http://ssrn.com/abstract=1734551 (discussing the impact of *Skilling* and the proposed Honest Services Restoration Act).

95. Legislators in New York recently introduced a type of honest services law that would create a "duty of faithful public service," defined as "[c]onduct that is free of self-dealing and free of unlawful or unauthorized conferral or intended conferral of a benefit to a public servant." Nicholas Confessore, *State Bill to Take on Public Corruption*, N.Y. Times, May 3, 2010, *available at* http://www.nytimes.com/2010/05/04/nyregion/ 04prosecute.html.

96. *Skilling*, 130 S. Ct. at 2942 (Sotomayor, J., dissenting).

## § 3.3.2 Direct proximate cause is required to support a civil RICO claim. *Hemi Group, LLC v. City of New York*

As more creative applications of the Racketeer Influenced and Corrupt Organizations Act (RICO) emerge, it is no surprise that state governments have turned to RICO in an effort to collect their tax revenue.[97] In *Hemi Group, LLC v. City of New York*,[98] New York City sued Hemi Group, a New Mexico-based online cigarette retailer, and its owner and officer, Kai Gachupin, alleging that the company's interstate sales and failure to file reports[99] containing purchaser information in New York State constituted mail and wire fraud sufficient to establish a pattern of racketeering activity under civil RICO provisions.[100] The district court dismissed the City's claims after determining that Gachupin did not have a duty to file the reports and, therefore, there was no predicate act that would support an allegation of an "enterprise."[101] The Second Circuit vacated the district court's opinion, concluding that Gachupin and Hemi operated as an "enterprise" by failing to file the Jenkins Act material with the State.[102] The Second Circuit also decided an issue that the district court did not reach, holding that lost tax revenue constituted an injury to "business or property" sufficient to support a RICO claim under § 1964.[103]

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97. Perhaps one of the most creative RICO claims and one that relied on the Supreme Court's decision in *Hemi* is *Pankros v. Tyler*, 929 N.E.2d 1217 (Ill. App. 2010), in which the plaintiff alleged that the (former) owners of a tavern knew that the plaintiff's ex-husband had both a drinking and gambling problem and subsequently charged the husband's credit card for food and beverage charges (instead of gambling) and thereby received funds from the plaintiff's marital estate. The Illinois Appellate Court ultimately rejected the plaintiff's claim because the theory of causation extended too far and the injury was too remote. *See Pankros*, 929 N.E.2d at 11-16.

98. *Hemi Group, LLC v. City of New York*, 130 S. Ct. 983 (2010).

99. The Jenkins Act, 15 U.S.C. §§ 375-378, requires out-of-state sellers to submit customer information to the states into which they ship cigarettes, and New York State has agreed to forward that information to New York City. That information helps the City track down cigarette purchasers who do not pay their taxes.

100. 18 U.S.C.S. § 1961 *et seq*. RICO provides a private cause of action for "[a]ny person injured in his business or property by reason of a violation of section 1962 of this chapter." 18 U.S.C. § 1964(c). Section 1962, in turn, contains RICO's criminal provisions. Specifically, § 1962(c) makes it "unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate . . . commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity." "[R]acketeering activity" is defined to include a number of so-called predicate acts, including mail and wire fraud. *See* 18 U.S.C. § 1961(1).

101. *City of New York v. Nexicon, Inc*., No. 03 CV 383 (DAB), 2006 WL 647716 (S.D.N.Y. Mar. 15, 2006), *aff'd in part, vacated in part*, 541 F.3d 425 (2nd Cir. 2008), *rev'd*, 130 S. Ct. 983 (2010).

102. *City of New York v. Smokes-Spirits.com, Inc*., 541 F.3d 425, 447-48 (2nd Cir. 2008), *rev'd*, 130 S. Ct. 983 (2010).

103. *Id*. at 444-45.

Reversing, the Supreme Court held that there was no viable RICO claim because the City's injuries were not caused by the failure to file the reports and could not be caused "by reason of" such failure.[104]

The *Hemi* decision is a reiteration of the causation standard on which the Court relied in which the several previous cases. Beginning with *Holmes v. Securities Investor Protection Corp*., 503 U.S. 258 (1992), the causation in civil RICO cases has included a proximate cause analysis, which requires a direct causal connection between the injury and the alleged RICO violation. In *Anza v. Ideal Steel Supply*, 547 U.S. 451 (2006), Ideal Steel Supply brought a RICO claim against a competitor that failed to charge New York sales tax and that subsequently offered lower prices to its customers, giving it a competitive edge over Ideal.

The Court ultimately disallowed the claim because the connection between the plaintiff's harm (offering lower prices) and the RICO violation (defrauding New York taxing authorities) was too attenuated.[105] In contrast, in *Bridge v. Phoenix Bond & Indemnity Co.*, the Court found a sufficient connection between the injury and the harmful behavior when the defendants violated a rule preventing agents from submitting bids in a tax lien sale and filed false compliance attestations and, by doing so, received more liens for themselves because bids were awarded on a rotational basis.[106] In this case, the harm to plaintiffs, i.e., the loss of valuable liens, was a direct result of the defendant's fraudulent behavior.[107]

Ultimately, the Court's holding in *Hemi* solidifies the rule that foreseeable harm will be insufficient to support a civil RICO claim—only harm directly caused by the predicate acts will satisfy the proximate cause analysis under the civil RICO statute.[108] In *Hemi*, the harm was clearly indirect. The City's theory ultimately rested on a long chain of events: Hemi failed to file the reports with New York State; without the reports, New York State could not pass them to the City of New York; because the City of New York did not receive the reports, it could not determine who owed taxes; and as a result, the City could not pursue those taxpayers and lost tax revenue.[109] Summing up *Hemi*, Chief Justice Roberts, writing for the majority, stated: "It is about the RICO liability of a company for lost taxes it had no obligation to collect, remit, or pay, which harmed a party to whom it owed no duty."[110] Following that logic, the Court makes it clear that where the liability stems from separate actions carried out by separate parties, there is an insufficient causal connection between the harm alleged and the RICO violation.[111] Justice Stevens and Justice Kennedy joined

104. *Hemi Group*, 130 S. Ct. at 987.
105. *Anza v. Ideal Steel Supply*, 547 U.S. 451, 458-60 (2006).
106. *Bridge v. Phoenix Bond & Indemnity Co.*, 553 U.S. 639 (2008).
107. *See id.*
108. *Hemi Group*, 130 S. Ct. 983.
109. *Id*. at 989.
110. *Id*. at 994.
111. *Id*. at 990.

in a dissenting opinion by Justice Breyer that insists harm that is "reasonably foreseeable" is still within the realm of proximate cause.[112]

Because the Court declined to decide whether a loss of tax revenue could constitute an injury to "business or property," even if a taxing authority could meet the RICO causation requirements, it remains unclear if such a claim would be successful.[113] The Supreme Court has held that under the criminal RICO statute, Canada's right to uncollected excise taxes—an entitlement to collect money and something of value—is "property" according to ordinary definitions of the word.[114] Whether this transcends to the civil RICO statutes is unclear.[115]

## § 3.3.3 Circuit Split: Can the doctrine of unclean hands apply to bar a RICO claim?

RICO was originally enacted in 1970 to combat the Mafia. Applied more broadly in the years since its enactment, RICO makes illegal the acquisition or investment of income derived from "a pattern of racketeering activity or through collection of an unlawful debt," or to participate in or have an interest in an entity that conducts "a pattern of racketeering activity or collection of an unlawful debt" that affects interstate or foreign commerce.[116]

Despite RICO's broad reach—or perhaps because of it—one issue that continues to plague lower courts is whether the equitable doctrine of unclean hands can apply to bar a RICO claimant from recovery if that plaintiff is himself "'guilty of any inequitable or wrongful conduct with respect to the transaction or subject matter sued on.'"[117] In the last two decades, circuit courts have split over this issue, sometimes avoiding the question by finding that, regardless of whether the doctrine of unclean hands applies in general, the plaintiffs in the specific cases before them did *not* have unclean hands.

For example, the First Circuit stated in the 1996 case *Roma Construction Co. v. Arusso* that it would not reach the issue because even assuming the doctrine did apply (an assumption with which it hinted it did not necessarily agree), the plaintiffs, who made extortion payments to town officials, did not have unclean hands when they paid only begrudgingly to protect their investments, ceased making payments as soon as was practical, and cooperated with the FBI.[118] On

112. *Id*. at 995-1002 (Breyer, J., dissenting).

113. *See id.* at 988.

114. *See Pasquantino v. United States*, 544 U.S. 349, 355-56 (2005).

115. The Second and Eighth Circuits have both dismissed cases in which foreign countries sought damages under the civil RICO statutes, because of the revenue rule prohibiting adjudication of tax claims brought by a different sovereign. *See Attorney General of Canada v. Reynolds*, 268 F.3d 103 (2nd Cir. 2001); *Republic of Honduras v. Philip Morris Co*., 341 F.3d 1253 (11th Cir. 2003).

116. 18 U.S.C. § 1962.

117. *Smithfield Foods, Inc. v. United Food & Commercial Workers Int'l Union*, 593 F. Supp. 2d 840, 847 (E.D. Va. 2008) (quoting *WorldCom, Inc. v. Boyne*, 68 F. App'x 447, 451 (4th Cir. 2003)).

118. *Roma Constr. Co. v. Arusso*, 96 F.3d 566, 569–75 (1st Cir. 1996).

the other hand, in *Sikes v. Teleline, Inc*. from 2002, the Eleventh Circuit posited in a footnote, "the possibility that the plaintiffs may be barred from bringing [a RICO claim based on illegal gambling] by the 'unclean hands' doctrine."[119] But like the First Circuit, the Eleventh Circuit did not rule on the question of whether the unclean hands doctrine applies, and further suggested that exceptions might exist if a plaintiff could prove it was an "unwitting participant," as the plaintiffs in that case had alleged.[120]

In *Laborers' Int'l Union v. Caruso*, with a cursory finding that the plaintiffs did not have unclean hands based on acts done in cooperation with the government after facing RICO charges themselves, the Seventh Circuit implied that the doctrine *was* applicable in RICO suits.[121] Finally, the Third Circuit held in *Northeast Women's Center, Inc. v. McMonagle*,[122] that if the doctrine of unclean hands is to apply, it must be addressed to conduct relating to the matter being litigated. Because the admitted wrongful conduct attributable to the plaintiff related to a matter wholly collateral to the defendants' acts that violated RICO (i.e., plaintiff's violation of a state medical statute was collateral to defendants' repeated and aggressive trespasses, harassment, and destruction of property), the unclean hands doctrine simply did not apply to those facts—suggesting that on other facts it would.[123]

Although not before the Supreme Court this term, the issue seems ripe for resolution. Acknowledging that RICO was "designed to advance important public policies,"[124] the Court has ruled that in other contexts, such as litigation over age discrimination and antitrust violations, the doctrine of unclean hands will *not* apply to bar *all* relief where Congress has authorized "broad equitable relief to service important national policies" or public purposes. [125]

However, the Court has also held that in such a situation, a plaintiff's misconduct is not entirely "irrelevant to all the remedies otherwise available under the statute."[126] In *McKennon*, the plaintiff brought suit under the Age Discrimination in Employment Act (ADEA),[127] alleging she was fired because of her age.[128] Through discovery, the defendant employer learned that the plaintiff had copied and shared the company's confidential financial information, conduct that itself would have legitimately resulted in her immediate termination.[129] The Court held that, although the plaintiff had unclean hands, she was entitled to relief

119. *Sikes v. Teleline, Inc*., 281 F.3d 1350, 1366 n.41 (11th Cir. 2002), *cert. denied*, 537 U.S. 884 (2002), *abrogated by Bridge v. Phoenix Bond & Indem. Co.*, 553 U.S. 639 (2008) (resolving circuit split over whether first-party reliance is an element of a civil RICO claim predicated on mail fraud).

120. *Id.*

121. *Laborers' Int'l Union v. Caruso*, 197 F.3d 1195, 1197–98 (7th Cir. 1999).

122. *Ne. Women's Center, Inc. v. McMonagle*, 868 F.2d 1342 (3d Cir. 1989).

123. *Id.* at 1353–55.

124. *Gilmer v. Interstate/Johnson Lane Corp*., 500 U.S. 20, 28 (1991).

125. *McKennon v. Nashville Banner Publ'g Co*., 513 U.S. 352, 360 (1995).

126. *Id.*

127. 29 U.S.C. § 621 *et seq*.

128. *McKennon*, 513 U.S. at 354.

129. *Id.* at 355.

under the ADEA because the employer admitted that the original termination decision was made on the basis of age at a time when they did not know of the confidentiality breaches.[130] However, the Court also held that her misconduct should have been taken into account, so the Court reversed and remanded to appropriately limit her damages recoverable under the ADEA, thus balancing the "duality between the legitimate interests of the employer and the important claims of the employee."[131]

Given the Court's holding in *McKennon*, should the Court grant certiorari in the future to resolve the circuit split on this issue, it seems unlikely that it would adopt a bright-line rule that the doctrine of unclean hands either does or does not apply in wholesale fashion to RICO actions. Instead, it is possible the Court might apply *McKennon* to rule that, where appropriate, a RICO claimant guilty of unclean hands could receive a *limited* recovery, though a recovery nonetheless. Such a decision might cause would-be litigants to think twice before bringing RICO claims if there is a possibility they could be accused of wrongdoing themselves, thus reducing the potential value of their claim. The flip side, of course, is that such plaintiffs would still be granted some sort of relief for their troubles. Until such a case comes before the Court for adjudication, lower courts are left to make the hard decisions in their jurisdictions as best they can.

## § 3.4 Financial Services and SEC Regulation

With the Dodd-Frank Wall Street Reform and Consumer Protection Act[132] (Dodd-Frank), which was signed into law by President Obama on July 21, 2010, Congress passed sweeping financial reform that subjects more financial companies to federal oversight, regulates derivatives contracts, and creates a panel charged with detecting risks to the financial system[133] as well as a consumer protection regulator.[134] The Supreme Court's opinions over the last year provide some insight into how federal courts, including the Supreme Court, may review these new financial reforms in the judicial challenges that are sure to follow. These rulings reflect the Court's reluctance to endorse government intervention into business—but an equal reluctance to strike them down wholesale—and may

130. *Id.* at 356–60.

131. *Id.* at 360–63.

132. Pub. L. No. 111-203, 124 Stat. 1376 (2010). The full text of Dodd-Frank is available at http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

133. Dodd-Frank created a council of regulators called the "Financial Stability Oversight Council," which is led by the Treasury Secretary and is responsible for identifying threats to the financial system.

134. Dodd-Frank also created the "Consumer Financial Protection Bureau," which will be housed at the Federal Reserve and will oversee consumer products and services, from mortgages to credit cards to check cashing.

well provide helpful analysis to parties seeking to undo some of Congress's financial reforms through litigation.

## § 3.4.1 The Supreme Court strikes down part of Sarbanes-Oxley as an unconstitutional restriction on the President's executive powers. *Free Enterprise Fund v. Public Company Accounting Oversight Board*

In the first case, *Free Enterprise Fund v. Public Company Accounting Oversight Board*,[135] the Supreme Court considered a constitutional challenge under the separation-of-powers doctrine[136] to the Public Company Accounting Oversight Board (PCAOB), which was created by the Sarbanes-Oxley Act as part of a series of accounting reforms in 2002 in the wake of the Enron and WorldCom debacles. The PCAOB was responsible for overseeing, examining, and disciplining accounting firms. Although a private nonprofit corporation, the PCAOB administered federal laws relating to the accounting firms. PCAOB was created with a double "for cause" tenure structure: Board members could only be removed by SEC Commissioners for good cause, and in turn the Commissioners could only be removed by the President for good cause. As a result, PCAOB members were effectively removed from the executive branch's direct control.

The *Free Enterprise Fund* case grew out of a PCAOB investigation into an accounting firm that resulted in an unfavorable report. The firm, joined by a nonprofit accounting organization, filed suit seeking a declaratory judgment that PCAOB violated the constitutional doctrine of separation of powers because it limited the President's ability to dismiss PCAOB members. The district court rejected this argument and held the PCAOB's structure was constitutional.[137] A divided Court of Appeals for the District of Columbia Circuit affirmed, ruling that the double-tenure structure was permissible because the PCAOB was subject to SEC influence, which in turn was subject to presidential control.[138]

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135. *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 130 S. Ct. 3138 (2010).

136. The U.S. Constitution divides the federal government's power "into three defined categories, Legislative, Executive, and Judicial." *INS v. Chadha*, 462 U.S. 919, 951 (1983). In relevant part, Article II of the Constitution vests "[t]he executive Power . . . in a President of the United States of America," who must "take Care that the Laws be faithfully executed." Art. II, § 1, cl. 1; *id*., § 3.

137. *Free Enter. Fund v. Public Co. Accounting Oversight Bd*., No. 06-0217 (JR). 2007 U.S. Dist. LEXIS 24310 (D.D.C. Mar. 21, 2007), *aff'd*, 537 F.3d 667 (2008), *aff'd in part, rev'd in part*, 130 S. Ct. 3138 (2010).

138. *Free Enter. Fund v. Public Co. Accounting Oversight Bd*., 537 F.3d 667 (D.C. Cir. 2008), *aff'd in part, rev'd in part*, 130 S. Ct. 3138 (2010).

> In a dissenting opinion, Circuit Judge Kavanaugh wrote that "[d]isputes over the scope of the President's appointment and removal powers have arisen sporadically throughout American history. This latest chapter involving the Public Company Accounting Oversight Board is the most important separation-of-powers case regarding the President's appointment and removal powers to reach the courts in the last 20 years."[139] Judge Kavanaugh's dissent set forth a thorough constitutional analysis and the reasoning upon which he would "hold that the PCAOB's structure unconstitutionally restricts the President's appointment and removal powers."[140]

The Supreme Court must have found Judge Kavanaugh's analysis to be persuasive—at least in part. In a 5-4 opinion written by Chief Justice Roberts, the Supreme Court reversed the court of appeals' opinion in part, and affirmed in part.[141] Noting that the President's executive power under the Constitution includes the ability to appoint, oversee, and remove inferior executive officers,[142] the Court held that the Commissioners' inability to remove Board members at will, coupled with the President's inability to remove the Commissioners at will, positioned the PCAOB at an unconstitutional distance from the executive branch's control.

The Court acknowledged that while it had upheld limitations on the President's ability to remove inferior officers in the past, those cases involved only one level of tenure-protection: "It was the President—or a subordinate he could remove at will—who decided whether the officer's conduct merited removal under the good-cause standard."[143] The double "for cause" structure set the PCAOB apart from these other cases. The Court went on to note that the double "for cause" structure impermissibly expanded Congress's power while diminishing the President's. Upholding this structure would empower Congress "to shelter the bureaucracy" by adding several layers of "for cause" tenure to inferior executive positions.[144] The Court declined, however, to hold the PCAOB itself unconstitutional, and instead limited its opinion to the double "for cause" tenure provisions.

Justice Breyer (joined by Justices Stevens, Ginsburg, and Sotomayor) wrote a dissenting opinion, which he read from the bench.[145] Looking to the text of the Constitution, Justice Breyer argued that its text does not answer the question of how much Congress can insulate federal officials from Presidential removal

139. *Id.* at 685 (Kavanaugh, J., dissenting).

140. *Id.* at 715 (Kavanaugh, J., dissenting).

141. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138 (2010).

142. Article II vests the President with the executive power. Art. II, § 1, cl. 1. "Since 1789, the Constitution has been understood to empower the President to keep these officers accountable—by removing them from office, if necessary." *Free Enter. Fund*, 130 S. Ct. at 3146 (citing *Myers v. United States*, 272 U.S. 52 (1926)).

143. *Free Enter. Fund*, 130 S. Ct. at 3153.

144. *Id.* at 3154.

145. *Id.* at 3164 (Breyer, J., dissenting).

powers. Instead of the bright-line rule the majority adopts here, Breyer would have adopted a more functional approach in which the judiciary should defer to the political branches, which in this case together agreed to confer the protections at issue. Because, in the dissent's view, even under two layers of "good cause" protection the President has practical ways of controlling the board other than removal, it is not unconstitutional.

The ramifications of *Free Enterprise Fund* are difficult to assess. One could argue that the Court's ruling dampens Congress's governmental regulation of business. Indeed, several commentaries suggest *Free Enterprise Fund* might begin the process of dismantling Sarbanes-Oxley.[146] From a more jurisprudential perspective, some view *Free Enterprise Fund* as a signal by the Court of its disfavor for congressional efforts to insulate independent administrative bodies from presidential control (an act of particular importance as administrations of different parties come and go). However, the notion that *Free Enterprise Fund* signals a retreat from regulation must be tempered for three reasons. First, the PCAOB regulates only accounting firms. Any effect on other businesses themselves would be indirect. Second, there is no guarantee that increased risk of termination will cause PCAOB members to be any less stringent in enforcing regulations. Finally, the *Free Enterprise Fund* opinion reflects the Court's reluctance to grant a wholesale constitutional challenge to financial reform legislation. As it stands, *Free Enterprise Fund* might signal less governmental regulation of business—but any definitive statement on this point would be premature.

## § 3.4.2 The Supreme Court clarifies the standard for determining when a mutual fund adviser's excessive fee may be a breach of fiduciary duty. *Jones v. Harris Associates L.P.*

In *Jones v. Harris Associates L.P.*, the Supreme Court clarified the standard for determining whether a mutual fund adviser breaches his fiduciary duty to the fund by receiving a disproportionately large fee.[147]

146. Grant Gross, *Supreme Court Strikes Down One Part of Sarbanes-Oxley*, PC WORLD (June 28, 2010), *available at* http://www.pcworld.com/businesscenter/article/200003/supreme_court_strikes_down_one_part_of_sarbanesoxley.html; Frank Ahrens, *Part of Sarbanes-Oxley Struck Down, But is the Rest of the Law Worth Keeping?*, WASH. POST (June 28, 2010), *available at* http://voices.washingtonpost.com/economy-watch/2010/06/part_of_sarbanes-oxley_struck.html; Daniel Fisher, *Supreme Court Curbs Enron-Related Accounting Board*, FORBES (June 28, 2010), *available at* http://blogs.forbes.com/docket/2010/06/28/supreme-court-curbs-enron-related-accounting-board.

147. *Jones v. Harris Associates L.P.*, 130 S. Ct. 1418 (2010).

Mutual funds are typically created by an adviser. "The adviser selects the fund's directors, manages the fund's investments, and provides other services."[148] This relationship between the mutual fund and its adviser makes arm's-length negotiations on adviser compensation difficult, if not impossible. Congress enacted the Investment Company Act of 1940 (ICA) to address this conflict of interest. The ICA, which regulates investment companies (including mutual funds), sets forth certain protections for shareholders, including a rule that no more than 60 percent of a mutual fund's directors can have an interest in or affiliation with the investment adviser.[149] The ICA also treats investment advisers as fiduciaries to their mutual funds and imposes certain duties on advisers when negotiating their compensation.[150]

In *Jones*, mutual fund shareholders claimed that the fund's adviser had breached its fiduciary duty by accepting excessive fees in violation of the ICA. Granting summary judgment for the investment adviser,[151] the district court applied the standard set forth in *Gartenberg v. Merrill Lynch Asset Management, Inc.*, which asks "whether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length in the light of all of the surrounding circumstances."[152] Applying this standard, the district court held that the plaintiffs' claims should be dismissed because they did not raise a fact question regarding whether fees charged "were so disproportionately large that they could not have been the product of arm's-length bargaining."[153]

On appeal, the Seventh Circuit affirmed the district court's dismissal of the claims but rejected its reliance on *Gartenberg*.[154] Instead, the circuit court emphasized the importance of full disclosure to the mutual fund board of all facts necessary to make an informed decision on the adviser's fee. In emphasizing disclosure, the panel criticized the *Gartenberg* analysis for ignoring the role markets play in setting adviser compensation, and held that the amount of the adviser's fee would be relevant only if it were so unusual that it gave rise to an inference of deceit. The Seventh Circuit denied a motion for rehearing en banc with an equally divided court.

In a unanimous opinion by Justice Alito, the Supreme Court reversed the Seventh Circuit. The Court's opinion began by noting that most circuits had adopted the *Gartenberg* standard, but that they were split on its proper application.[155] In order to resolve this split, the Court clarified the adviser's fiduciary duties under the ICA: when setting the fee, the adviser's "fiduciary duty" to the mutual fund is satisfied when all circumstances show that "'the transac-

148. *Id.* at 1422.
149. 15 U. S. C. § 80a-10(a); § 80a-2(a)(19).
150. 15 U.S.C. § 80a-35(b).
151. *Jones v. Harris Assocs. L.P.*, No. 04-C-8305, 2007 U.S. Dist. LEXIS 13352 (N.D. Ill. Feb. 27, 2007).
152. *Gartenberg v. Merrill Lynch Asset Mgmt, Inc.*, 694 F.2d 923 (2nd Cir. 1982).
153. *Jones*, 2007 U.S. Dist. LEXIS 13352 at *22, 27-28.
154. *Jones v. Harris Assocs. L.P.*, 527 F.3d 627 (7th Cir. 2008).
155. *Jones*, 130 S. Ct. at 1425.

tion carries the earmarks of an arm's length bargain.'"[156] However, the Court noted that the ICA had modified the legal duty "in a significant way: it shifts the burden of proof from the fiduciary to the party claiming breach, 15 U.S.C. § 80a-35(b)(1), to show that the fee is outside the range that arm's-length bargaining would produce."[157]

The Court then described how this standard should operate. The ICA emphasizes full and complete disclosure of all facts necessary for the mutual fund board to make an informed decision on adviser pay. Buttressed by disinterested directors acting as "independent watchdogs," the board would regulate the potential conflict of interest between the mutual fund and the adviser in setting adviser compensation. But in order to do so, *Gartenberg* requires that mutual fund boards be aware of "'all information reasonably . . . necessary to evaluate the terms' of the adviser's contract."[158]

When this standard is met, the Supreme Court emphasized that the lower courts should afford board determinations of adviser compensation due deference. However, this deference is not absolute—"the appropriate measure of deference varies depending on the circumstances."[159] The Court clarified that the "appropriate measure of deference" is a function of board "procedure and substance."[160] In other words, a board with robust methods of setting adviser compensation is owed far more deference than a board whose procedure is deficient or which lacks full and complete disclosure of all relevant facts.[161]

In concluding its opinion, the Court admonished lower courts to avoid overturning mutual fund board determinations simply because they disagree with the results reached. Emphasizing the necessity of deference, the Court noted that the judicial system is "not well suited to make . . . precise calculations" when it comes to setting adviser compensation.[162]

On the one hand, *Free Enterprise Fund*'s emphasis on deference to board decisions on compensation reflects a reluctance to second-guess business decisions. This view is supported by the Court's (1) view that mutual fund boards, populated by vigilant disinterested directors, are capable of setting proper adviser fees and therefore are owed deference, and (2) the district courts' inability to make determinations of appropriate adviser fees. On the other hand, in reversing the Seventh Circuit, the Supreme Court rejected a "markets solve all" theory, which would have been much more deferential to compensation decisions.

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156. *Id.* at 1427 (quoting *Pepper v. Litton*, 308 U.S. 295, 306-307 (1939)).

157. *Id.*

158. *Id.* at 1428 (quoting *Gartenberg*).

159. *Id.*

160. *Id.* at 1429.

161. In elaborating upon "all relevant facts," the Court cautioned that comparisons between adviser fees charged to a captive mutual fund and fees charged to independent clients may not be beneficial. These comparisons may not be helpful because services for a mutual fund could be different than those given to independent clients. Comparisons between fees charged by multiple or different advisers are suspect for the same reason as well.

162. *Jones*, 130 S. Ct. at 1430.

## § 3.4.3 The Supreme Court will address consumer credit card notice requirements under the Truth in Lending Act. *McCoy v. Chase Manhattan Bank, USA*

The Supreme Court recently granted review in *McCoy v. Chase Manhattan Bank, USA*, a consumer class action lawsuit that addresses notice requirements under the Truth in Lending Act (TILA).[163] The Ninth Circuit held in *McCoy* that the version of TILA that was in effect before 2009 requires creditors to give credit card holders notice that their interest rates had increased due to a default even though the customer agreement disclosed the possibility of an increase. Whatever the Supreme Court decides, the Court's opinion will certainly bear upon the Court's pro-business reputation and give insight into the Court's view of legislative finance reforms aimed at protecting consumers from predatory lending.

"Congress enacted TILA to 'assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.'"[164] The Federal Reserve Board (FRB), the agency charged with implementing TILA, adopted "Regulation Z," which addresses when and how a credit card company must notify a cardholder of changes in terms.[165] Regulation Z reads in relevant part as follows:

> Whenever any term required to be disclosed under § 226.6 is changed or the required minimum periodic payment is increased, the creditor shall mail or deliver written notice of the change to each consumer who may be affected . . . at least 15 days prior to the effective date of the change. The 15-day timing requirement does not apply if the change has been agreed to by the consumer, or if a periodic rate or other finance charge is increased because of the consumer's delinquency or default; the notice shall be given, however, before the effective date of the change.[166]

Section 226.6, in turn, requires that a creditor disclose "each periodic rate that may be used to compute the finance charge."[167]

In *McCoy*, the plaintiff sued Chase Manhattan Bank, USA, N.A. (Chase), individually and on behalf of others similarly situated, claiming that Chase

163. *McCoy v. Chase Manhattan Bank, USA*, 559 F.3d 963 (9th Cir. 2009), *cert. granted*, 130 S. Ct. 3451 (2010).

164. *Id.* at 964 (quoting 15 U.S.C. § 1601(a)).

165. 12 C.F.R. § 226.9(c)(1) ("Regulation Z").

166. *Id.*

167. 12 C.F.R. § 226.9(a)(2).

violated TILA's notice requirement by retroactively increasing, without notice, his interest rate as a result of a late payment to Chase or another creditor. Chase responded that it was not required to provide TILA notice because the governing Cardmember Agreement disclosed the possibility of a rate increase in the event of a missed payment.

The case turned on the interpretation of Regulation Z's phrase "any term required to be disclosed under § 226.6." Chase argued that Regulation Z only required that it give the cardholder notice of the contractual terms in the Cardmember Agreement. McCoy argued that Regulation Z required more detailed disclosure, including notice that the cardholder's interest rate had increased due to missed payments. Rejecting the plaintiff's interpretation, the district court dismissed the complaint, holding that the Cardmember Agreement provided all requisite TILA notice.[168]

The Ninth Circuit reversed on the TILA issue.[169] Finding the regulation to be ambiguous, the Court cited the rule that federal courts will defer to an agency's interpretation of its own ambiguous regulations as long as it is not "'plainly erroneous or inconsistent with the regulation.'"[170] After analyzing FRB commentary interpreting Regulation Z, the Court rejected Chase's interpretation, and held that Chase had violated TILA by not giving contemporaneous notice of the retroactive rate hike that occurred due to creditor default.[171] In a dissent, Circuit Judge Cudahy criticized the majority for what he viewed as a lack of deference to the FRB's interpretation of its rule.

*McCoy* is the first and only case interpreting Regulation Z to require notice in addition to what is stated in a credit card customer agreement. *McCoy* departs from the accepted interpretation of Regulation Z espoused by numerous

168. *McCoy v. Chase Manhattan Bank USA*, No. SACV 06-107 JVS (RNBx), 2006 U.S. Dist. LEXIS 97257 (C.D. Cal. Aug. 10, 2006), *aff'd in part, rev'd in part*, 559 F.3d 963 (9th Cir. 2009), *cert. granted*, 130 S. Ct. 3451 (2010).

169. The Ninth Circuit's opinion was not limited to the TILA issue. *McCoy* also involved state claims brought under Delaware's Banking Act. The Ninth Circuit held that the Cardmember Agreement's rate increases violated the Banking Act because discretionary increases of interest rates were not permitted under the Act. As a result, McCoy had stated a colorable claim that the Cardmember Agreement's provisions allowing for discretionary rate hikes were unconscionable and that "he should be afforded a reasonable opportunity to present evidence as to the commercial setting, purpose, and effect to aid the court in making its determination" regarding damages. *McCoy*, 559 F.3d at 969-72. However, the Ninth Circuit affirmed the district court's dismissal of McCoy's state claims for fraud and breach of the implied duty of good faith.

170. *McCoy*, 559 F.3d at 965 (quoting *Auer v. Robbins*, 519 U.S. 452, 461 (1997), which in turn cites *Robertson v. Methow Valley Citizens Council*, 490 U.S. 332, 359 (1989)).

171. The plaintiff relied on Comment 3 to Regulation Z, which states that "a notice of change in terms is required . . . if there is an increased periodic rate or any other finance charge attributable to the consumer's delinquency or default." 12 C.F.R. § 226.9(c)(1), cmt. 3. In response, Chase relied on Comment 1, which detailed the circumstances under which notice was not needed. Comment 1 states that no "notice of a change in terms need be given if the specific change is set forth initially." 12 C.F.R. § 226.9(c), cmt. 1. Chase argued that under Comment 1, the possibility of a rate hike was disclosed in the Cardmember Agreement and so no subsequent notice was required. The Ninth Circuit rejected Chase's argument and held that Comment 3 governed the case. *McCoy*, 559 F.3d at 965-68.

district courts—that FRB commentary indicated that no notice is necessary.[172] Indeed, after *McCoy* was decided, the First Circuit issued its opinion in *Shaner v. Chase Bank USA, N.A.*, which reached the opposite conclusion in part based on an amicus filed by the FRB confirming it did not view TILA notice to be required prior to a rate hike where it was previously disclosed in the governing Cardmember Agreement.[173]

To be sure, the circuit split caused great consternation for banks. As argued in an amicus brief filed by the American Bankers Association, credit card companies had come to rely on the interpretation in providing TILA notice.[174] As the American Bankers Association amicus brief notes: "The Ninth Circuit's decision to reject the Board's construction of Regulation Z, as expressed in its Official Commentary and in administrative rulemakings, directly affects the continued ability of financial institutions to safely rely on Board guidance in connection with TILA."[175]

Significantly, as with a number of other recent business cases, the Court invited the Solicitor General to file an amicus expressing the views of the United States on whether certiorari should be granted.[176] The Solicitor General filed an amicus encouraging reversal of the Ninth Circuit's opinion, particularly in light of the FRB's amicus in the *Shaner* case.[177] At argument on December 8, 2010, questioning from the justices seemed to indicate that reversal is likely. In light of these signals, the Ninth Circuit's pro-consumer opinion in *McCoy* may be short-lived.

*Update: the Ninth Circuit's opinion was indeed short-lived. On January 24, 2011, the Supreme Court reversed and remanded in a unanimous opinion authored by Justice Sotomayor, holding that, before 2009, credit card companies were not required to notify cardholders in writing before they raise interest rates.*[178] *Of course, under the Federal Reserve Board's Regulation Z, now they do—but before 2009, the Court held, the regulation was not explicit on this point.*

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172. *McCoy*, 559 F.3d at 968-69 ("[A]lthough no binding authority has addressed this question, several district court opinions and one unpublished memorandum disposition in this circuit have accepted Chase's view.") (citing *Evans v. Chase Bank USA, N.A.*, 267 Fed. App'x 692, 693 (9th Cir. 2008) (unpublished disposition); *Swanson v. Bank of America*, 566 F. Supp. 2d 821 (N. D. Ill. 2008); *Williams v. Wash. Mut. Bank*, 2008 U.S. Dist. LEXIS 5325 (E.D. Cal. Jan. 10, 2008); *Shaner v. Chase Bank, USA, N.A.*, 570 F. Supp. 2d 195, 200 (D. Mass. 2008); *Evans v. Chase Manhattan Bank USA, N.A.*, 2006 U.S. Dist. LEXIS 5259 (N.D. Cal. Jan. 27, 2006)).

173. *Shaner v. Chase Bank USA, N.A.*, 587 F.3d 488 (1st Cir. Mass. 2009).

174. Brief of the American Bankers Association as *Amicus Curiae* in Support of Petitioner, *Chase Bank USA v. McCoy* (No. 09-329), *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/09-10/09-329_PetitionerAmCuAmericanBankersAssociation.pdf.

175. *Id.*

176. *Chase Bank USA, N.A. v. McCoy*, 130 S. Ct. 1317 (2010).

177. Brief for the United States as Amicus Curiae Supporting Petitioner, *Chase Bank USA, N.A. v. McCoy*, *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/09-10/09-329_PetitionerAmCuUSA.pdf.

178. *Chase Bank USA, N.A. v. McCoy*, 131 S. Ct. 871 (2011).

## § 3.4.4 In *Bloomberg* and *Fox News Network*, the Supreme Court may decide whether the Federal Reserve is required by the FOIA to disclose detailed information to the media about loans made to banks in the 2008 financial bailout

As of the date of this writing, petitions for writ of certiorari are currently pending before the Supreme Court in a pair of cases that seek disclosure of sensitive documents detailing the $2 trillion in emergency bailout loans given by the Federal Reserve to banks in the early stages of the financial collapse, including the March 2008 sale of Bear Stearns to JPMorgan Chase.

In *Bloomberg v. Board of Governors of the Federal Reserve System*,[179] and the related proceeding *Fox News Network, LLC v. Board of Governors of the Federal Reserve System*,[180] the Second Circuit held that the Federal Reserve Banks' Board of Governors (the Board) was required to comply with requests made under the Freedom of Information Act[181] (FOIA) seeking information about emergency loans made by the Federal Reserve Banks in Fall 2007 through Spring 2008. In *Bloomberg*, Bloomberg News submitted FOIA requests to the Board for (1) the name of each borrowing bank; (2) the amount of the loan; (3) origination and maturation dates; and (4) the collateral. *Fox News* involved similar facts except Fox News sought information from August 2007 to November 2008.

The Board denied the FOIA requests, claiming that responsive documents in its possession were protected by FOIA "Exemption 4." FOIA Exemption 4 allows a government agency to refuse disclosure of "trade secrets and commercial or financial information obtained from a person and privileged or confidential."[182] Under Second Circuit precedent, Exemption 4 applies if a three-part test is met: "(1) The information for which exemption is sought must be a trade secret or commercial or financial in character; (2) it must be obtained from a person; and (3) it must be privileged or confidential."[183]

The district courts considering *Bloomberg* and *Fox News* reached different results. The district court in *Bloomberg* granted summary judgment for the

179. *Bloomberg v. Board of Governors of the Federal Reserve System*, 601 F.3d 143 (2d Cir. 2010) (petition for writ of certiorari filed Nov. 18, 2010).

180. *Fox News Network, LLC v. Board of Governors of the Federal Reserve System*, 601 F.3d 158 (2d Cir. 2010) (petition for writ of certiorari filed Nov. 18, 2010).

181. The FOIA empowers federal district courts to compel the production of improperly withheld "agency records" in response to a FOIA request. 5 U.S.C. § 552(a)(4)(B). If these three criteria are not met, the district court lacks jurisdiction to force an agency to comply with an FOIA request.

182. 5 U.S.C. § 552(b)(4).

183. *Bloomberg*, 601 F.3d at 147 (quoting *Nadler v. FDIC*, 92 F.3d 93, 95 (2d Cir. 1996)).

plaintiff, holding that Exemption 4 did not apply.[184] The lower court in *Fox News*, however, concluded that the requested information was exempt and that the Board was therefore not required to produce the information.[185]

Beginning with *Bloomberg*, the Second Circuit affirmed the district court, and held that the information requested (bank identity, loan amount, origination/maturity dates, and collateral securing the loan) was not covered by Exemption 4 and therefore had to be disclosed. First, the Court analyzed and rejected the Board's argument that the FOIA request sought information from the borrowing banks that did not qualify as "agency records" subject to FOIA disclosure. Unpersuaded, the Second Circuit found that the requests sought documents "generated within a Federal Reserve Bank upon its decision to grant a loan."[186] Even though one could make inferences about the borrowing banks based on these documents, the FOIA requests were legitimate because they did not seek information from the borrowing banks, but from governmental entities covered by FOIA.

The Second Circuit then rejected the Board's contention that disclosure would impair its mission of furnishing "critical infusions to distressed banks on a confidential basis—and thereby prevent loss of confidence, bank runs, fluctuations of bank stock, and rippling harm to the banking system."[187] The Second Circuit construed this argument as a request to expand Exemption 4 to include the so-called "program effectiveness" test adopted by the First and District of Columbia Circuits, which allows agencies to withhold information from disclosure if nonproduction "serves a valuable purpose and is useful for the effective execution of its statutory responsibilities."[188] The Second Circuit rejected the program-effectiveness test, reasoning that such expansion of Exception 4 would allow any agency to withhold most information as it could be argued that most disclosures would harm the agencies' "mission and effectiveness." On this analysis, the Second Circuit affirmed the district court's holding that the Board was required to comply with Bloomberg's FOIA requests.

Applying upon these rulings in *Fox News*, the Second Circuit held that the Board was required to search records held at Federal Reserve Banks and not in its possession in order to fully comply with Fox News's FOIA requests.[189] Noting that it did not have the power to issue the loans in question, the Board argued that Fox News had requested documents held by the Federal Reserve Banks—documents that were unavailable to the Board. The Second Circuit was

184. *Bloomberg L.P. v. Bd. of Governors of the Fed. Reserve Sys.*, 649 F. Supp. 2d 262, 274 (S.D.N.Y. 2009), *aff'd*, 601 F.3d 143 (2d Cir. 2010).

185. *Fox News Network, LLC v. Bd. of Governors of the Fed. Reserve Sys.*, 639 F. Supp. 2d 384 (S.D.N.Y. 2009), *rev'd*, 601 F.3d 158 (2d Cir. 2010).

186. *Bloomberg*, 601 F.3d at 148.

187. *Id.* at 150.

188. *Id.* (quoting *9 to 5 Org. for Women Office Workers v. Bd. of Governors of Fed. Reserve Sys.*, 721 F.2d 1, 11 (1st Cir. 1983), and citing *Critical Mass Energy Project v. Nuclear Regulatory Comm'n*, 830 F.2d 278, 287 (D.C. Cir. 1987) (adopting program-effectiveness test), *overruled on other grounds*, 975 F.2d 871, 879 (D.C. Cir. 1992) (*en banc*)).

189. *Fox News*, 601 F.3d at 160-61.

unpersuaded. Under Federal Reserve Bank regulations, certain documents are considered to be "Board documents" if they are "maintained for administrative reasons in the regular course of business in official files in any division or office of the Board or any Federal Reserve Bank in connection with the transaction of any official business."[190] The Second Circuit interpreted this provision to mean that records "belonging" to the Federal Reserve Banks also "belonged" to the Board. As a result, the Court ordered the Board to produce these documents in conjunction with Fox News's FOIA request even though it technically did not possess them.

In a significant turn of events, the Solicitor General apparently instructed the Federal Reserve not to seek review at the Supreme Court.[191] Instead, an association of 20 banks that received the emergency loans, known as the Clearing House Association LLC,[192] filed a petition for writ of certiorari in the Supreme Court seeking to avoid disclosure of the documents.[193] The banks argued that disclosure of the requested information would cause harm because the public could "observe [the banks'] borrowing patterns during the recent financial crisis and draw inference—whether justified or not—about their current financial conditions."[194] Noting that the Federal Reserve had never disclosed such information, the banks' argument suggests that the public's confidence in the banking system might be shaken if such information becomes available to the public. However, one could easily question how much faith the public currently has in lending institutions. In any event, such disclosures would provide the public with a clearer picture of the events surrounding the financial collapse in late 2007 and the novelty of complying with these requests would force greater transparency on American banks.

190. 12 C.F.R. § 261.2(i)(1)(ii).

191. Bob Ivry and Greg Stohr, *Obama's Solicitor General Told Fed Not to Appeal, Banks Say*, Bloomberg.com, Oct. 27, 2010, *available at* http://www.bloomberg.com/news/2010-10-27/obama-s-solicitor-general-told-fed-to-give-up-appeal-banks-say.html.

192. The New York-based Clearing House includes Bank of America NA, Bank of New York Mellon, Citibank NA, Deutsche Bank Trust Co. Americas, HSBC Bank USA NA, JPMorgan Chase Bank NA, U.S. Bank NA and Wells Fargo Bank NA.

193. Petition for Writ of Certioriari filed by The Clearing House Association L.C.C., No 10-543, *available at* http://sblog.s3.amazonaws.com/wp-content/uploads/2010/11/10-543.pdf.

194. Jacqueline Bell, *Banks Ask High Court to Review Bailout Details Case*, Law 360, Oct. 26, 2010 (available at http://appellate.law360.com/print_article/204367).

# § 3.5 Antitrust

## § 3.5.1 Assessing the Supreme Court's recent trend toward restricting private antitrust claims

The business community has witnessed a dramatic increase in antitrust suits filed in the United States in recent years.[195] As a judicial counterbalance—intentional or not—the Supreme Court has issued a number of significant opinions that, together, indicate a trend toward restricting antitrust suits brought by private individuals.[196]

The Court's 2008-09 term was no exception. In *Pacific Bell Telephone Co. v. Linkline Communications, Inc*., the Court dealt a blow to plaintiffs asserting antitrust claims under a "price squeeze" theory.[197] In *Linkline*, Internet service providers (ISPs) sued Pacific Bell, claiming that the company was charging them excessively high wholesale prices for digital subscriber line (DSL) access in comparison to the unreasonably low price it charged Pacific Bell's retail customers. The ISPs alleged that the scheme constituted "price squeezing" in violation of § 2 of the Sherman Antitrust Act. A price squeeze occurs when a company holding a monopoly on the production of certain goods sets its wholesale prices higher than its retail prices, effectively preventing the wholesale customers from competing with it at the retail level. The district court denied

195. *See, e.g.*, David Emanuelson, Parker Norman & Joseph Ostoyich, *More of the Same: Growth in Private Antitrust Litigation and Cutbacks by the US Supreme Court*, GLOBAL COMPETITION REVIEW: THE ANTITRUST REVIEW OF THE AMERICAS 2009 (noting that "the number of federal court antitrust cases filed each year not only continues to grow, but is poised to reach levels not seen since the 1970s").

196. *See Leegin Creative Leather Products, Inc. v. PSKS Inc*., 551 U.S. 877 (2007) (reversing an almost century-old rule that treated vertical resale price maintenance as per se illegal, and holding that vertical agreements are subject to the "rule of reason"); *Credit Suisse Securities (USA) L.L.C. v. Billing*, 551 U.S. 264 (2007) (holding that immunity can be implied when application of the antitrust laws might create a conflict with a competing federal regulatory regime); *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) (holding that in order to survive a Rule 12(b)(6) motion to dismiss a Sherman Act § 1 horizontal conspiracy claim, the plaintiff must plead facts that show it has a "plausible" claim; allegations that the defendants engaged in parallel conduct, coupled with "mere labels and conclusions" that the conduct resulted from "a conspiracy," is insufficient); *Weyerhauser Co. v. Ross-Simmons Hardwood Lumber Co. Inc*., 549 U.S. 312 (2007) (holding that in order to prove predatory bidding—the practice of bidding up input costs to drive rivals out of business—the plaintiff must satisfy the *Brooke Group* standard, which requires a plaintiff prove that the alleged predatory bidding led to below-cost pricing of the predator's outputs) (citing *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp*., 509 U.S. 209 (1993) (holding that in a single-product predatory pricing case, a plaintiff must prove that (1) its rival's low prices were below an appropriate measure of its rival's costs and (2) its rival "had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices")).

197. *Pacific Bell Telephone Co. v. Linkline Communications, Inc*., 129 S. Ct. 1109 (2009).

Pacific Bell's motion to dismiss the case for failure to state a claim under Rule 12(b)(6), but granted its motion for an interlocutory appeal.[198] Lower courts previously had found antitrust violations where wholesale prices are set "too high" in relation to retail prices to allow firms purchasing from the integrated producer at wholesale to earn a "fair profit" through retail sales. Based on these authorities, the Ninth Circuit affirmed and held that the ISPs had stated a legitimate price squeezing claim.[199]

Reversing in a landmark opinion by Chief Justice Roberts, the Supreme Court held that vertically integrated producers are not subject to antitrust liability for so-called price squeezes unless they (1) have an "antitrust duty to deal" with their competitors at the wholesale level and (2) engaged in "predatory pricing" at the retail level of competition.[200] The Court held that a "price squeezing" claim cannot be brought under § 2 of the Sherman Antitrust Act when the defendant is under no duty to sell inputs to the plaintiff in the first place.

Relying on its decision in *Verizon Communications Inc. v. Law Offices of Curtis v. Trinko*, the Court held Pacific Bell only owed the ordinary antitrust duty not to engage in predatory pricing.[201] The Supreme Court then remanded, noting that the ISPs had already been allowed to file an amended complaint alleging an ordinary predatory pricing claim but that this claim "may not survive a motion to dismiss" because "if [Pacific Bell] can bankrupt plaintiffs by refusing to deal altogether, plaintiffs must demonstrate why the law prevents Pacific Bell from putting them out of business by pricing them out of the market."[202]

As a practical matter, the Supreme Court's new standard in *Linkline* effectively forecloses price-squeeze antitrust claims except in the most extreme circumstances. But in the context of the larger trend of restricting private litigants' ability to bring antitrust claims, it exhibits the increasing difficulty antitrust claimants face at the courthouse. What remains to be seen is whether this judicial trend will have the effect of reducing the number of antitrust claims actually filed.

In the October 2009 term, the number of antitrust claims precipitously declined: the Court issued only one antitrust opinion (but it was a good one, for you sports fans). There are, however, a few pending antitrust cases are worth discussion, whether or not the Supreme Court decides grant certiorari to resolve them.

198. *LinkLine Communs., Inc. v. SBC Cal., Inc.*, No. CV 03-5265 SVW (SHx), 2004 U.S. Dist. LEXIS 30761 (C.D. Cal. Oct. 19, 2004), *aff'd*, 503 F.3d 876 (9th Cir. 2007), *rev'd*, 129 S. Ct. 1109 (2009).

199. *Linkline Communs., Inc. v. Cal., Inc.*, 503 F.3d 876, 886-87 (9th Cir. 2007), *rev'd*, 129 S. Ct. 1109 (2009).

200. *Pacific Bell Telephone Co. v. Linkline Communications, Inc.*, 129 S. Ct. 1109 (2009).

201. *Id.* at 1120-21 (citing *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) (holding that a firm with no antitrust duty to deal with its competitors has no obligation to provide those competitors with a "sufficient" level of service)).

202. *Id.* at 1123.

## § 3.5.2 Professional sports leagues (other than baseball) are not immune from antitrust liability. *American Needle, Inc. v. National Football League*

No question, professional sports means big business. Billions of dollars are exchanged every year between players, vendors, media, advertisers, teams, owners, and fans. Despite their fierce competition on the field, however, teams and their umbrella leagues may cooperate in an effort to maximize profits for the league (e.g., through ticket prices or pay scales for players)—conduct that could invoke antitrust laws. This was the subject of the Supreme Court's recent holding in *American Needle, Inc. v. National Football League*.[203] The topic of many a commercial-break discussion during the 2010 Super Bowl,[204] *American Needle* involved a multimillion dollar[205] deal struck between the National Football League (NFL) and Reebok International Ltd. (Reebok) that granted Reebok the exclusive right to make hats, sweatshirts, and other gear with NFL team logos. American Needle, a small family-owned manufacturer from Buffalo Grove, Illinois, challenged Reebok's exclusive license as an illegal restriction of competition between businesses.

To put *American Needle* in context, one must look to another favorite American pastime—baseball—and reflect back to the year when Babe Ruth and the Yankees lost the World Series (for the second time in a row) to the New York Giants. In 1922, the Supreme Court narrowed the scope of antitrust law by exempting major league baseball from liability under the Sherman Antitrust Act, holding that "personal effort, not related to production, is not a subject of commerce," and, therefore, Congress had no power to regulate it.[206] Despite many efforts, no other sport, including football, has won such sweeping immu-

203. *Am. Needle, Inc. v. Nat'l Football League*, 130 S. Ct. 2201 (2010).

204. *American Needle* was argued to the Supreme Court just a few weeks before the New Orleans Saints defeated the Colts for their first-ever Super Bowl win.

205. Based on media reports, the exclusive license was estimated to be worth about $250 million and involved billions of dollars in product sales.

206. *See Fed. Baseball Club of Baltimore, Inc. v. Nat'l League of Prof'l Baseball Clubs*, 259 U.S. 200 (1922) (creating the so-called "baseball exception").

nity to liability under the Sherman Antitrust Act from either the Supreme Court or Congress.[207]

The NFL is an unincorporated association of 32 separately owned professional football teams, with each team owning its own name, colors, logo, and related intellectual property. Through the National Football League Properties[208] (NFLP), the NFL licenses and markets intellectual property owned by the NFL teams. Prior to December 2000, NFLP granted nonexclusive licenses to many different vendors, including American Needle, to manufacture and sell apparel bearing team insignias. In December 2000, however, the teams authorized NFLP to grant exclusive licenses. With that authority, NFLP granted Reebok International Ltd. an exclusive 10-year license to manufacture and sell trademarked headwear for *all* 32 NFL teams and declined to renew American Needle's nonexclusive license. It was reported that immediately after the Reebok deal eliminated competitors, the price of a high-end fitted cap jumped to $30 from $19. Seven years into Reebok's 10-year license, American Needle filed a lawsuit against the NFL, NFLP, the 32 NFL teams, and Reebok, challenging the agreements by which NFLP granted to Reebok an exclusive license as a Section 1 Sherman Act violation.[209]

Unable to rely on the baseball exemption, the NFL pursued the so-called "single-entity defense," which was addressed by the Supreme Court in *Copperweld Corp. v. Independence Tube Corp*. In *Copperweld*, the Supreme Court held that a parent and wholly owned subsidiary constitute a single economic unit incapable of conspiring with each other for Section 1 purposes and, consequently, their coordinated activities fall outside the reach of Section 1 (which

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207. Despite the fact that the commerce analysis of *Federal Baseball* was quickly superseded by other law, the Court has declined to overrule *Federal Baseball*, thereby preserving Major League Baseball's proverbial cat-bird seat in the annals of antitrust law. As Justice Blackmun wrote for the Court in 1972:

> [The baseball exception] is an aberration that has been with us now for half a century, one heretofore deemed fully entitled to the benefit of stare decisis, and one that has survived the Court's expanding concept of interstate commerce. It rests on a recognition and an acceptance of baseball's unique characteristics and needs. Other professional sports operating interstate— football, boxing, basketball, and, presumably, hockey and golf—are not so exempt.

*Flood v. Kuhn*, 407 U.S. 258, 282-83 (1972); *see also Toolson v. New York Yankees, Inc*., 346 U.S. 356 (1953) (declining to abandon the baseball exception, noting that congressional silence in the wake of *Federal Baseball* was evidence that "Congress had no intention of including the business of baseball within the scope of federal antitrust laws").

208. The NFL teams formed the NFLP in 1963 to develop, license, and market the NFL's intellectual property.

209. Section 1 of the Sherman Antitrust Act makes "[e]very contract, combination . . . or, conspiracy, in restraint of trade" illegal. Sherman Antitrust Act, 15 U.S.C. § 1 (2006). Section 1, therefore, applies only to concerted action—agreements by two or more entities—that restrain trade. Actions by a single economic entity, or independent action, are only potentially subject to liability under Section 2 of the Sherman Antitrust Act for illegal monopolization or attempted monopolization. Liability under Section 2 is narrower and more difficult to prove, explaining, in part, the value of being treated as a single entity for purposes of antitrust law.

requires more than one actor).[210] According to the Court, the exemption for the conduct of a parent and wholly owned subsidiary stems from the companies' "unity of interest" and common control.[211] Relying on *Copperweld*, the NFL and NFLP asserted that they were incapable of conspiring within the meaning of Section 1 because the NFL, NFLP, and the NFL teams are a single entity with respect to the challenged conduct.[212] This became a test case for all sports. In its reluctance to expand the baseball exemption to other sports, and in the almost nine decades since *Federal Baseball* was decided, the Court had left unsettled the fundamental question of whether professional sports teams or leagues are immune to antitrust liability when they take action together, potentially or actually adding to their enormous money-making machines and impeding competition and consumers' choices in the marketplace.

The Supreme Court finally—but only partially—answered this question in *American Needle* by holding unanimously that the NFL's licensing activities constitute concerted action that is *not* categorically immune from the coverage of Section 1 of the Sherman Act because the NFLP is not a single entity, but rather a collection of 32 "independent centers of decisionmaking."

The district court sided with the NFL and dismissed American Needle's Section 1 claim, finding that the NFL, NFLP, and the NFL teams qualified as a single entity under *Copperweld* and, therefore, were immune from Section 1 antitrust liability.[213] The Seventh Circuit affirmed the district court, holding that the NFL teams are a "single source of economic power when promoting NFL football through licensing the teams' intellectual property."[214]

In an audacious move,[215] despite having prevailed on all of American Needle's claims, the NFL supported American Needle's petition to the Supreme

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210. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 777 (1984).

211. *Id.* at 771-72; *see also Davidson & Schaaff, Inc. v. Liberty Nat'l Fire Ins. Co.*, 69 F.3d 868, 871 (8th Cir. 1995) (wholly owned sister corporations with the same parent cannot conspire under Section 1); *Williams v. I.B. Fischer Nevada*, 794 F. Supp. 1026, 1032 (D. Nev. 1992), *aff'd*, 999 F.2d 445 (9th Cir. 1993) (franchisor and franchisee are a single enterprise within the meaning of *Copperweld*).

212. The NFL's single entity argument did not sit well with many fans and players, including New Orleans Saints' quarterback Drew Brees, who wrote in an editorial that "[t]he notion that the teams function as a single entity is absurd; the 32 organizations composing the NFL and the business people who run them compete with unrelenting intensity for players, coaches and, most of all, the loyalty of fans." Drew Brees, *Saints quarterback Drew Brees weighs in on NFL's Supreme Court case*, WASH. POST, Jan. 10, 2010, *available at* http://www.washingtonpost.com/wpdyn/content/article/2010/01/07/AR2010010702947.html?hpid%3dopinionsbox1.

213. *Am. Needle, Inc. v. New Orleans La. Saints*, 496 F. Supp. 2d 941 (N.D. Ill. 2007).

214. *Am. Needle, Inc. v. Nat'l Football League*, 538 F.3d 736, 744 (7th Cir. 2008).

215. As the New Orleans Saints quarterback Drew Brees put it:

> Amazingly, after the NFL won the case [in the Court of Appeals], it asked the Supreme Court to dramatically expand the ruling and determine that the teams act as a single entity not only for marketing hats and gear, but for pretty much everything the league does. It was an odd request—as if I asked an official to review an 80-yard pass of mine that had already been ruled a touchdown.

Brees, *supra*, note 212.

Court for certiorari, seeking an even *broader* bright-line rule that "the NFL's internal decisions about how to produce and promote NFL Football" are completely immune from Section 1 Sherman Act scrutiny.[216] Such a broad rule would evoke the baseball exemption and have consequences that far exceed logo licensing—consequences that had professional sports stars and fans up in arms. As an amicus brief filed by players' associations in other sports argued, owners might use single-entity status to end or severely restrict free agency, continue to enter into exclusive agreements that will further raise prices on merchandise, set higher ticket prices, and lock coaches into salary scales. As ESPN commentator Lester Munson fretted, invoking practically every epic struggle since the Battle of Thermopylae:

> Experts agree that the case known as *American Needle vs. NFL* could easily be the most significant legal turning point in the history of American sports. If the high court rules in favor of the NFL, the development will be more important to the sports industry than Curt Flood's battle against the reserve clause in the 1970s; than baseball's collusion cases in the mid-'80s; than the NFL players union's epic fight for free agency in a series of antitrust cases that stretched over a decade; and even than the enactment of the Sports Broadcasting Act.[217]

To Munson's great relief, the Supreme Court rejected the NFL's invitation to bestow blanket antitrust liability because the NFL and NFLP claimed to be a single entity under the *Copperweld* doctrine. Agreeing with the sentiment expressed by NFL detractors such as Drew Brees, the Court stated that "[t]he NFL teams do not possess either the unitary decisionmaking quality or the single aggregation of economic power characteristic of independent action," thereby depriving them of single entity status. The Court stressed that the mere formation of a separate single entity by independent third parties does not immunize their joint conduct from Section 1 scrutiny, and that holding otherwise could potentially protect a variety of illegal agreements created under the appearance of a single entity. In the end, the NFLP's distinct legal status did not shield it from Section 1 antitrust inquiry.

Even though the Supreme Court decided in *American Needle* that the collective decisions of independent NFL teams are subject to Section 1 scrutiny, not every joint decision is illegal under the Sherman Act. The Court simply answered the antecedent question of whether the arrangement between the NFL, NFLP, and the NFL teams constituted a contract, combination, or conspiracy to which Section 1 applied. The Court remanded back to the district court the determination of whether such concerted action was in restraint of trade and

216. *See* Brief for the NFL Respondents at 15, *Am. Needle, Inc. v. Nat'l Football Leagu*e, 130 S. Ct. 2201 (2010) (No. 08-661), *available at* http://www.scotusblog.com/wp-content/uploads/2009/12/NFL-merits-brief.pdf.

217. Lester Munson, *Antitrust Case could be Armageddon*, ESPN.com, July 17. 2009, *available at* http://sports.espn.go.com/espn/columns/story?columnist=munson_lester&id=4336261.

thus an antitrust violation. Notably, the NFL recently announced that it will replace Reebok with Nike, under an exclusive five-year license.[218]

## § 3.5.3 The Supreme Court is asked to test the bounds of the "state-action antitrust immunity doctrine." *S&M Brands, Inc. v. Caldwell*

In *S&M Brands, Inc. v. Caldwell*,[219] the Supreme Court has another opportunity to limit its holding in *Parker v. Brown*,[220] which created the oft-questioned "*Parker* state-action immunity doctrine" that exempts states from antitrust liability and grants them latitude to create regulation with anti-competitive effects. As of the date of this writing, the Supreme Court has yet to decide whether to grant the petition for certiorari.

The state-action immunity doctrine stems from the Supreme Court's refusal in 1943 to apply the Sherman Antitrust Act to a California agricultural statute that authorized the creation of marketing programs for state-produced agricultural commodities for the purposes of diminishing competition among growers and artificially increasing price levels.[221] A farmer challenged the California statute and sought to enjoin it on the ground that its price-fixing schemes and other components violated the Sherman Act.[222] The Supreme Court noted that the California statute would only violate the Sherman Act if it was an agreement between private parties.[223] The Court held that California, as a sovereign State, was free to regulate its own markets, and that Congress did not intend to restrain the several States' ability to do so in passing the Sherman Act.[224] The Court thus held that "the state in adopting and enforcing its agricultural statute made no contract or agreement and entered into no conspiracy in restraint of trade or to establish monopoly but, as sovereign, imposed the restraint as an act of government which the Sherman Act did not undertake to prohibit."[225] Nevertheless, despite the broad grant of antitrust immunity awarded to the states, the Court noted that a state may not avoid antitrust scrutiny if it acts as a "participant in a private agreement or combination by others for restraining of trade," or seeks to "give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful."[226]

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218. Ken Belson, *Nike to Replace Reebok as N.F.L.'s Licensed-Apparel Maker*, N.Y. Times (Oct. 12, 2010), *available at* http://www.nytimes.com/2010/10/13/sports/football/13nike.html.

219. *S&M Brands, Inc. v. Caldwell*, 614 F.3d 172, 174-75 (5th Cir. 2010), *petition for writ of certiorari filed*, No. 10-622 (Nov. 8, 2010).

220. 317 U.S. 341 (1943).

221. *See id.* at 345-48 (1943).

222. *Id.* at 348-49.

223. *Id.* at 350.

224. *Id.* at 350-52.

225. *Id.* at 352.

226. *Id.* at 351-52.

The Supreme Court has the opportunity in *S&M Brands, Inc. v. Caldwell* to answer the question it left open in *Parker*—whether a state enjoys immunity from antitrust liability when it contracts with private parties in restraint of trade.[227] *Caldwell* involves a Master Settlement Agreement (MSA), entered in 1996 between the four largest tobacco manufacturers and 52 governmental entities. The MSA settled litigation initiated by various governmental entities to recover billions of dollars in increased healthcare costs related to the tobacco manufacturers' allegedly fraudulent sales and marketing techniques.[228] Under the MSA, the settling governmental entities agreed to release the defendant tobacco manufacturers from past, present, and future tobacco-related claims in exchange for large, perpetual payments to the governmental entities, calculated according to the tobacco manufacturers' relative market shares.[229] Tobacco manufacturers that were not parties to the initial MSA were given the opportunity to opt-in to the MSA and receive full releases for certain tobacco-related claims in return for agreeing to pay certain amounts to the governmental entities.[230]

The most controversial aspect of the MSA, however, was its effect on tobacco manufacturers who elected not to participate in the MSA.[231] Because the MSA left participating tobacco manufacturers at a competitive disadvantage with nonparticipating manufacturers, the MSA called for the settling governmental entities to enact so-called "Escrow" or "Qualifying" statutes that compelled nonparticipating manufacturers to pay into escrow an amount equal to or greater than what these manufacturers would pay had they elected to participate in the MSA.[232]

The plaintiffs in *Caldwell*—a Louisiana tobacco manufacturer, a small tobacco retailer, and a local smoker—sued the Attorney General of Louisiana alleging that the MSA and the Louisiana Escrow Statute violate the Compact Clause, the First Amendment, the Federal Cigarette Labeling and Advertising Act, the Commerce and Due Process Clauses, and federal antitrust laws.[233] The federal district court granted the defendant's motion for summary judgment, and the Fifth Circuit Court of Appeals affirmed. Regarding the plaintiffs' antitrust claims, the Fifth Circuit concluded that the MSA was immune from antitrust scrutiny under the *Parker* state-action immunity doctrine.[234] Significantly, however, the parties in *Caldwell* agree that had the tobacco companies entered

227. *Caldwell*, 614 F.3d at 174-75.

228. *Id.*

229. *Id.*

230. *See id.*

231. There are numerous other features of the MSA that potentially deserve antitrust scrutiny, including provisions that restrain competition among all participating manufacturers by forbidding numerous forms of advertising, as well as lobbying and litigation adverse to the MSA, and through various provisions that tend to discourage price competition for market share among tobacco manufacturers. *See* MSA, *available at* http://www.naag.org/backpages/naag/tobacco/msa/msa-pdf (last accessed Dec. 4, 2010).

232. *Caldwell*, 614 F.3d at 174-75; *see e.g.*, LA. REV. STAT. § 13:5061 (Louisiana "Escrow" statute).

233. *Id.* at 175.

234. *Id.* at 175-77.

into the MSA without state participation, the agreement would constitute a *per se* violation of the Sherman Act.[235]

Because the MSA appears to constitute an agreement in restraint of trade that was entered between both public and private entities, the key question that the petitioners in *Caldwell* raise is whether the governmental entities that are parties to the MSA are acting as "participants in a private agreement" and are thus not entitled to state-action immunity from antitrust scrutiny.[236] Whether the Supreme Court will address this question remains to be seen. Indeed, it may be unlikely given the fact that the Sixth, Eighth, and Ninth Circuits, in addition to the Fifth Circuit, have all held that the MSA and the related "Escrow" statutes enjoy state-action immunity from antitrust scrutiny, and the Supreme Court has twice denied review.[237]

## § 3.5.4 Circuit Split: Do "pay-for-delay" settlements between patent holders and generic manufacturers violate antitrust law?

In a series of significant cases that combine issues involving antitrust law, patent rights, and the pharmaceutical industry, the U.S. Circuit Courts of Appeals have continued to consider the legality of so-called "reverse payment settlements" in the past year, maintaining a circuit split and priming the way for the Supreme Court to finally weigh in on the validity of such settlements.

"Reverse payment settlements," also known as "pay-for-delay" settlements, are arrangements characterized by payments from pharmaceutical patent holders to generic manufacturers in return for settling challenges to the patent's validity, and for delaying the introduction of generics into the market. Pharmaceutical patent holders often enter into such agreements in order to delay the market entry of competing generic drugs, thus extending the patent holder's market exclusivity and profit. As these settlements have become increasingly popular among pharmaceutical companies, they have also become increasingly controversial. Critics charge that the agreements cost consumers and taxpayers billions of dollars every year.

The Federal Trade Commission (FTC) has taken a firm stance in both courts and in Congress that reverse payment settlements are *per se* illegal. As FTC Chairman Jon Leibowitz has written, "One of the Commission's top competition priorities is stopping 'pay-for-delay' agreements between brand-name

235. *See* Petition for Writ of Certiorari, filed in No. 10-622, U.S. Supreme Court (Questions Presented), *available at* http://sblog.s3.amazonaws.com/wp-content/uploads/2010/11/SM-Cert-Pet-Final.pdf.

236. *See id*.

237. *See Grand River Enters. Six Nations v. Beebe*, 574 F.3d 929, 936-38 (8th Cir. 2009), *cert. denied*, 130 S. Ct. 2095, 176 L. Ed. 2d 723 (U.S. 2010); *Sanders v. Brown*, 504 F.3d 903, 908-11 (9th Cir. 2007), *cert. denied*, 553 U.S. 1031 (2008); *Tritent Int'l Corp. v. Kentucky*, 467 F.3d 547, 557 (6th Cir. 2006) (no petition for certiorari filed).

pharmaceutical companies and generic competitors that delay the entry of lower priced generic drugs into the market."[238] Because of what the FTC calls "the inherently anticompetitive nature of these deals and the enormous consumer harm caused by pay-for-delay," the FTC continues to challenge these arrangements in court and by initiating investigations, although these efforts has had limited success in the courts.[239]

The increasing popularity of reverse payment settlements in recent years[240] has given rise to a split among the U.S. Circuit Courts of Appeals on the question of whether and to what extent reverse payment settlements are lawful. The Sixth Circuit has adopted the FTC's *per se* argument and held that such settlements are *per se* violations of Section 1 of the Sherman Antitrust Act.[241] On the other hand, all other circuit courts that have confronted the issue—the Eleventh Circuit, Second Circuit, and Federal Circuit—have approved reverse payment settlements where they fall within the "exclusionary zone" of the patent.[242]

Most recently, the Second Circuit upheld a reverse payment settlement in *Arkansas Carpenters Health and Welfare Fund v. Bayer, AG*. In *Arkansas Carpenters*, Barr, the maker of a generic version of "Cipro," a brand-name antibiotic, agreed to delay entry of a generic into the market for a period of time in exchange for payments amounting to $398.1 million.[243] The Second Circuit affirmed the district court's ruling, holding that it was bound by the *Tamoxifen* decision—an earlier Second Circuit decision holding that reverse payment settlements do not violate antitrust laws where they fall within the exclusionary zone of the patent—and thus the only potential basis for an antitrust violation would be if the settlement agreement "exceeded the scope of the Cipro patent."[244]

In its decision, however, the Second Circuit identified several reasons for revisiting that precedent and invited plaintiffs to petition for rehearing en banc.[245]

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238. Prepared Statement of the Federal Trade Commission, Before the United States House of Representatives Committee on the Judiciary Subcommittee on Courts and Competition Policy at 3 (Washington D.C. July 27, 2010), *available at* http://www.ftc.gov/os/testimony/100727antitrustoversight.pdf (last accessed Oct. 18, 2010) (the "July 27 FTC Statement").

239. *Id.* at 5. The FTC is actively pursuing two antitrust cases in which they challenge reverse payment settlements. *In re AndroGel Antitrust Litig* (No. II), 1:09-MD-2084-TWT (N.D. Ga.); *FTC v. Cephalon, Inc.*, No. 2:08-cv-2141 (E.D. Pa.).

240. As of 2004, there were no recorded reverse payment settlements. In 2009, the FTC identified 19 reverse payment settlements. *See* July 27 FTC Statement at 4.

241. *In re Cardizem CD Antitrust Litig.*, 332 F.3d 896, 914-15 (6th Cir. 2003), *cert. denied sub nom, Andrx Pharmaceuticals, Inc. v. Kroger Co.*, 543 U.S. 939 (2004).

242. *Arkansas Carpenters Health & Welfare Fund v. Bayer, AG.*, 604 F.3d 98, 103 (2d Cir. 2010); *In re Ciprofloxacin Hydrochloride Antitrust Litig*., 544 F. 3d 1323, 1341 (Fed. Cir. 2008), *cert. denied*, 129 S. Ct. 2828 (2009); *In re Tamoxifen Citrate Antitrust Litig.*, 466 F.3d 187, 228 (2d Cir. 2006), *cert. denied*, 127 S. Ct. 3001 (2007); *Schering-Plough Corp. v. Fed. Trade Comm'n*, 402 F.3d 1056, 1076 (11th Cir. 2005), *cert. denied*, 126 S. Ct. 2929 (2006); *Valley Drug Co. v. Geneva Pharms., Inc.*, 344 F.3d 1294, 12 (11th Cir. 2003).

243. *Arkansas Carpenters Health & Welfare Fund v. Bayer, AG*, 604 F.3d 98, 101-02 (2d Cir. 2010).

244. *Id.* at 106.

245. *Id.* at 109-10.

Most notably, the court cited the DOJ's urging to repudiate *Tamoxifen*, and cited an FTC report that there is evidence that the practice of entering into reverse payment settlements has increased since the *Tamoxifen* decision.[246] On May 20, 2010, the Solicitor General and FTC filed amicus briefs recommending that the Second Circuit reconsider its decision and grant a rehearing en banc.

On September 7, 2010, the Second Circuit denied the request for rehearing en banc. Circuit Judge Rosemary S. Pooler filed a vigorous dissent, criticizing the *Tamoxifen* decision and reverse payment settlements in general. Judge Pooler noted that reverse payment settlements, "once unheard of, [have] become increasingly common. This Court has played a significant role in encouraging this unfortunate practice."[247] Judge Pooler noted that in the five years before *Tamoxifen* was decided, "there were no settlements involving exclusion payments, and even pharmaceutical industry representatives appear to have conceded the illegality of the practice . . . ."[248] However, "[i]n the four years since *Tamoxifen*, by contrast, the Federal Trade Commission has identified fifty-three pharmaceutical patent settlements involving exclusion payments."[249] Judge Pooler stated that reverse payment settlements serve "no obvious redeeming social purpose" and urged that the *Tamoxifen* decision should be reconsidered:

> The *Tamoxifen* majority recognized the "troubling dynamic" of permitting exclusion payments that "inevitably protect patent monopolies that are, perhaps, undeserved." Subsequent experience has shown that the majority was right to be "troubled." Although the "enormous importance" of the issues that this case raises is beyond dispute, Fed. R. App. P. 35(a)(2), a majority of this Court has voted against *en banc* rehearing . . . . It will be up to the Supreme Court or Congress to resolve the conflict among the Courts of Appeals.[250]

Thus, the Second Circuit elected not to repudiate reverse payment settlements on a per se basis, but instead left it to the Supreme Court or Congress to prohibit such settlements.

On December 7, 2010, a group of drug purchasers filed a petition for writ of certiorari in the Supreme Court in *Louisiana Wholesale Drug Co., Inc., v. Bayer AG*, (Case No. 10-762), arguing that the agreements "are annually costing consumers and taxpayers billions of dollars."[251] The petition echoed Judge Pooler's concern that reverse payment settlements have become an increas-

246. *Id.* at 105, 109.

247. *Ark. Carpenters Health & Welfare Fund v. Bayer AG*, 625 F.3d 779, 780 (2d Cir. 2010).

248. *Id.*

249. *Id.*

250. *Id.* at 782.

251. Petition for Writ of Certiorari at 5-6, *Louisiana Wholesale Drug Co., Inc. et al. v. Bayer AG et al.* (internal citations omitted), No. 10-762, in the U.S. Supreme Court, *available at* http://www.hpm.com/pdf/CIPRO%20-%20SCt%20Cert%20Pet%20-%20Patent%20Settlement.pdf.

ingly controversial practice, and suggested that the Second Circuit's decision was contrary to the decisions of all other circuits that have ruled on the issue, which have either found reverse payment settlements to be per se invalid (Sixth Circuit) or valid only where they are within the patent holder's exclusionary right (Eleventh Circuit, Federal Circuit). Moreover, the petition suggested that the Second Circuit's decision was contrary to the views of the FTC and the Justice Department, and urged the Supreme Court to side with the FTC and Justice Department in finding these settlements invalid. The petition stated in pertinent part:

> This Court should grant review to resolve the circuit split, reject the Second Circuit standard, require compliance with this Court's precedents that favor judicial testing of patent validity, and restore the Hatch-Waxman Act balance by prohibiting brand manufacturers from paying competitors to forgo judicial examination of patents and thereby preserve unwarranted monopolies.[252]

Ultimately, the issue may be resolved not in the courts, but by Congress, which is currently considering legislation that would end the practice of reverse payment settlements. Both the House and the Senate have introduced federal legislation attempting to prohibit (or severely restrict) reverse payment settlements since 2009.[253] Most recently, the House adopted S. 369 as an amendment to the War Funding Bill in H.R. 4899, the Supplemental Appropriations Act of 2010. The amendment would grant authority to the FTC to initiate a civil action against "the parties to any agreement resolving or settling . . . a patent infringement claim, in connection with the sale of a pharmaceutical product."[254] The amendment further would provide that "an agreement shall be presumed to have anticompetitive effects" if the Abbreviated New Drug Application (ANDA) filer "receives anything of value" and it agrees "to limit or forego research, development, manufacturing, marketing, or sales of the ANDA product for any period of time."[255] A party would be able to rebut this presumption by "demonstrat[ing] by clear and convincing evidence that the procompetitive benefits of the agreement outweigh the anticompetitive effects."[256] The House bill does not call for a ban on reverse payment settlements, but instead would allow the FTC to act on any settlement believed to be illegal. This amendment was passed by the House of Representatives on July 1, 2010, and was cleared for White House approval on July 27, 2010, but not before the Senate stripped away the amendment on reverse payment settlements.

252. *Id.*

253. Protecting Consumer Access to Generic Drugs Act of 2009, 111th Cong. H.R. 1706, § 2(a), 4 (2009); Preserve Access to Affordable Generics Act of 2009, 111th Cong., S.369 (2009).

254. Preserve Access to Affordable Generics Act, H.R. 4899, 111th Cong., at 74 (2010).

255. *Id.* at 74-75.

256. *Id.*

It remains to be seen what will happen with the pending federal legislation on reverse payment settlements, but it is unlikely that this debate is over. Should such legislation be passed in the future, the FTC will be able to curtail the use of reverse payment settlements, essentially abrogating federal court decisions on the validity of such settlements. As of now, the Supreme Court has passed on six opportunities to resolve the circuit split over the validity of reverse payment settlements, suggesting that the most likely solution may come from Congress. However, the Supreme Court's unwillingness to weigh in on the issue in the past may have been influenced by the Bush administration's position on the issue—which has markedly shifted with the new Obama administration, which strongly disfavors reverse payment settlements.

In the *Arkansas Carpenters* case, the DOJ accepted the Second Circuit's invitation that the DOJ weigh in on the issue. In its brief, the DOJ for the first time sided with the FTC and argued that reverse payment settlements should be treated as "presumptively unlawful" as antitrust violations.[257] Should the appellants in *Arkansas Carpenters* seek review in the Supreme Court, it is reasonable to assume that the DOJ will weigh in again as an amicus, but this time on the side of the FTC.

One thing is clear: whether Congress passes legislation limiting the legitimacy of these agreements—or if the Supreme Court takes up the issue in *Arkansas Carpenters* or in another case—the landscape of reverse payment settlements may soon change.

*Update: Amicus briefs filed in early 2011 support speculation that this case may have a chance of review: On January 7, 2011, Attorneys General from 32 states filed an amicus brief in support of granting a writ of certiorari, along with a group of 86 intellectual property, antitrust, economics, and other law professors.*[258]

257. *See* Brief for the United States in Response to the Court's Incitation, *In re Ciprofloxacin Hydrochloride Antitrust Litig.*, No. 05-2851-cv (2d. Cir. July 6, 2009), *available at* http://www.justice.gov/atr/cases/f247700/247708.pdf.

258. *See* Amicus Brief of States Attorneys General as Amici Curiae Supporting Petitioners, (Jan. 7, 2010), filed in No. 10-762, in the U.S. Supreme Court, *available at* http://ag.ca.gov/cms_attachments/press/pdfs/n2022_amicus.pdf; *see also* Brief of Amici Curiae of 86 Intellectual Property Law, Antitrust Law, Economics, Business and Public Health Professors in Support of Ceriorari (Jan. 7, 2010), filed in No. 10-762, in the U.S. Supreme Court, *available at* http://www.patentlyo.com/Louisiana-reverse-payment.pdf.

# § 3.6 Copyright

## § 3.6.1 The Supreme Court splits 4-4 on the validity of the "first-sale" defense against copyright infringement claims for domestic resale of "gray market" copyrighted works. *Costco Wholesale Corp. v. Omega*

In 2010, copyright owners, retailers, and consumer-rights groups awaited with anticipation the Supreme Court's decision in *Costco Wholesale Corp. v. Omega SA*, a copyright infringement suit out of the Ninth Circuit arising from the international sale and distribution of copyrighted Omega-brand watches.[259] To the disappointment (or perhaps relief) of many, an equally divided Supreme Court issued a 4-4 per curium opinion (with Justice Kagan recused) affirming the Ninth Circuit's opinion without discussion.[260]

At issue in *Costco* was the "first-sale" defense, and whether domestic retailers may buy copyrighted products abroad in the "gray market"[261] and resell them in the United States at greatly reduced prices, which prevents copyright owners from controlling the prices of their products in various markets. In the context of an exponentially expanding global marketplace driven by Internet-based commerce that is increasingly disconnected from geopolitical boundaries, *Costco* promised to be a major development in copyright law.

Omega makes watches in Switzerland and sells them through a global network of authorized distributors and retailers. Each watch bears an engraved, U.S.-copyrighted "Omega Globe Design." Omega first sold its copyrighted watches to authorized non-U.S. distributors overseas. Costco obtained the copyrighted watches from the overseas gray market and sold them to consumers in California for about one-third less than Omega's suggested retail price, drastically undercutting the prices Omega was demanding in the United States. Although Omega had authorized the initial foreign sales of the watches, it did not authorize Costco to either import or sell them in the United States. On

259. *Omega S.A. v. Costco Wholesale Corp*., 541 F.3d 982 (9th Cir. 2008), *aff''d*, No. 08-1423, 2010 U.S. LEXIS 9597 (U.S. Dec. 13, 2010).

260. *Costco Wholesale Corp. v. Omega, S.A.*, No. 08-1423, 2010 U.S. LEXIS 9597 (U.S. Dec. 13, 2010).

261. "'Gray-market' goods, or 'parallel imports,' are genuine products possessing a brand name protected by a trademark or copyright. They are typically manufactured abroad, and purchased and imported into the United States by third parties, thereby bypassing the authorized U.S. distribution channels." *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477, 481 n.6 (9th Cir. 1994). U.S. retailers can "sell these products at a discount because the gray market arbitrages international discrepancies in manufacturers' pricing systems." *Omega*, 541 F.3d at 984 n.1.

these facts, Omega sued Costco for copyright infringement under 17 U.S.C. § 106(3)[262] and 17 U.S.C. § 602(a).[263]

Costco argued in its defense that, under the "first-sale doctrine" (which is codified at 17 U.S.C. § 109(a)[264]), Omega's initial foreign sale of the watches barred any infringement claim against Costco for acquiring and selling the watches. Under the first-sale doctrine, after a copyright owner authorizes the sale of a particular copy of its work, it no longer controls—and cannot bring infringement claims based on—the subsequent distribution of that copy by third parties. Relying on settled Ninth Circuit precedent,[265] Omega countered that Costco had no first-sale doctrine defense because, although the Omega design was copyrighted in the United States, the watches bearing the design were manufactured and first sold overseas. Therefore, in Omega's view, the copies of the design were not "lawfully made" under U.S. copyright laws for the purposes of § 109(a) and the first-sale defense was not triggered. The district court sided with Costco, granting summary judgment on the basis of § 109(a) and dismissing Omega's copyright claim.[266]

The Ninth Circuit reversed, rejected Costco's first-sale defense, and expressed the view that recognizing the first-sale defense for goods manufactured in foreign countries would inappropriately extend copyright law beyond U.S. borders.[267] The underlying issue before the Ninth Circuit was whether its own precedent had been invalidated by the Supreme Court's more recent decision in *Quality King Distribs., Inc. v. L'anza Res. Int'l, Inc.*[268] *Quality King* involved so-called "round trip" importation, where a product copyrighted in

262. Section 106(3) provides that a copyright owner "has the exclusive rights to . . . to distribute copies . . . of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending." 17 U.S.C. § 106(3).

263. Section 602(a) provides in relevant part that "[i]mportation into the United States, without the authority of the owner of copyright under this title, of copies . . . of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies . . . under section 106, actionable under section 501." 17 U.S.C. § 602(a). Section 501, in turn, provides that "[a]nyone who violates any of the exclusive rights of the copyright owner as provided by sections 106 through 122, . . . or who imports copies . . . into the United States in violation of section 602, is an infringer of the copyright. . . ." 17 U.S.C. § 501.

264. Section 109(a) provides: "Notwithstanding the provisions of section 106(3), the owner of a particular copy. . . . *lawfully made* under this title . . . is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy. . .." 17 U.S.C. § 109(a) (emphasis added).

265. *Denbicare U.S.A. Inc. v. Toys "R" Us, Inc.*, 84 F.3d 1143 (9th Cir. 1996); *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477 (9th Cir. 1994); *BMG Music v. Perez*, 952 F.2d 318 (9th Cir. 1991) (each holding that, where the copies at issue were made and first sold abroad, § 109(a) provides no defense against an infringement claim under § 602(a) because the phrase "*lawfully made under this title*" in § 109(a) grants first sale protection only to copies "legally made" and sold in the United States).

266. *Omega S.A. v. Costco Wholesale Corp.*, No. CV 04-5443-TJH(RCx), 2005 U.S. Dist. LEXIS 47014 (C.D. Cal., June 8, 2005), *rev'd*, 541 F.3d 982 (9th Cir. 2008), *aff'd*, No. 08-1423, 2010 U.S. LEXIS 9597 (U.S. Dec. 13, 2010).

267. *Omega*, 541 F.3d at 985.

268. *Quality King Distribs., Inc. v. L'anza Res. Int'l, Inc.*, 523 U.S. 135 (1998).

the United States is initially manufactured *inside* the United States, exported to an authorized foreign distributor, and then sold to unidentified third parties overseas that in turn then ship the product back to the United States without the copyright owner's permission, and resell the product to consumers in the United States through unauthorized retailers.[269] In *Quality King*, the Supreme Court held that the first-sale doctrine applies to, and is a valid defense to infringement in, cases involving round-trip importation.[270]

Siding with Omega, the Ninth Circuit distinguished *Quality King* on the ground that it did not involve unauthorized importation of copies that were initially manufactured overseas (Omega produced and first sold them in Switzerland), and reaffirmed the Ninth Circuit's rule that the first-sale defense only applies to copyright claims involving *domestically*-made copies of U.S.-copyrighted works.[271]

The Supreme Court heard oral argument in *Costco* on November 8, 2010, during which the Justices posed difficult questions to both parties that provoked uncertainty as to how they would resolve the case.[272] Sure enough, the Court's 4-4 opinion furthers that doubt, given the lack of a majority opinion. For now, by affirming the Ninth Circuit's *Costco* decision, the Supreme Court has effectively restricted the ability of U.S. retailers to sell copyrighted products purchased from the foreign gray market at a discount to U.S. consumers. This result benefits copyright owners, particularly in the global market for luxury brands (to the disappointment of bargain-seeking consumers). The impact will not be limited, however, to luxury brands. The *Costco* decision has significant implications for international Internet retailers such as Amazon and eBay that

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269. *Id.* at 138-39.

270. *Id.* at 144-52.

271. *Omega*, 541 F.3d at 987. The Ninth Circuit noted Justice Ginsburg's concurrence in Quality King, in which she wrote that "we do not today resolve cases in which the allegedly infringing imports were manufactured abroad." *Id.* (quoting *Quality King*, 523 U.S. at 154 (Ginsburg, J., concurring)).

272. Justice Ginsburg asked a number of questions at the oral argument that heralded back to her *Quality King* concurrence. *See* Kali Murray, *Argument recap: The Court considers an expanded first-sale doctrine in the import context*, www.scotusblog.com, Nov. 10, 2010, *available at* http://www.scotusblog.com/?p=108438 (noting that Justice Ginsburg asked a number of questions that alluded to her concurrence in *Quality King*, which would have limited its scope to "round-trip" goods). But questions from the other Justices did not indicate how much support Justice Ginsburg's view had from the rest of the Court. As one commentator reported:

> The complexity of the discussion at oral arguments suggests that the outcome in Costco is not a certain one. The arguments ranged from the guarded support expressed by Justices Ginsburg and Kennedy for limiting the scope of Quality King to those cases involving "round-trip" copyrighted goods, to the outright skepticism expressed by Justices Breyer and Sotomayor with regard to any attempts to limit the scope of the "first-sale" doctrine within the context of copyright law.

*Id.* The transcript of the *Costco* oral argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/08-1423.pdf.

buy and sell large quantities of copyrighted products that are made in the United States and abroad.[273]

On a practical level, the *Costco* impasse highlights the impact of Justice Kagan's recusal on the Court's decision-making process: she was recused in about half of the cases in the Court's term through 2010 due to her prior position as Solicitor General. In any case where the Court is evenly split, Kagan's absence could greatly impact the outcome of the case. In *Costco*, with Kagan in the mix, the Court likely would have issued a 5-4 opinion resolving the issue for lower courts with a definitive majority opinion one way or another. For example, if she were to side with the Obama Administration's position in support of the respondent, as expressed in the current Solicitor General's amicus brief, the Court still would affirm 5-4. By affirming per curium without a majority, however, it remains to be seen whether the Court intends to address the issue in *Costco* at some future time, or how *Costco* will be applied in the lower courts.

## § 3.6.2 The Supreme Court changes the landscape of jurisdiction in unregistered copyright cases. *Reed Elsevier, Inc. v. Muchnick*

Subject to certain exceptions, the Copyright Act requires a copyright holder to register a work with the Copyright Office before suing for copyright infringement. 17 U.S.C.A. § 411(a).[274] The Second Circuit and six other circuit courts had interpreted § 411(a) to mean that copyright registration is a *jurisdictional*

273. Notably, both Amazon and eBay—along with many other Internet resellers—filed amici curiae briefs in support of Petitioner Costco, arguing against expansion of the first-sale doctrine. The U.S. Government and various interests groups, including filmmakers and software companies, filed amici curiae briefs on behalf of the Respondent Omega. *See* http://www.scotusblog.com/case-files/cases/costco-v-omega/ (providing links to briefs filed by amici curiae).

274. Section 411(a) states in relevant part that, subject to certain exceptions,

> [N]o civil action for infringement of the copyright in any United States work shall be instituted until preregistration or registration of the copyright claim has been made in accordance with this title. . . . The Register [of Copyrights] may, at his or her option, become a party to the action with respect to the issue of registrability of the copyright claim by entering an appearance within sixty days after such service, but the Register's failure to become a party shall not deprive the court of jurisdiction to determine that issue.

17 U.S.C. § 411(a).

prerequisite to filing suit for copyright infringement,[275] which had the effect of greatly limiting a district court's ability to address not only infringement, but other issues related to the copyright. In *Reed Elsevier, Inc. v. Muchnick*, the Supreme Court abrogated this line of cases and, in an opinion by Justice Thomas, held that although § 411(a)'s registration requirement is a precondition to filing infringement claims, it does not impair the district court's jurisdiction to consider the claim.[276] As one district court recently noted, the "Supreme Court's *Reed Elsevier* decision changed the landscape with regard to a federal court's subject matter jurisdiction to adjudicate a copyright infringement claim involving unregistered works."[277]

*Reed Elsevier* involved a class action by freelance authors and trade groups asserting copyright infringement claims related to the electronic reproduction of works in which the authors retained copyright ownership. While the named plaintiffs and many members of the class had registered their works with the U.S. Copyright Office, some members of the class had not. On appeal, the Second Circuit held that the district court did not have jurisdiction to approve a settlement agreement in which "unregistered copyright holders" received an award for copyright violations.[278]

Reversing, the Supreme Court stressed "the important distinctions between jurisdictional prescriptions and claim-processing rules."[279] The Court looked to § 411(a)'s statutory language and noted that it says nothing about subject matter jurisdiction—it merely states that the failure of the Register of Copyrights to join the action does not deprive the court of jurisdiction. The Court held that this reference to jurisdiction was not intended to make registration a jurisdictional prerequisite to assert a claim for copyright infringement.

Of course, the Supreme Court's holding in *Reed Elsevier* does not change the fact that registration is still a prerequisite to suit under § 411(a). Indeed, the Court declined to address the question of "whether § 411(a)'s registration requirement is a mandatory precondition to suit that . . . district courts may or should enforce *sua sponte* by dismissing copyright infringement claims involv-

275. *See In re Literary Works in Electronic Databases Copyright Litigation*, 509 F.3d 116, 121 (2d Cir. 2007) (citing "widespread agreement among the circuits that [registration of the copyright] is jurisdictional"); *see also La Resolana Architects, PA v. Clay Realtors Angel Fire*, 416 F.3d 1195, 1200-1201 (10th Cir. 2005); *Positive Black Talk Inc. v. Cash Money Records Inc*., 394 F.3d 357, 365 (5th Cir. 2004); *Well-Made Toy Mfg. Corp. v. Goffa Int'l Corp*., 354 F.3d 112, 114-115 (2d Cir. 2003); *Xoom, Inc. v. Imageline, Inc*., 323 F.3d 279, 283 (4th Cir. 2003); *Murray Hill Publications, Inc. v. ABC Communications, Inc*., 264 F.3d 622, 630 & n.1 (6th Cir. 2001); *Morris v. Business Concepts, Inc*., 259 F.3d 65, 72-73 (2d Cir. 2001); *Brewer-Giorgio v. Producers Video, Inc*., 216 F.3d 1281, 1285 (11th Cir. 2000); *Data Gen. Corp. v. Grumman Systems Support Corp.*, 36 F.3d 1147, 1163 (1st Cir. 1994).

276. *Reed Elsevier, Inc. v. Muchnick*, 130 S. Ct. 1237 (2010).

277. *Kruska v. Perverted Justice Foundation Inc*., No. CV 08-00054-PHX-SMM, 2010 WL 1875514, at *4 (D. Ariz. 2010).

278. *In re Literary Works in Electronic Databases Copyright Litigation*, 509 F.3d 116 (2d Cir. 2007), *rev'd*, 130 S.Ct. 1237 (2010).

279. *Reed Elsevier*, 130 S. Ct. at 1244.

ing unregistered works."[280] With this in mind, *Reed Elsevier*'s impact in future copyright infringement cases may well be more form than substance. While acknowledging *Reed Elsevier* may obviate a motion to dismiss for lack of subject matter jurisdiction under Federal Rule of Civil Procedure 12(b)(1), some courts have nonetheless dismissed infringement claims regarding unregistered works for failure to state a claim under Rule 12(b)(6). For example, in *Cosmetic Ideas, Inc. v. IAC/Interactivecorp.*, the Ninth Circuit held that although registration is not jurisdictional, it is an element of the plaintiff's cause of action that must be pleaded and proved to state a prima facie infringement claim that will survive dismissal.[281] *Reed Elsevier*'s impact will therefore likely be more apparent in cases where the district court is not passing on the merits of an infringement claim, but is exercising its jurisdiction on a matter related to the copyright (i.e., certifying a class or approving a settlement).

On balance, the Supreme Court's ruling in *Reed Elsevier* may be good news for copyright-holding plaintiffs, especially those seeking quick injunctive relief before they are able to register their works with the Copyright Office. Even if a court were inclined to dismiss a copyright infringement claim for lack of a registration, plaintiffs may attempt to cure this error by showing that they have applied for a registration. But this should not encourage plaintiffs to delay registration. Failure to register a work before an infringement suit can result in the loss of certain remedies, including potentially substantial attorneys' fees and statutory damages. Wary plaintiffs holding unregistered copyrightable works of authorship should therefore at least apply for a copyright registration before or shortly after filing a copyright infringement lawsuit. Similarly, savvy defendants should seek to dismiss claims regarding unregistered works on grounds other than lack of subject matter jurisdiction.

Going forward, efforts to dismiss infringement claims based on § 411(a) will more likely turn on what qualifies as sufficient "registration." Indeed, there is a robust circuit split that may just give rise to another Supreme Court decision in the future. As the Ninth Circuit discussed in the recent *Cosmetic Ideas* case, in deciding whether to dismiss a copyright claim for lack of registration, "we are asked to answer the question: What does it mean to 'register' a copyrighted work?"[282] The analysis depends on whether a court considers a copyright to be registered "at the time the copyright holder's application is received by the Copyright Office (the 'application approach'), or at the time that the Office

280. *Id*. at 1249.

281. *Cosmetic Ideas, Inc. v. IAC/Interactivecorp.*, 606 F.3d 612, 615-16 (9th Cir. 2010), *cert. denied*, 2010 WL 4811301 (U.S. 2010); *see also TI Training Corp. v. FAAC, Inc.*, No. 1:09CV00973-WYD-MER, 2010 WL 2490535, at *3 (D. Colo. June 15, 2010) (reconsidering dismissal of copyright claim on basis of lack of jurisdiction, but dismissing nonetheless on the alternative ground that § 411(a) imposes a mandatory precondition to suit); *DRK Photo v. Houghton Mifflin Harcourt Publishing Co.*, No. CV-09-8225-PCT-NVW, 2010 WL 1688767, at *1 (D. Ariz. April 26, 2010) (dismissing copyright infringement claim to the extent it referred to unregistered work); *Shell v. Am. Family Rights Ass'n*, No. 09-CV00309-MSK-KMT, 2010 WL 1348548, at *15 n.22 (D. Colo. March 31, 2010) (same).

282. *Id.* at 615.

acts on the application and issues a certificate of registration (the 'registration approach')."[283] Noting the circuit split,[284] the Ninth Circuit held that "receipt by the Copyright Office of a complete application satisfies the registration requirement of § 411(a)."[285] A careful copyright holder will, of course, seek to register before asserting claims. But until the Supreme Court resolves this circuit split, he must also be aware of the circuit in which his registration will be adjudicated lest he fail to satisfy its rules.

## § 3.6.3 Circuit Split: Can the doctrine of laches bar a copyright infringement claim that is filed within the statute of limitations?

The eminent Judge Learned Hand wrote almost 100 years ago:

> It must be obvious to every one familiar with equitable principles that it is inequitable for the owner of a copyright, with full notice of an intended infringement, to stand inactive while the proposed infringer spends large sums of money in its exploitation, and to intervene only when his speculation has proved a success. Delay under such circumstances allows the owner to speculate without risk with the other's money; he cannot possibly lose, and he may win.[286]

Judge Hand's equitable analysis supports the application of the doctrine of laches to bar a copyright owner from suing an infringing party when it has delayed in enforcing its rights.

The *Haas* opinion, however, was issued before a three-year statute of limitations was added to the Copyright Act in 1957.[287] What to do, then, when a copyright owner knows of infringing conduct, but employs a "wait-and-see" strategy and files its claim on the last day of the limitations period only after the infringing party has begun to collect a profit? The answer is of particular

283. *Id.*

284. The Fifth and Seventh Circuits have adopted the application approach. *Apple Barrel Prods., Inc. v. Beard*, 730 F.2d 384, 386-87 (5th Cir. 1984); *Chicago Bd. of Educ. v. Substance, Inc.*, 354 F.3d 624, 631 (7th Cir. 2003). The Tenth and Eleventh Circuits have adopted the registration approach. *La Resolana Architects, PA v. Clay Realtors Angel Fire*, 416 F.3d 1195, 1202-04 (10th Cir. 2005), *abrogated in part by Reed Elsevier*, 130 S.Ct. at 1243 & n.2; *M.G.B. Homes, Inc. v. Ameron Homes, Inc.*, 903 F.2d 1486, 1489 (11th Cir. 1990), *abrogated in part by Reed Elsevier*, 130 S.Ct. at 1243 & n.2. The Ninth Circuit also noted that district courts are split on how to assess the fact of registration, sometimes even within the same circuit. *Cosmetic Ideas*, 606 F.3d at 615 n.4.

285. *Cosmetic Ideas*, 606 F.3d at 621.

286. *Haas v. Leo Feist, Inc.*, 234 F. 105, 108 (S.D.N.Y. 1916); *cf. Teamsters & Employers Welfare Trust of Ill. v. Gorman Bros. Ready Mix*, 283 F.3d 877, 882 (7th Cir. 2002) ("What is sauce for the goose (the plaintiff seeking to extend the statute of limitations [with the discovery rule]) is sauce for the gander (the defendant seeking to contract it [through laches]).").

287. 17 U.S.C. § 507(b).

importance in the copyright context because "[e]ach act of infringement is a distinct harm giving rise to an independent claim for relief."[288] Because infringing conduct often repeats, giving rise to new claims, a copyright owner may wait many years to file claims and not technically be barred by limitations for those claims arising within three years of the suit.

The U.S. Circuit Courts of Appeals are split on this question. The Fourth Circuit has held that the doctrine of laches cannot bar a copyright infringement claim that is filed within the statute of limitations.[289] In *Lyons Partnership*, the court reasoned that laches, as a judicially created doctrine, cannot usurp legislatively enacted statutes of limitations.[290] The court commented that because Congress created a cause of action under the Copyright Act, and further provided both legal and equitable remedies, the Copyright Act's statute of limitations should govern regardless of the remedy sought.[291] Therefore, because the Copyright Act provides for a three-year statute of limitations, "a court is not free to shorten the limitations period, even when a plaintiff seeks equitable relief."[292]

In the *Peter Letterese* case, the Eleventh Circuit parted with the Fourth Circuit and declined to hold that laches can never apply to a copyright case, but adopted a "strong presumption that a plaintiff's suit is timely if it is filed before the statute of limitations has run."[293] The Eleventh Circuit acknowledged that a court *may* apply laches to shorten a statute of limitations, but only in limited, rare cases.[294] Laches, for instance, could be applied in situations "where the plaintiff has unreasonably and inexcusably delayed in prosecuting its rights and where that delay has resulted in material prejudice to the defendant."[295] The court held, however, that even if laches were applied to a case, it "serves as a bar only to the recovery of retrospective damages, not to prospective relief."[296] Therefore, while limitations would bar an untimely claim altogether, laches would only bar recovery of damages, and not prospective injunctive relief.

The Sixth Circuit found that such an extraordinary circumstance existed in *Chirco v. Crosswinds Communities, Inc*.[297] In *Chirco*, the plaintiffs sought destruction of a condominium complex that allegedly infringed the plaintiffs' copyright. The Sixth Circuit determined that that situation constituted an extraordinary case for which the defense of laches could properly be applied.[298] The

288. *Stone v. Williams*, 970 F.2d 1043, 1049 (2d Cir. 1992).

289. *Lyons P'ship, L.P. v. Morris Costumes, Inc.*, 243 F.3d 789, 798-99 (4th Cir. 2001).

290. *Id.* at 798.

291. *Id.*

292. *Id.*

293. *Peter Letterese & Assocs. v. World Inst. Of Scientology Enters., Int'l*, 533 F.3d 1287, 1320 (11th Cir. 2008).

294. *Id.* at 1321; *see also Stuart Weitzman, LLC v. Microcomputer Res., Inc.*, 542 F.3d 859, 867 (11th Cir. 2008) (citing *Peter Letterese* and stating in dicta that "laches may provide an equitable defense even to timely filed infringement actions under extraordinary circumstances").

295. *Id.*

296. *Id.*

297. *Chirco v. Crosswinds Communities, Inc.*, 474 F.3d 227, 234 (6th Cir. 2007), *cert. denied*, 551 U.S. 1131 (2007).

298. *Id.* at 229.

Sixth Circuit reasoned that, in spite of the fact that the case was filed within the statute of limitations, laches could be raised as a defense because "the plaintiffs knew of the defendants' challenged construction plans and activities and yet failed to take readily-available actions to abate the alleged harm[.]"[299] Additionally, the defendants and innocent third parties had been unduly prejudiced by the plaintiffs' inaction.[300]

A number of other circuits have also held that laches may apply to bar a copyright claim in exceptional circumstances.[301] In light of this circuit split and the Fourth Circuit's bright-line rule, businesses seeking to enforce their copyright interests should be mindful of their circuit's position on the applicability of laches to infringement suits. However, even in the Fourth Circuit, a defendant should still preserve a laches argument in extreme situations, in case review might be possible in the Supreme Court.

# § 3.7 Patent

## § 3.7.1 The Supreme Court raises new questions about the patentability of business methods. *Bilski v. Kappos*

Whether and to what extent business methods can be patented is an important question for a variety of businesses, including financial institutions and software companies. Patents create substantial property rights that have inherent value, and can be used as leverage to outshine competitors in increasingly sophisticated markets.

The U.S. Supreme Court's much-anticipated decision in *Bilski v. Kappos*, offers both hope and confusion to owners and inventors of business methods.[302] Although *Bilski* may be viewed as good news by some because it holds that business methods *may be* patentable, the decision did not provide clear certainty as to which business methods *are* patentable, and increases the likelihood of unpredictable patent prosecution and litigation as courts attempt to develop further tests in line with the Supreme Court's reasoning.

299. *Id.* at 236.

300. *Id.*

301. *See Jacobsen v. Deseret Book Co.*, 287 F.3d 936, 951 (10th Cir. 2002), *cert. denied*, 537 U.S. 1066 (2002) ("Although 'it is possible, in rare cases, that a statute of limitations can be cut short by the doctrine of laches,'. . . we see no reason to supplant the statute of limitations in this case.") (quoting *United States v. Rodriguez-Aguirre*, 264 F.3d 1195, 1207-08 (10th Cir. 2001)); *Danjaq LLC v. Sony Corp.*, 263 F.3d 942, 952-53 (9th Cir. 2001); *Jackson v. Axton*, 25 F.3d 884, 888 (9th Cir. 1994), *overruled on other grounds by Fogerty v. Fantasy, Inc.*, 510 U.S. 517, 531-32 (1994); *New Era Publs. Int'l v. Henry Holt & Co.*, 873 F.2d 576, 584 (2d Cir. 1989), *cert. denied*, 493 U.S. 1094 (1990).

302. *Bilski v. Kappos*, 130 S. Ct. 3218 (2010).

In 1998, the Federal Circuit held in *State Street Bank* that any business method that produces a "useful, concrete and tangible result" is eligible for patent protection.[303] *State Street Bank* involved a patent application for a data processing system for a "hub and spoke" financial services configuration, by which mutual funds pooled their assets in a central "hub." By adopting the "useful, concrete and tangible result" test, the Federal Circuit extended patent eligibility to a wider range of method and process inventions than had been previously available. In response, many companies, some of which are non-practicing entities (i.e., companies that own patents but do not manufacture products covered by the patents), began aggressive campaigns of applying for and enforcing patents covering a myriad of software processes and business methods.

Ten years later, in 2008, the Federal Circuit backed away from the *State Street Bank* holding and held that the "useful, concrete and tangible test" was not to be relied upon exclusively for determining the patent eligibility of business methods.[304] Instead, the Federal Circuit held that, for a business method to be eligible for patent protection, it must satisfy the "machine-or-transformation test."[305] Under this test, a business method is patentable only if it: (1) is tied to a particular machine or apparatus or (2) transforms a particular article into a different state or thing.

With *In re Bilski* in hand, the Patent Office began routinely to reject patent applications for business methods that had been previously permitted under the useful, concrete and tangible test. Federal district courts began to invalidate existing business method patents on the basis that they were not eligible for consideration as patentable inventions. Thus, investors in, and owners of, substantial or important business method patents watched as the value of these patent assets sank toward worthlessness as *Bilski* was used to reject and invalidate business method patents. One district court dramatically noted that "[t]he closing bell may be ringing for business method patents, and their patentees may find they have become the bagholders."[306]

The Federal Circuit's 2008 decision in *In re Bilski* was appealed to the Supreme Court, which resulted in the June 28, 2010, opinion in *Bilski v. Kappos*. While the Supreme Court maintained the Federal Circuit's denial of patent rights for Bilski, the Supreme Court offered some hope to other business method patents by ruling that the machine-or-transformation test is an "investigative tool," but not the sole test for deciding whether a business method is eligible for patent protection. In other words, if a business method satisfies the machine-or-transformation test, it is most likely eligible for patent protection. If the business method does not satisfy the test, however, it may nevertheless still be

303. *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998).

304. *In re Bilski*, 545 F.3d 943 (Fed. Cir. 2008), *aff'd*, 130 S. Ct. 3218 (2010).

305. *Id.* at 959-60.

306. *CyberSource Corp. v. Retail Decisions, Inc.*, 620 F. Supp. 2d 1068, 1081 (N.D. Cal. 2009).

patent eligible. This may be good news for business method patent applicants and owners, but how good remains to be seen.

Although the Supreme Court's rejection of the exclusivity of the machine-or-transformation test may be encouraging, *Bilski v. Kappos* should also give business method patent applicants and owners pause. First, the Supreme Court did not outline acceptable alternatives to the machine-or-transformation test, and instead relied on "guideposts" from previous Supreme Court rulings, which stand for the long-accepted rule that laws of nature, physical phenomena, and abstract ideas are not eligible for patent protection. The Supreme Court further suggested that additional tests may be developed in the future.

Second, the Supreme Court's application of the "guideposts" in *Bilski* was remarkably short. The patent application in question sought to protect a specific series of steps for mitigating a company's exposure to fluctuations in the price of a commodity, which was summarily characterized by the Supreme Court as "hedging." The Supreme Court then asserted that "hedging" was an abstract idea and thus ineligible for patent protection. This analytical approach—distilling an invention to one word and then calling it an abstract idea—may encourage the Federal Circuit, district courts, and the Patent Office to follow suit. Thus, patent applications for inventions that are new and useful, but that nonetheless can be summarily reduced to a shorter phrase or a single term, may be invalidated or rejected.

When seeking to apply for or enforce patents covering business methods and processes, applicants and owners should presume that the machine-or-transformation test is likely to remain the primary test for patent eligibility.[307] Moreover, courts are likely to develop additional tests for patent eligibility, or modify the machine-or-transformation test, particularly given that the Supreme Court invited the development of such tests to separate patentable advances from unpatentable abstract ideas. As a guide, the Supreme Court indicated that any future tests should further the goals of the patent system— to promote the progress of science and useful arts.

Thus, while the Supreme Court has kept business method patents afloat, it is clear that the future of business method and software patents is anything but clear. When pursuing patent protection, inventors and counselors must carefully consider how to navigate the uncharted waters ahead. Only with sufficient planning in protecting business method inventions will patent owners be able to pass through the rocky shoals of *Bilski* and land successfully.

307. In fact, one recent court utilized the machine-or-transformation test and held (i) tying a process to the "Internet" and the "mere act of storing media on computer memory" does not meet the machine test, and (ii) transfer of data from one computer to another does not meet the transformation test. The court then distilled the invention to "one can use advertisement as an exchange or currency," labeled it an abstract idea, and invalidated the patent. *Ultramercial, LLC v. Hulu, LLC*, Case No. CV 09-06918 RGK, 2010 U.S. Dist. LEXIS 93453 (C.D. Cal. Aug. 13, 2010).

## § 3.7.2 The Supreme Court will consider the level of proof required to establish the state-of-mind element of a claim that the defendant induced patent infringement. *Global-Tech Appliances, Inc. v. SEB S.A.*

In *Global-Tech Appliances, Inc. v. SEB S.A.*,[308] the Supreme Court is primed to clarify the burden of proof on the state-of-mind element necessary to support a claim for inducing patent infringement.[309] Specifically, the Court will consider the issue of whether knowledge of a patent's existence is required to support a claim that a defendant induced infringement by a third party, or if "deliberate indifference" is sufficient to satisfy the state-of-mind requirement.

In *Global Tech*, defendant Pentalpha Enterprises, Ltd. (Pentalpha) was alleged to have copied a portion of the design of a competitor's product, an insulated deep fryer for home kitchen use.[310] Pentalpha retained an attorney to conduct a right-to-use study, but failed to inform the attorney that it had copied its design from an existing product.[311] The attorney analyzed 26 patents and concluded that none of the claims in those patents read on the defendant's fryer design.[312] Pentalpha began selling the infringing fryers to Sunbeam, Fingerhut, and Montgomery Ward (the Resellers), each of which in turn resold the fryers under their own trademarks.[313] The plaintiff patent holder (SEB) brought claims against Pentalpha for direct infringement and for inducing patent infringement by the Resellers.

After the close of evidence at trial, Pentalpha moved for judgment as a matter of law on the ground that there was no evidence that Pentalpha had knowledge of the patent's existence.[314] The district court rejected the motion and submitted the infringement claims to the jury, which found in favor of the plaintiff on both the direct infringement and the inducement claims and awarded $4.65 million in damages.[315]

Shortly after the jury's verdict in *Global-Tech*, the Federal Circuit issued its opinion in *DSU Medical Corporation v. JMC Co.*, in which it attempted to clarify the standard for demonstrating the required specific intent under a theory of induced infringement.[316] Sitting en banc, the Federal Circuit held that "the plaintiff has the burden of showing that the alleged infringer's actions

308. *SEB S.A. v. Montgomery Ward & Co.*, 594 F.3d 1360, 1369 (Fed. Cir. 2010), *cert. granted*, *Global-Tech Appliances, Inc. v. SEB S.A.*, 131 S. Ct. 458 (2010).

309. "Whoever actively induces infringement of a patent shall be liable as an infringer." 35 U.S.C. § 271(b).

310. *Id.* at 1366.

311. *Id.*

312. *Id.*

313. *Id.*

314. *Id.* at 1367, 1373.

315. *Id.* at 1368, 1374.

316. *DSU Medical Corporation v. JMC Co.*, 471 F.3d 1293, 1304 (Fed. Cir. 2006).

included infringing acts and that he knew of or should have known his action would induce actual infringement."[317] The circuit court further noted that "[t]he requirement that the alleged infringer knew or should have known his actions would induce actual infringement necessarily includes the requirements that he or she knew of the patent."[318]

Based in part on the holding of *DSU Medical*, Pentalpha appealed, complaining again that there was no evidence that it "knew of the patent."[319] The Federal Circuit affirmed the district court's judgment on the inducement claim, holding that Pentalpha's "deliberate indifference of a known risk is not different from actual knowledge, but is a form of actual knowledge."[320]

The *Global-Tech* case obfuscates the standard for demonstrating the specific intent that is required to prove induced infringement. Indeed, the Federal Circuit explicitly declined to "establish the outer limits of the type of knowledge needed for inducement," and noted in dicta that "a patentee may perhaps only need to show . . . constructive knowledge with persuasive evidence of disregard for clear patent markings," leaving alleged infringers to fend for themselves.[321] For instance, a significant question arises as to how to gauge an alleged infringer's constructive knowledge or deliberate indifference, particularly when the alleged infringer relies on the advice of counsel regarding its right to use a particular design. The Supreme Court's consideration of these issues in *Global-Tech* should provide some much-needed clarity regarding the necessary level of proof of intent to sustain a finding of induced patent infringement.

*Update: oral argument took place on February 23, 2011.*

## § 3.7.3 Is a defendant required to prove a patent-invalidity defense by clear and convincing evidence? *Microsoft Corp. v. i4i Limited Partnership*

The Supreme Court will hear arguments in a patent case that may test the "business-friendly" tagline that has been associated with the Roberts court. In *Microsoft Corp. v. i4i Limited Partnership*,[322] the Court will consider whether

317. *Id.* (citing *Manville Sales Corp. v. Paramount Sys., Inc.*, 917 F.2d 544, 554 (Fed. Cir. 1990)).

318. *Id.*

319. *Global-Tech Appliances*, 594 F.3d at 1376.

320. *Id.* at 1377 (citing *United States v. Carani*, 492 F.3d 867, 873 (7th Cir. 2007) and *Woodman v. WWOR-TV, Inc.*, 411 F.3d 69, 84 n.14 (2d Cir. 2005)). The court did note, however, that an "accused infringer may defeat a showing of subjective deliberate indifference to the existence of a patent where it shows that it was genuinely 'unaware even of an obvious risk.'" *Id.* at 1376-77 (quoting *Farmer V. Brennan*, 511 U.S. 825, 840 (1994)). The defendant in *Global-Tech* had presented no such evidence.

321. *Id.* at 1378.

322. *i4i Ltd. P'ship v. Microsoft Corp.*, 598 F.3d 831 (Fed. Cir. 2010), *cert. granted*, *Microsoft Corp. v. I4I Ltd. P'ship*, 131 S. Ct. 647 (2010).

the "invalidity defense" provided for in the Patent Act must be proved by clear and convincing evidence, or whether a less exacting standard should apply. Current Federal Circuit precedent requires "clear and convincing" evidence before a defendant accused of patent infringement can successfully assert as a defense that the underlying patent was invalid.[323] The titans of the technology, communications, and wholesale industries have all lined up as amici to support petitioner Microsoft in an effort to persuade the Court to ease the standards for invalidating patents.

The software company "i4i" invented and patented a program for editing custom XML, a computer language which, among other tasks, tells the computer when a word should appear in bold on the screen. i4i sued Microsoft, alleging that the XML editor in certain versions of Microsoft Word infringed on i4i's patent. Microsoft argued at trial that i4i's patent was invalid because the "invention was anticipated under 35 U.S.C. § 102(b),"[324] because i4i sold a program that arguably contained the patent to another company more than a year before i4i filed the patent application.

The test for the invalidity of a patent under an "anticipation" defense is whether the patent was "on sale in this country more than one year prior to the date of the application for patent in the United States."[325] On that issue, the jury was asked, "[d]id Microsoft prove by clear and convincing evidence" that i4i's patent claims were invalid? The jury answered in the negative, and the district court denied Microsoft's motions for judgment as a matter of law or for a new trial on the issue.[326] The jury found Microsoft liable for willful infringement and awarded i4i $200 million in damages.

On appeal, Microsoft argued that the jury instruction requiring Microsoft to prove invalidation by clear and convincing evidence was reversible error. The Federal Circuit disagreed, holding that to "prove invalidity by the on-sale bar, a challenger must show by clear and convincing evidence that the claimed invention was on sale in this country more than one year prior to the date of the application for patent in the United States."[327] Microsoft filed a petition for writ of certiorari, asking the Supreme Court to decide whether an invalidity defense must be proved by clear and convincing evidence.

This case has elicited amici briefs from a veritable "who's who" of technology and wholesale companies, with Google, Yahoo!, Facebook, Verizon, Dell, Hewlett-Packard, Netflix, and Walmart, among others, all siding with Micro-

323. *Id.* at 846 (citing cases).

324. Section 102(b) addresses the conditions of patentability, and provides in relevant part that a person shall be entitled to a patent unless "the invention was patented or described in a printed publication in this or a foreign country or in public use or on sale in this country, more than one year prior to the date of the application for patent in the United States." 35 U.S.C. § 102(b).

325. *i4i Ltd. P'ship*, 598 F.3d at 834.

326. *i4i Ltd. P'ship v. Microsoft Corp.*, 670 F. Supp. 2d 568 (E.D. Tex. 2009).

327. *i4i Ltd. P'ship*, 598 F.3d at 846 (internal quotes and citation omitted).

soft.[328] Even Microsoft's primary competitor, Apple, filed an amicus brief in support of Microsoft's position. Google's brief claims that it, along with the other amicus filers, has "also been unfairly and repeatedly accused of infringing others' patented technology [and thus has] a strong interest in a fair and balanced patent system that rewards rather than impedes actual innovation."[329] A common theme in the briefs filed by the amici is the assertion that the Patent and Trademark Office (PTO) issues too many unsupportable patents, and thus defendants should not be forced to surmount the "clear and convincing" standard to invalidate patents that should never have been granted.

The Court's decision in *Microsoft* could serve a major blow to the current deference given to the PTO's administrative decisions, and could ring a victory for large technology companies faced with a near-constant battery of patent infringement claims, many of which have resulted in large jury awards such as the $200 million at issue in the *Microsoft* case.

# § 3.8 Preemption

## § 3.8.1 The Perfect Preemption Storm: The risks and rewards for businesses invoking federal preemption doctrines in turbulent times

For the business law community and the industries it serves, the practical importance of the federal preemption doctrine cannot be overstated. Preemption can be an effective way for businesses to maintain uniformity and predictability in multi-state operations and insurance matters, to avoid substantial liability under state product liability and negligence laws, and to thwart state efforts to impose burdensome regulations on local business activities. Hundreds of millions of dollars are often at stake for the nationwide industries in which preemption tends to arise—a sampling of which includes food, agriculture, healthcare, communications, utilities, employment, banking, pharmaceuticals, the automotive industry, securities, and immigration.

Federal preemption has received special attention in the Supreme Court's recent terms, in which the Court has issued a stream of important opinions refining federal preemption jurisprudence and applying it in the context of recent legislative reforms. Congress's power to preempt state law is derived from the United States Constitution, Article VI, Clause 2—the Supremacy Clause—which provides as follows:

328. The various briefs filed in the appeal are available at http://www.i4ilp.com/papers.php.

329. *See* Brief of Google Inc., Verizon Communications Inc., Dell Computer Corp., Hewlett-Packard Co., HTC Corp., and Wal-Mart Stores Inc. as *Amici Curiae* in Support of Petitioner, at 1, *available at* http://www.i4ilp.com/court/i4i%20--%20Google-Verizon%20Amicus%20Br.pdf.

> This Constitution, and the Laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the constitution or laws of any state to the contrary notwithstanding.

Although the States possess sovereignty concurrent with that of the federal government, state sovereignty is subject to limits imposed by the Supremacy Clause.[330] In effect, the Supremacy Clause gives Congress the power to exclude—or "preempt"—state law in a field as Congress defines it, as long as Congress is acting within the powers granted it under the Constitution.

Predicting the preemption doctrine's application to, or effect upon, a particular state law or business activity is no simple task—and the consequences of a prediction later proven to be mistaken can cost a business dearly. As many of the cases discussed in this subchapter illustrate, litigating these issues can take years and cost millions, and a defendant's victory at the district court or circuit court level cannot necessarily be relied upon as a predictor of what a higher appellate court might later decide. Moreover, a preemption decision in a case involving an individual business could have dramatic consequences for all businesses in the same or related industries. In light of the stakes involved and the Supreme Court's recent focus on the subject, a review of the special challenges presented in preemption cases is warranted.

*First*, preemption standards are complex and hard to navigate. Preemption jurisprudence is arcane, fact-specific, and can vary significantly depending on the laws alleged to be in conflict and the jurisdiction in which the lawsuit is filed. Preemption can be express or implied, complete or partial. State law can be preempted by federal inaction or action, including the U.S. Constitution, congressional actions, federal common law and judicial precedent, executive actions, or agency regulations. Federal laws giving rise to preemption arguments may be mooted by legislative amendment or judicial review on non-preemption grounds. Whether a particular federal law preempts a specific state action often depends heavily on statutory language, express or implied congressional intent, and legislative history—any of which can be sparse, ambiguous, and subject to conflicting interpretations by different courts. A preemption argument can qualify as a claim or defense, which impacts a party's ability to invoke federal removal jurisdiction or to keep a case in state court. These variables make preemption jurisprudence difficult to navigate for even the most devoted Supreme Court scholars and talented litigators.

*Second*, like all common law doctrines, preemption is constantly evolving and can thus prove to be unpredictable over time. The rules governing the application of preemption doctrines can vary significantly depending on the area of law and the industry in question, and are constantly subject to interpretation and refinement in subsequent cases. Although legal authorities often describe three tests for determining whether a state statute is preempted (express preemption,

330. *Tafflin v. Levitt*, 493 U.S. 455, 458 (1990).

field preemption, and implied conflict preemption[331]), there are many nuances to these tests that can impact strategy in a particular case, as the Supreme Court has described:

> Pre-emption occurs when Congress, in enacting a federal statute, expresses a clear intent to pre-empt state law, . . . when there is outright or actual conflict between federal and state law, . . . where compliance with both federal and state law is in effect physically impossible, . . . where there is implicit in federal law a barrier to state regulation, . . . where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the States to supplement federal law, . . . or where the state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress.[332]

In the quarter century since the Supreme Court outlined these categories in the *Louisiana Public Service Commission case*, the Court has issued dozens of preemption opinions further revising and honing preemption tests, which have in turn been interpreted and applied in thousands of lower federal and state cases. Conflicts have emerged between federal courts in different circuits, as well as between federal and state courts. Conflicts are resolved by judicial review or legislation, after which other conflicts eventually emerge for renewed debate and eventual resolution among the assorted courts and jurisdictions. This constant evolution of preemption jurisprudence makes it virtually impossible to predict with long-term reliability how preemption will apply to a particular business activity or regulation. This uncertainty is particularly problematic when legislative revisions and industry innovations outpace the "deliberate" speed of judicial decision-making.

*Third*, modern crises and shifting national priorities have provoked sweeping legislative reforms that will give rise to uncharted preemption issues. In the last few years, the United States has experienced dramatic political shifts in Congress and the White House, a growing national healthcare emergency, and the worst financial crisis since the Great Depression of the 1930's. After decades of gradual banking deregulation, the federal government was suddenly forced to undertake an unprecedented government bailout of major banking institutions to avoid national economic calamity. As the financial crisis detonated and swelled, businesses and state governments alike struggled with

331. The three tests for determining whether a state law is preempted have been described as: "[(1)] Whether the scheme of federal regulation is so pervasive as to make reasonable the inference that Congress left no room for the states to supplement it; [(2)] Whether the federal statutes touch a field in which the federal interest is so dominant that the federal system must be assumed to preclude enforcement of state laws on the same subject; and [(3)] whether enforcement of the state statute presents a serious danger of conflict with the administration of the federal program." 16A Am. Jur. 2d *Constitutional Law* § 234 (citing cases).

332. *Louisiana Public Service Comm'n v. Fed. Commc'n Comm'n*, 476 U.S. 355, 368-69 (1986) (case citations omitted).

paralyzing liquidity and credit scarcities, suffered dramatic losses in the stock market, pension funds, and real estate, and faced bankruptcy (if they could afford the financing needed for the process) or financial ruin. Major financial institutions, insurance companies, and accounting firms—many of which had enjoyed unprecedented profits during the period of deregulation—were forced to defend exorbitant executive compensation packages as their customers and employees lost their life savings and jobs. Executives and institutions alike faced massive lawsuits and criminal prosecutions alleging Ponzi schemes, securities fraud, and expanding lender liability theories predicated on the wrongful conduct of others. The consumer lending industry, after enjoying a prolonged period of relatively minimal regulation and strong consumer appetite to spend beyond one's means, was charged with predatory consumer lending practices that contributed to insurmountable debt and home foreclosures as real estate prices plummeted and unemployment shot up.

This economic upheaval, transpiring at the same time the U.S. is engaged in the costly effort to protect its borders and citizens from terrorist threats at home, abroad, and online, has understandably given rise to local and vocal anti-immigration movements, tougher consumer finance protection rules, sweeping healthcare reform, demands for greater transparency and accountability for financial institutions and their executives, and stricter divides between banking and investing activities.[333] Whether arising from state or federal law, all of these legislative actions are likely to give rise to preemption issues as new federal priorities conflict with state laws.

## § 3.8.2 Do the Supreme Court's recent preemption decisions cast doubt upon the Court's supposed "pro-business" leaning?

In striking succession, Supreme Court issued a number of significant preemption opinions in the October 2008 term that are worthy of review in setting the stage for analyzing the Court's 2010 decisions. As these cases illustrate, it is fair to say that the Court's pro-business reputation has not exactly been vindicated by its recent preemption jurisprudence.

In early 2008, the Court held in *Riegel v. Medtronic* that the Medical Device Amendments of 1976 (MDA) created a scheme of federal safety oversight for

333. Major recent legislative initiatives passed by Congress and signed into law by President Obama include the Lilly Ledbetter Fair Pay Act; the Children's Health Insurance Reauthorization Act; the American Recovery and Reinvestment Act; the Credit Card Accountability, Responsibility, and Disclosure Act of 2009; the Worker, Homeownership, and Business Assistance Act of 2009; the Patient Protection and Affordable Care Act; the Dodd-Frank Wall Street Reform and Consumer Protection Act; the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010; and the Food Safety and Modernization Act. Each of these legislative actions is likely to give rise to preemption issues as they come into conflict with state law and regulate businesses that would otherwise be subject to state law.

medical devices that preempted state tort claims.[334] The MDA includes an express preemption provision under which state may establish a safety or effectiveness requirement that "is different from, or in addition to, any requirement applicable under this chapter to the device."[335] The Supreme Court applied this provision to hold that the MDA's preemption clause bars common-law claims challenging the safety or effectiveness of a medical device marketed in a form that received premarket approval from the FDA.

Despite its preemption holding in *Medtronic*, the Supreme Court soon disappointed pro-business observers in *Altria Group, Inc. v. Good*, holding that a state deceptive-trade-practices law prohibiting deceptive tobacco advertising was not preempted by federal law regulating cigarette advertising.[336] The Court held that, while smokers' lawsuits are preempted by the Federal Cigarette Labeling and Advertising Act (the Labeling Act) if they claim that the tobacco companies did not warn them in their marketing about how unhealthy cigarette smoking is, their claims based on a broader legal obligation detached from claims about smoking and health—for example, a claim that the cigarette company's marketing was an attempt to deceive by misrepresenting or leaving out key facts about their products (fraud)—may proceed. Justice Thomas, joined by Chief Justice Roberts and Justices Scalia and Alito, issued a dissenting opinion, arguing that the Court should adopt a clear test that expressly preempts any state law claim that imposes an obligation because of the effect of smoking upon health.

Then, in March 2009, the Supreme Court held in the much-anticipated decision in *Wyeth v. Levine* that the Federal Drug Administration's (FDA) approval of a brand-name drug's warning label does not bar lawsuits under state law giving rise to liability for inadequate warnings of a health risk.[337] The plaintiff in *Levine* was forced to undergo an arm amputation after suffering an adverse reaction to the anti-nausea drug Phenergren. Levine sued the manufacturer of the drug, Wyeth, in Vermont state court for failure to warn under state-law tort theories. Wyeth sought summary judgment on the state failure-to-warn claim on the basis that it was preempted by federal law because the warnings on the drug's label had been deemed sufficient by the FDA when it approved the drug and its labeling. Following a jury verdict and judgment in the plaintiff's favor, the Vermont Supreme Court affirmed, holding that the state law claim was not preempted because the "federal labeling requirements create a floor, not a ceiling, for state regulation."[338] In dissent, Vermont's Chief Justice Reiber argued that the jury's verdict conflicted with federal law because it was inconsistent with the FDA's conclusion that intravenous administration of Phenergan was safe and effective. Noting "[t]he importance of the pre-emption issue, coupled with the fact that the FDA has changed its position on state tort law and now

334. *Riegel v. Medtronic, Inc.*, 552 U.S. 312 (2008).
335. 21 U.S.C. § 360c.
336. *Altria Group, Inc. v. Good*, 555 U.S. 70 (2008).
337. *Wyeth v. Levine*, 129 S. Ct. 1187 (2009).
338. *Levine v. Wyeth*, 944 A.2d 179, 184 (Vt. 2006), *aff'd*, 129 S. Ct. 1187 (2009).

endorses the views expressed in Chief Justice Reiber's dissent," the Supreme Court was persuaded to grant certiorari.[339]

Affirming the Vermont high court in a 6-3 opinion by Justice Stevens, the Supreme Court held in *Levine* that the state law claims were not preempted by the FDA's approval of the brand-name warning label. The Court first held that Wyeth had not shown it was impossible to comply with both federal and state warning requirements.[340] The Court then rejected Wyeth's argument that the FDA "must be presumed to have performed a precise balancing of risks and benefits and to have established a specific labeling standard that leaves no room for different state-law judgments."[341] In support of this argument, Wyeth relied on the preamble to a 2006 FDA regulation governing the content and format of prescription drug labels, in which the FDA expressed the view that "FDA approval of labeling . . . preempts conflicting or contrary State law" and that state failure-to-warn claims "threaten FDA's statutorily prescribed role as the expert Federal agency responsible for evaluating and regulating drugs."[342] The Court recognized that although an agency regulation with the force of law can preempt conflicting state requirements, "an agency's mere assertion that state law is an obstacle to achieving its statutory objectives" is insufficient to preempt state law.[343] However, although the Court ruled against preemption in *Levine*, a concurring opinion by Justice Breyer gave preemption supporters some comfort by emphasizing that "it is possible" that "lawful specific [FDA] regulations describing, for example, when labeling requirements serve as a ceiling as well as a floor . . . would have pre-emptive effect."[344] Notably, *Levine* applies only to brand-name pharmaceuticals because the Court did not address the preemption question with regard to generic drug makers. That open question should be resolved by the Court's December 10, 2010 decision to grant certiorari in a trio of consolidated cases that raise the issue of whether *Levine* should be extended to generic drug manufacturers.[345]

In the summer of 2009, the Supreme Court considered a federal law that attempted to do just that, and nonetheless found no preemption. In *Cuomo v. Clearing House Ass'n, L.L.C.*, the Court held in a 5-4 opinion by Justice Scalia that claims under state fair lending laws are not preempted by the National Banking Act (NBA) and that a state attorney general may bring a judicial enforcement action to enforce state law against a national bank.[346] The Court held that the Office of the Comptroller of the Currency's (OCC) regulation

339. *Wyeth*, 129 S. Ct. at 1193.

340. *Id*. at 1199.

341. *Id*. at 1200.

342. 71 Fed. Reg. 3922, 3934-35 (2006).

343. *Wyeth*, 129 S. Ct. at 1193.

344. *Id.* at 1204 (Breyer, J., concurring).

345. *See infra* § 3.8.4, discussing *PLIVA, Inc. v. Mensing*, No. 09-993, 131 S. Ct. 817 (2010), and related cases consolidated for oral argument.

346. *Cuomo v. Clearing House Ass'n, L.L.C.*, 129 S. Ct. 2710 (2009). *Cuomo* involved the New York Attorney General's investigation into the lending practices of several national banks that were alleged to have issued a disproportionate number of high-interest loans to minority borrowers.

purporting to preempt state law enforcement is not a reasonable interpretation of the NBA, which provides that "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts . . . or . . . directed by Congress."[347] The Court construed the term "visitorial powers" to be limited "to a sovereign's supervisory powers over corporations," or "administrative oversight."[348] The Court emphasized the distinction between supervisory powers, where the OCC has a monopoly and the NBA preempts state action, and law enforcement (such as bringing suit to enforce state law against a national bank), where federal agencies and the states have jurisdiction over national banks.

Consistent with Breyer's concurring opinion in *Levine* (noting that any "lawful" and "specific" federal regulations may preempt state law), the Court's analysis in *Medtronic*, *Altria Group*, and *Cuomo* indicates that the Court is willing to review regulations purporting to preempt law to ensure they are both authorized by federal statute and specific to the state law claim alleged to be preempted. Indeed, the Court is currently considering a number of significant cases involving federal laws with variously-worded preemption provisions—each of which turned in the lower courts on the Supreme Court's analysis in these cases.

## § 3.8.3 The Supreme Court will decide whether tort claims related to vaccines are preempted by the National Childhood Vaccine Injury Act. *Bruesewitz v. Wyeth*

Following on the heels of *Wyeth v. Levine*, the Supreme Court is currently considering in *Bruesewitz v. Wyeth*[349] the question of whether the National Childhood Vaccine Injury Act of 1986[350] (the Vaccine Act) preempts state tort claims alleging design defects and failure to warn. The Vaccine Act protects vaccine manufacturers from tort liability for certain injuries caused by vaccines, and instead offers injured patients the opportunity for government compensation through an alternative "Vaccine Court."

In April 1992, six-month-old Hannah Bruesewitz received Wyeth's Tri-Immunol diphtheria-tetanus-pertussis (DTP) vaccine. The vaccine caused numerous seizures, leaving Hannah developmentally impaired and likely to require medical care for the remainder of her life. In 1998, Wyeth withdrew Tri-Immunol from the market.[351]

347. 12 U.S.C. § 484(a).

348. *Cuomo*, 129 S. Ct. at 2721.

349. *Bruesewitz v. Wyeth Inc.*, 561 F.3d 233 (3d Cir. 2009), *cert. granted*, 130 S. Ct. 1734 (2010).

350. P.L. 99-660, Title III, 100 Stat. 3743, 3756-3784 (codified at 42 U.S.C. § 300aa-1 *et seq.*).

351. *Bruesewitz*, 561 F.3d at 236-37.

The Vaccine Act provides that "[n]o vaccine manufacturer shall be liable in a civil action for damages . . . *if* the injury or death resulted from side effects that were *unavoidable* even though the vaccine was properly prepared and was accompanied by proper directions and warning."[352] In lieu of these state court civil actions, the Vaccine Act established a so-called Vaccine Court, which is part of the United States Court of Federal Claims, to consider claims and compensate families of children who suffer certain "on-table" vaccine-related injuries.[353]

A petitioner in a Vaccine Court is entitled to compensation from the government if: (1) the Vaccine Act applies to the vaccine in question; (2) the plaintiff suffered an injury listed on the "Vaccine Injury Table";[354] and (3) it cannot be shown by a preponderance of the evidence that the alleged injuries were *not* caused by the vaccine.[355] If a petitioner suffered an injury that is not listed on the Vaccine Injury Table, he may still obtain compensation by proving that the vaccine caused his injury.[356] After the Vaccine Court has issued a final judgment, the petitioner may either accept or reject that judgment.[357] If the petitioner rejects the judgment, he may pursue certain limited claims in state or federal court.[358]

Hannah's parents filed a petition in the Vaccine Court in April 1995, alleging that Hannah suffered an on-table residual seizure disorder and encephalopathy. After the Vaccine Court rejected these claims, the petitioners pursued claims against Wyeth in federal district court for negligence and strict liability. The district court held that the Act preempted all design defect claims and concluded that the petitioners failed to provide sufficient evidence to support the other two claims.[359]

The Third Circuit affirmed, noting that the states have "'broad police powers in regulating the administration of drugs by the health professions,'"[360] and that "[h]istorically, the states have possessed 'great latitude under their police powers to legislate as to the protection of the lives, limbs, health, comfort, and quiet' of their citizens."[361] The Third Circuit found the relevant provisions in the Vaccine Act to be ambiguous, and in support of its holding conducted an analysis of "the language, structure, and purpose of the Vaccine Act to ascertain

352. 42 U.S.C. § 300aa-22(b)(1) (emphasis added).

353. *Bruesewitz*, 561 F.3d at 235-36 (citing 42 U.S.C. § 300aa-11).

354. 42 U.S.C. § 300aa-14 (listing the "vaccines, the injuries, disabilities, illnesses, conditions, and deaths resulting from the administration" of vaccines for which individuals may seek compensation).

355. *Id*. at §§ 300aa-11, 300aa-13.

356. *Bruesewitz*, 561 F.3d at 236.

357. 42 U.S.C. § 300aa-21 *et seq.*

358. 42 U.S.C. § 300aa-21.

359. *Bruesewitz v. Wyeth, Inc*., 508 F. Supp. 2d 430 (E.D. Pa. 2007), *aff'd*, 561 F.3d 233 (3d Cir. 2009), *cert. granted*, 130 S. Ct. 1734 (2010).

360. *Bruesewitz v. Wyeth, Inc*., 561 F.3d 233, 235 (3d Cir. 2009), *cert. granted*, 130 S. Ct. 1734 (2010) (quoting *Whalen v. Roe*, 429 U.S. 589, 603 (1977)).

361. *Bruesewitz*, 561 F.3d at 235 (quoting *Metro. Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 756 (1985)).

whether it preempts all design defect claims."[362] The Supreme Court granted the petition for writ of certiorari on September 3, 2010.[363]

The issue on appeal revolves around the proper statutory interpretation of the Vaccine Act. The petitioners argue that the Vaccine Act was enacted to promote vaccine safety and to ensure fair compensation for vaccine-related injuries.[364] With this purpose in mind, petitioners contend that the Vaccine Act's phrase "[n]o vaccine manufacturer shall be liable in a civil action for damages . . . *if* the injury or death resulted from side effects that were *unavoidable*"[365] must be interpreted to mean that the vaccine manufacturer enjoys immunity from civil liability only for those side effects that "could not have been prevented" by a better drug design.[366] Under this view, the issue of avoidability is a predicate to immunity that must be determined on a case-by-basis as part of a court's examination of a design defect claim.[367]

In support of their interpretation, petitioners argue that "unavoidable" is a term of art that Congress intended to be construed as used in comment k to Restatement (Second) of Torts § 402A.[368] Comment k reads in relevant part as follows:

> *Unavoidably unsafe products.* There are some products which, in the present state of human knowledge, are *quite incapable of being made safe for their intended and ordinary use*. These are especially common in the field of drugs. An outstanding example is the vaccine for the Pasteur treatment of rabies, which not uncommonly leads to very serious and damaging consequences when it is injected. Since the disease itself invariably

362. *Id.* at 245.

363. *Bruesewitz v. Wyeth, Inc.*, 130 S. Ct. 1734 (2010).

364. *See* Brief for Petitioners Russell Bruesewitz and Robalee Bruesewitz, Parents and Natural Guardians of Hannah Bruesewitz, a minor child, and In Their Own Right at 51, *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/09-10/09-152_Petitioner.pdf.

365. 42 U.S.C. § 300aa-22(b)(1) (emphasis added). The Vaccine Act does not define the term "unavoidable."

366. *See* Brief for Petitioners Russell Bruesewitz and Robalee Bruesewitz at 28.

367. *See id.* at 35-45.

368. RESTATEMENT (SECOND) OF TORTS § 402A ("Special Liability of Seller of Product for Physical Harm to User or Consumer"). Restatement § 402A reads as follows:

(1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if
   (a) the seller is engaged in the business of selling such a product, and
   (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

(2) The rule stated in Subsection (1) applies although
   (a) the seller has exercised all possible care in the preparation and sale of his product, and
   (b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

> leads to a dreadful death, both the marketing and the use of the vaccine are fully justified, notwithstanding the unavoidable high degree of risk which they involve. Such a product, *properly prepared, and accompanied by proper directions and warning*, is not defective, nor is it unreasonably dangerous. . . . The seller of such products, *again with the qualification that they are properly prepared and marketed, and proper warning is given*, where the situation calls for it, is not to be held to strict liability for unfortunate consequences attending their use, merely because he has undertaken to supply the public with an apparently useful and desirable product, attended with a known but apparently reasonable risk.[369]

Petitioners rely on this language to argue that a product's safety risks are "unavoidable" under the Vaccine Act only "*if*" it is "incapable of being made safe for [its] intended and ordinary use."[370]

Wyeth argues in response that the Vaccine Act preempts all but two kinds of state-law tort claims: those arising from manufacturing defects and a failure to warn.[371] According to Wyeth, which also relies on comment k to Restatement § 402A, state law claims may be asserted only if the injury or death could have been avoided by proper preparation or proper directions and warnings, and that adoption of the petitioners' reasoning would eviscerate the Vaccine Act's immunity protections.[372] By allowing design-defect claims to proceed through trial and putting manufacturers through the expense of establishing "unavoidability" on case-by-case basis (i.e., that their vaccines employed the safest design), the Vaccine Act would offer no protection to manufacturers beyond that already available under state law before the Act.[373] Wyeth argues that the structure of the Act, with generous payments to victims of vaccine injuries, as well as contemporaneous legislative history, all indicate that Congress intended to bar state law design-defect claims like those asserted by the Bruesewitzes.[374]

At argument on October 12, 2010, the Justices struggled with the question of why the Vaccine Act's language was so opaque if Congress had intended to preempt all design-defect claims, and why it had not simply made the Vaccine Court an exclusive remedy.[375] On the other hand, the Justices appeared somewhat animated by the fear that a ruling in favor of the petitioners would open the doors for thousands of cases for parents alleging a link between vaccines and autism. Indeed, Justice Breyer queried during the oral argument whether

369. Restatement (Second) of Torts § 402A cmt. k (emphasis added).

370. *See* Brief for Petitioners Russell Bruesewitz and Robalee Bruesewitz at 32.

371. *See* Brief for Respondent Wyeth, Inc. F/K/A Wyeth Laboratories, Wyeth-Ayerst Laboratories, Wyeth Lederle, Wyeth Lederle Vaccines and Lederle Laboratories, *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/09-10/09-152_Respondent.pdf.

372. *See, e.g.*, *id.* at 42-43.

373. *See id.* at 53-57.

374. *See id.* at 56-48.

375. Transcript of Oral Argument, *Bruesewitz v. Wyeth, Inc*. (Oct. 12, 2010), *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-152.pdf.

a holding in favor of the Bruesewitzes would undermine Congress's intent by "driving certain vaccines from the market."[376]

Whatever the Court's decision in *Bruesewitz*, it will surely have great significance in products liability cases concerning vaccines and for the pharmaceutical industry, particularly given the continuing controversy about allegations that some vaccines are linked to autism and healthcare reform measures related to pediatric vaccines.[377]

*Update: In a 6-2 opinion by Justice Scalia issued on February 22, 2011, the Supreme Court affirmed the Third Circuit, holding that "the National Childhood Vaccine Injury Act preempts all design-defect claims against vaccine manufacturers brought by plaintiffs who seek compensation for injury or death caused by vaccine side effects." Bruesewitz v. Wyeth LLC, No. 09-152, 2011 U.S. LEXIS 1085, at *35 (U.S. Feb. 22, 2011). Justice Breyer concurred, noting that "congressional reports and history, the statute's basic purpose as revealed by that history, and the views of the expert agency along with those of relevant medical and scientific associations, all support the Court's conclusions." Id. at *44 (Breyer, J. concurring). Justice Sotomayor, joined by Justice Ginsburg, dissented, taking the view that in holding the Vaccine Act preempts state tort claims, "the Court imposes its own base policy preference over the considered judgment of Congress." Id. at *45-46 (Sotomayor, J., dissenting).*

376. *Id.* at 16-17 (quoting Justice Breyer) ("[I]f [petitioner] wins, we're turning this over to judges and juries instead of the FDA and the specialized agencies, that the result could well be driving certain vaccines from the market, and basically, a lot of children will die.") (referring to the Brief Amici Curiae for the American Academy of Pediatrics and 21 Other Physician and Public Health Organizations in Support of Respondent, *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/09-10/09-152_RespondentAmCuAAPand 21PhysandPubHealthOrgs.pdf).

377. *See, e.g.*, Sharyl Attkisson, *Vaccines, Autism and Brain Damage: What's in a Name?*, CBSNews.com (Jan. 14, 2010), *available at* http://www.cbsnews.com/8301-31727_162-20016356-10391695.html; *see also* Donald G. McNeil, Jr., *Book Is Rallying Resistance to the Antivaccine Crusade*, N.Y. TIMES (Jan. 12, 2009), *available at* http://www.nytimes.com/2009/01/13/health/13auti.html?_r=1 (discussing various publications addressing the debate over vaccines and autism); *see also* Melissa Foster, *Health care reform may have implications for vaccine providers*, Pediatric Supersite (May 3, 2010), *available at* http://www.pediatricsupersite.com/view.aspx?rid=63827 (noting that the health care bill includes many child insurance reform provisions, but that issues like undervaccination and reimbursement will continue to be debated).

## § 3.8.4 The Supreme Court is considering whether to apply *Wyeth v. Levine* to state law failure-to-warn claims brought against generic drug manufacturers. *PLIVA, Inc. v. Mensing*

On December 10, 2010, the Supreme Court granted certiorari in a trio of cases consolidated as *PLIVA, Inc. v. Mensing*,[378] to consider whether to extend the Court's seminal 2009 ruling in *Wyeth v. Levine*[379] to generic drugs. In *Levine*, the Court held that the Federal Drug Administration's (FDA) approval of a brand-name drug's warning label does not preempt state law claims alleging failure to warn of a health risk. *Levine* left open, however, the question of whether generic label approval preempts state law claims.

The Drug Price Competition and Patent Term Restoration Act—commonly referred to as the "Hatch-Waxman Amendments"—amended the Food, Drug, and Cosmetic Act to allow for the approval of generic versions of previously-approved drugs through a condensed approval process. The Hatch-Waxman Amendments require that the generic drug labels be the same as the FDA-approved labeling for the brand name drug.[380]

In March 2001, Mensing was prescribed the brand-name drug Reglan, which her pharmacist filled with its generic bioequivalent. After four years of taking the generic drug, Mensing developed tardive dyskinesia. In 2009, after Mensing stopped taking the drug, the FDA ordered a black box warning about the increased risk of tardive dyskinesia from long term use of Reglan. Prior to the FDA's black box warning in 2009, the increased risk of tardive dyskinesia posed by long term use was not clear on the generic drug label. Mensing brought state law failure-to-warn claims against manufacturers of the generic version of Reglan, alleging that the generic drug's labeling failed to warn about the danger of tardive dyskinesia associated with long-term use. The district court, ruling before the Supreme Court issued its decision in *Wyeth v. Levine*, granted the generic drug manufacturer's motion to dismiss, concluding that the state tort claims were preempted by the Hatch-Waxman Amendments and the regulatory scheme governing generic drugs.[381]

On appeal, the Eighth Circuit applied the Supreme Court's holding in *Wyeth v. Levine* and held that a plaintiff's state law failure-to-warn claims against generic manufacturers were not preempted by the Hatch-Waxman Amendments because it was possible to comply with both federal labeling requirements and

378. *PLIVA, Inc. v. Mensing*, Docket No. 09-993, 131 S. Ct. 817 (Dec. 10, 2010) (granting petitions for writ of certiorari in *Mensing v. Wyeth, Inc.*, 588 F.3d 603 (8th Cir. 2009) and *Demahy v. Actavis, Inc.*, 593 F.3d 428 (5th Cir. 2010)) (consolidated with *Actavis Elizabeth, L.L.C. v. Mensing* (Docket No. 09-1039) and *Actavis, Inc. v. Demahy* (Docket No. 09-1501)).

379. *See Wyeth v. Levine*, 129 S. Ct. 1187 (2009), discussed *supra* at § 3.8.2.

380. *See generally Demahy*, 593 F.3d at 431-433.

381. *Mensing v. Wyeth, Inc.*, 562 F. Supp. 2d 1056 (D. Minn. 2008).

state law.[382] According to the Eighth Circuit, generic drug manufacturers are subject to the requirement in 21 CFR § 201.57(e) that labeling "shall be revised as soon as there is reasonable evidence of an association of a serious hazard with a drug."[383] At a minimum, therefore, generic drug manufacturers should alert the FDA to new safety hazards. The Eighth Circuit concluded that the state-law failure to warn claims were not preempted because nothing in the Hatch-Waxman Amendments forbids generic drug manufacturers from proposing a label change through the prior approval process or suggesting to the FDA that warning letters to healthcare professionals be sent.

In their petition for writ of certiorari, the generic drug manufacturers argue that the preemption analysis in *Levine* does not apply because *Levine* concerned brand-name drugs, and generic drug labeling is subject to a different approval process and labeling rules.[384] In her response, Mensing asks the Court to deny the petition for review because the Eighth Circuit's decision does not conflict with other circuit court opinions and is consistent with the decisions of the Court because it is a straightforward application of *Wyeth v. Levine*.[385] Mensing points out that the Eighth Circuit was the first appellate court decision to apply *Levine* to state law claims against generic manufacturers, subsequent appellate courts have also determined that generic manufacturers can strengthen label warnings and be held liable under state failure-to-warn laws. In addition, the lower courts have had no difficulty applying *Levine* and have all concluded that state law claims are not preempted.

On May 24, 2010, the Court requested the views of the U.S. Solicitor General.[386] On November 3, 2010, the Solicitor General filed its much awaited amicus brief, which recommended that the Supreme Court deny certiorari based on the current lack of a split of authority among the circuits, as well as several uncertainties in the case.[387] The government's position is that the "court of appeals correctly rejected petitioner's contention that respondent's failure-to-warn claims are categorically preempted by the FDCA, and its decision is consistent with the decision of the only other court of appeals to address this question since *Wyeth v. Levine*."[388]

382. *Mensing v. Wyeth, Inc.*, 588 F.3d 603 (8th Cir. 2009).

383. *Id.* at 609.

384. *See* Petition for Writ of Certiorari, No. 09-993, filed in the U.S. Supreme Court (Feb. 19, 2010), *available at* http://www.scotusblog.com/wp-content/uploads/2010/05/09-993_pet.pdf.

385. *See* Respondent's Brief in Opposition, No. 09-993, filed in the U.S. Supreme Court (April 21, 2010), *available at* http://www.scotusblog.com/wp-content/uploads/2010/05/09-993_bio.pdf.

386. *PLIVA, Inc. v. Mensing*, 130 S. Ct. 3349 (2010).

387. *See* Brief for the United States as Amicus Curiae, No. 09-993 and 09-1039, filed in the U.S. Supreme Court (Nov. 2, 2010), *available at* http://sblog.s3.amazonaws.com/wp-content/uploads/2010/11/CVSG.Pliva_.pdf.

388. *Id.* at 10.

*Update: the result in PLIVA will impact a newly-issued Ninth Circuit decision, as well as a number of cases pending in various circuits on the generic preemption issue.*[389]

## § 3.8.5 Are state law product liability claims arising from a car manufacturer's failure to install a lap/shoulder belts preempted by federal minimum safety requirements that require only a lap belt? *Williamson v. Mazda Motor of America, Inc.*

In *Williamson v. Mazda Motor of America, Inc.*,[390] the Court will consider a preemption defense in yet another products liability case. *Williamson* raises the question of whether state product liability and wrongful death claims are preempted by safety regulations promulgated by the National Highway Traffic Safety Administration (NHTSA) that set forth minimum safety requirements when state law tort law would require additional safety measures. *Williamson* is an example of a preemption case that may have far-reaching consequences for a major industry by exposing automakers to more lawsuits and potential liability over auto safety.

Pursuant to the authority Congress delegated to NHTSA in the National Traffic and Motor Vehicle Safety Act of 1966 (the Safety Act),[391] NHTSA issues Federal Motor Vehicle Safety Standards (FMVSS). The Safety Act defines a "safety standard" as a "*minimum* standard for motor vehicle or motor vehicle equipment performance."[392] At the relevant time, one of these minimum standards—FMVSS 208, entitled "Occupant crash protection"—"specifies performance requirements for the protection of vehicle occupants in crashes," and requires automobile manufacturers install shoulder/lap belts in all "outboard" seats (next to windows), but requires only lap belts for the interior seating positions of a vehicle.[393] In 1984 and 1989, NHTSA evaluated whether to mandate lap/shoulder belts on interior seating positions as well, but declined to do so, concluding that requiring lap/shoulder belts would be too difficult and

389. *See Gaeta v. Perrigo Pharms. Co.*, No. 09-15001, 2011 U.S. App. LEXIS 1382 (9th Cir. Jan. 24, 2011) (applying *Levine* to hold that a state law duty to warn consumers with an appropriate label on the generic ibuprofen drug was not preempted by federal law); *see also Morris v. Wyeth, Inc.*, No. 09-5509, pending in the 6th Circuit; *Smith v. Wyeth, Inc.*, No. 09-5460, pending in the 6th Circuit; and *Wilson v. Pliva, Inc.*, No. 09-5466, pending in the 6th Circuit; *Pustejovsky v. Pliva, Inc.*, No. 09-10983, pending in the 5th Circuit.

390. *Williamson v. Mazda Motor Co. of Am., Inc.*, 167 Cal. App. 4th 905, 84 Cal. Rptr. 3d 545, 556 (Cal. Ct. App. 2008), *cert. granted*, 130 S. Ct. 3348 (2010).

391. 49 U.S.C. § 30101 *et seq.*

392. 49 U.S.C. § 30102(a)(9) (emphasis added).

393. 49 C.F.R. § 571.208, S1 (2008).

costly in comparison to projected safety benefits.[394] Therefore, at the time of Williamson's injury, federal safety standards did not require lap/shoulder belts for the seat in which Williamson was sitting.

The Safety Act contains a preemption clause that states, "When a motor vehicle safety standard is in effect under this chapter, a State or a political subdivision of a State may prescribe or continue in effect a standard applicable to the same aspect of performance of a motor vehicle or motor vehicle equipment only if the standard is identical to the standard prescribed under this chapter."[395] However, the Safety Act also contains a preemption "savings clause," which provides that "[c]ompliance with a motor vehicle safety standard prescribed under this chapter *does not exempt a person from liability at common law*."[396] The Safety Act's preemption and savings clauses are central to the preemption dispute in the *Williamson* case.

Thanh Williamson was killed when the Mazda minivan her husband was driving was struck head-on by a Jeep Wrangler that had detached from the motor home that was towing it. Williamson was seated in an aisle seat of the middle row of the car that was equipped with a lap-only seatbelt, which she was wearing. Williamson died of severe abdominal injuries and internal bleeding as a result of collision forces that caused her body to "jackknife" around her lap-only seatbelt. Williamson's daughter—who was seated directly behind the driver's seat—and her husband were both wearing lap/shoulder seatbelts, and survived the crash with minor injuries.

After her death, Williamson's family sued Mazda under California tort law, asserting products liability, negligence, and wrongful death claims. The Williamsons alleged that the minivan was defective because it lacked a lap/shoulder combination belt for the interior aisle seat, which would have protected Williamson's upper torso in a collision. The trial court granted Mazda's demurrer on the ground that the Williamsons' tort claims were preempted by federal auto minimum safety standards set forth in FMVSS 208, and dismissed the Williamsons' claims. The California intermediate court of appeals affirmed, and the California Supreme Court denied review.[397]

The Williamsons filed a petition for writ of certiorari in the U.S. Supreme Court seeking review on two issues: (1) whether FMVSS 208, which sets forth federal minimum safety standards, impliedly preempts a state-law product liability claim despite the fact that the Safety Act contains a preemption savings clause; and (2) whether under *Levine*, discussed *supra* in § 3.8.2, federal safety standards that allow manufacturers to install *either* a lap-only belt *or* a

394. *Williamson*, 167 Cal. App. 4th at 912.

395. 49 U.S.C. § 30103(b)(1).

396. 49 U.S.C. § 30103(e) (emphasis added).

397. *Williamson (Delbert) v. Mazda Motor of America, Inc*., 2009 Cal. LEXIS 1759 (Cal. Feb. 11, 2009).

shoulder/lap belt impliedly preempt state failure-to-warn tort claims.[398] The Supreme Court granted certiorari on the first issue only.[399]

Central to the *Williamson* preemption issue is a similar Supreme Court decision that lower federal and state courts have applied to preempt state-law product liability claims. In *Geier v. American Honda Motor Co.*,[400] the Supreme Court held that the version of FMVSS 208 in effect at the time preempted a state tort law claim arising from a manufacturer's failure to install an airbag. In *Geier*, the plaintiff suffered injury in a front-end collision. Although the vehicle was equipped with both shoulder and lap seatbelts (which require voluntary passenger use), the plaintiff sued the manufacturer alleging the car was defective and unreasonably dangerous because it lacked an airbag (a "passive" protection that operates automatically). In a 5-4 opinion (authored by Justice Breyer, who is often viewed as part of the Court's so-called "liberal" minority, and joined by then-Chief Justice Rehnquist, and Justices Scalia, Kennedy, and O'Connor) the Court resolved a split among state and federal courts and held that FMVSS 208—which made installation of an airbag *optional*, but not mandatory—impliedly preempted the plaintiff's state law tort claims because they would have effectively made air bags mandatory.[401] Lower courts subsequently applied *Geier* to dismiss virtually every tort claim based on an alleged design defect regarding seat belts or airbags.

In their petition, the Williamsons argued that Congress intended FMVSS 208 to be a minimum safety standard that operates concurrently with state law, which might require more rigorous safety precautions. The Williamsons argued that the lower courts have misinterpreted *Geier* by applying it well beyond its limited facts, ignoring the Safety Act's savings clause, and converting the Safety Act's minimum safety standards from a floor to a ceiling, contrary to the cooperative federalism Congress intended. In their opposition brief, Mazda argued that the regulatory history of FMVSS 208 indicates that NHTSA intentionally left manufacturers free to choose between shoulder/lap

398. *See* Petition for Writ of Certiorari, filed in No. 08-1314, U.S. Supreme Court, *available at* http://www.scotusblog.com/wp-content/uploads/2009/09/08-1314_pet1.pdf.

399. *Williamson v. Mazda Motor of Am., Inc.*, 130 S. Ct. 3348 (2010).

400. *Geier v. Am. Honda Motor Co*., 529 U.S. 861 (U.S. 2000).

401. *Id.* Justice Breyer wrote for the Court:

> Several state courts have held . . . that neither the [Safety] Act's express pre-emption nor FMVSS 208 pre-empts a "no airbag" tort suit.. . . All of the Federal Circuit Courts that have considered the question, however, have found pre-emption. One rested its conclusion on the Act's express pre-emption provision. . . . Others, such as the Court of Appeals [for the District of Columbia Circuit], have instead found pre-emption under ordinary pre-emption principles by virtue of the conflict such suits pose to FMVSS 208's objectives, and thus to the Act itself. We granted certiorari to resolve these differences. We now hold that this kind of "no airbag" lawsuit conflicts with the objectives of FMVSS 208, a standard authorized by the Act, and is therefore pre-empted by the Act.

*Id.* at 866. (citations omitted). In an interesting split, Justice Stevens dissented in an opinion joined by Justices Souter, Thomas, and Ginsburg. *Id.* at 886 (stevens, J., dissenting).

belts and lap-only belts because of unique technological obstacles to installing shoulder/lap belts that would make widespread adoption extremely costly with limited safety upside.[402]

Whether the Supreme Court will apply *Geier* to conclude the claims in *Williamson* are preempted or limit *Geier* to its facts remains to be seen. Significantly, although Justice Breyer ruled for preemption in the *Geier* case, in the *Williamson* oral argument he expressed an inclination to defer to the federal agency.[403] Therefore, it could be key that the U.S. Solicitor General filed an amicus brief supporting the plaintiffs, arguing that the California courts misread *Geier*, and that the family should be allowed to pursue their product liability case to its end.[404] Some commentators speculate that the Court might split evenly (Justice Kagan is recused), or split 5-3 in favor of the Williamsons and against preemption, with Justices Breyer, Ginsburg, Kennedy, Sotomayor, and Thomas voting against preemption and Chief Justice Roberts and Justices Alito and Scalia voting for it.[405]

*Update: Surprising those observers who anticipated a split decision, the Supreme Court reversed the California court of appeal in a unanimous opinion authored by Justice Breyer on February 23, 2011—one day after Justice Scalia's opinion in the Bruesewitz case was issued. See supra § 3.8.3. While the Court in Bruesewitz ruled in favor of preemption, in Williamson the Court held "that providing manufacturers with this [lap-only] seatbelt choice is not a significant objective of the federal regulation. Consequently, the regulation does not pre-empt the state tort suit." Williamson v. Mazda Motor of Am., Inc., No. 08-1314, 2011 U.S. LEXIS 1711, at *6 (U.S. Feb. 23, 2011).*

402. *See* Brief in Opposition for Respondents Mazda Motor Corporation, *et al.*, filed in No. 08-1314, in the U.S. Supreme Court, *available at* http://www.scotusblog.com/wp-content/uploads/2009/09/08-1314_bio.pdf.

403. The Supreme Court heard oral argument on November 3, 2010. The transcript of the oral argument in *Williamson* is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/08-1314.pdf.

404. *See* Brief for the United States as Amicus Curiae, filed in No. 08-1314, in the U.S. Supreme Court, *available at* http://www.scotusblog.com/wp-content/uploads/2010/05/08-1314_amicus-us.pdf.

405. *See* Professor William Funk, *In* Williamson v. Mazda, *SCOTUS Has Chance to Right Preemption Wrongs*, posted in ACSblog.com (Nov. 1, 2010), *available at* http://www.acslaw.org/node/17448.

## § 3.8.6 The Supreme Court is primed to decide whether and to what extent Arizona's immigration reform measures are preempted by federal law. *Chamber of Commerce v. Whiting*

The State of Arizona has been at the epicenter of recent controversies concerning aggressive immigration reform measures. One commentator recently described state efforts to spearhead tough immigration initiatives: "Frustrated at Congress's inability—or unwillingness—to reform immigration control law, and urged on by a rising political tide of nativist sentiment, state and local governments are adopting their own policies to deal with the nearly 11 million non-citizens who have entered the country illegally."[406] In addition to the polarizing politics of immigration reform, these local laws also run squarely into the field of preemption—which, as this subchapter describes, is recently of great interest to the Supreme Court.

In the pending case *Chamber of Commerce v. Whiting*,[407] the U.S. Chamber of Commerce (joined by a variety of business owners, civil rights lawyers, and immigrants' rights groups) sought an injunction to prevent the enforcement of a new Arizona immigration law, called the Legal Arizona Workers Act[408] (LAWA), on the ground that it is preempted by federal immigration law. LAWA—which to date has yet to be enforced against any employer—empowers the state to revoke the business licenses of any entity that knowingly or intentionally hires illegal aliens. *Whiting* likely will have far-reaching implications for employers that hire immigrant and migrant workers, particularly in border states, and may well prove to be a testing ground for state-based immigration reform that seeks to implement restrictions and regulations that exceed those imposed by federal law.

In *Whiting* the Chamber brought a facial challenge to LAWA on the ground that it is expressly and impliedly preempted by the Federal Immigration Reform and Control Act of 1986[409] (IRCA) and the Illegal Immigration Reform and Immigrant Responsibility Act of 1996[410] (IIRIRA).[411] IRCA, which Congress

406. Lyle Denniston, *Argument Preview: State Power Over Aliens*, posted on SCOTUSblog.com (Dec. 5, 2010), *available at* http://www.scotusblog.com/?p=109873.

407. *Chicanos Por La Causa, Inc. v. Napolitano*, 544 F.3d 976 (9th Cir. 2008), *reprinted as amended*, 558 F.3d 856 (9th Cir. 2009), *cert. granted, Chamber of Commerce of the United States v. Candelaria*, No. 09-115, 130 S. Ct. 3498 (2010).

408. The Legal Arizona Workers Act, ARIZ. REV. STAT. §§ 23-211 to 23-216.

409. 8 U.S.C.S. §§ 1324a-1324b.

410. Pub. L. No. 104-208, 110 Stat. 3009 (1996) (codified in various sections of 8 U.S.C. and 18 U.S.C.).

411. *Chicanos Por La Causa*, 558 F.3d at 861. Petitioners also alleged that LAWA violates employers' rights to due process by denying them an opportunity to challenge the federal determination of the work-authorization status of their employees before sanctions are imposed. *Id.*

enacted as a "comprehensive scheme prohibiting the employment of illegal aliens in the United States,"[412] prohibits knowingly or intentionally hiring or continuing to employ an unauthorized alien,[413] which it defines as an alien either not lawfully admitted for permanent residence or not authorized to be employed by IRCA or the U.S. Attorney General.[414] IRCA established a method by which an employer can demonstrate its compliance with the law by verifying an employee's eligibility, called the "I-9 system."[415] Under the I-9 system, employees attest to their eligibility and present identity documents in support of their status.[416] The employer is then required to review the identity documents to determine whether it appears genuine.[417] Employers who utilize the I-9 system are entitled to a defense to sanctions under IRCA if they show good-faith compliance with the system.[418] IRCA has a provision that expressly addresses preemption: "The provisions of this section preempt any State or local law imposing civil or criminal sanctions (other than through licensing and similar laws) upon those who employ, or recruit or refer for a fee for employment, unauthorized aliens."[419] Central to the *Whiting* case is the savings clause embedded within the preemption provision, which allows state or local "licensing and similar laws."[420]

Approximately ten years after IRCA was passed, Congress enacted IIRIRA, which directed the U.S. Attorney General to establish three pilot programs to improve the process by which businesses verify employees' immigration status.[421] One of those programs—currently known as E-Verify—remains in existence and is administered by the Secretary of Homeland Security.[422] E-Verify "is an internet-based system that allows an employer to verify an employee's work-authorization status."[423] E-Verify reports the work authorization status of a new hire to an employer by checking records at the Social Security Administration (SSA) and Department of Homeland Security (DHS) U.S. Citizenship and Immigration Services (USCIS).[424] An alternative to IRCA's 1-9 system, the E-Verify provisions set forth specific procedures and rules for verifying an

412. *Hoffman Plastic Compounds v. NLRB*, 535 U.S. 137, 147 (2002) (internal quotation marks omitted).
413. 8 U.S.C. § 1324a(a).
414. *Id.* at § 1324a(h)(3).
415. *Id.* at § 1324a(b).
416. *Id.* at § 1324a(b)(1),(2).
417. *Id.* at § 1324a(b)(1)(A).
418. *Id.* at § 1324a(b)(6).
419. *Id.* at. § 1324a(h)(2).
420. *Id.*
421. *Chicanos Por La Causa*, 558 F.3d at 861 (citing Pub. L. No. 104-208, §§ 401-405, 110 Stat. 3009, 3009-655 to 3009-666).
422. *Id.* at 861-862.
423. *Id.* at 862.
424. *Ariz. Contrs. Ass'n, Inc. v. Candelaria*, 534 F. Supp. 2d 1036, 1042 (D. Ariz. 2008).

employee's immigration status.[425] E-Verify remains voluntary at the national level.[426]

Arizona enacted the Legal Arizona Workers Act on July 2, 2007.[427] LAWA allows the superior courts of Arizona to suspend or revoke the business licenses of employers who knowingly or intentionally hire unauthorized aliens.[428] LAWA also makes participation in the federal E-Verify program *mandatory* for all employers, although it provides no penalty for violation of the requirement.[429] LAWA includes an affirmative defense for good-faith compliance, expressly incorporating IRCA.[430]

The Chamber of Commerce challenged LAWA in federal district court on preemption grounds, arguing that LAWA attempts to take advantage of a licensing "loophole" in the savings clause that Congress did not intend to establish.[431] In the Chamber's view, LAWA is not a licensing scheme at all, but an attempt to locally regulate the employment of aliens. The district court disagreed, holding that because LAWA only revokes the business licenses of employers that violate its terms, it qualifies as a "licensing sanction" and is therefore permissible under the savings clause.[432] The Ninth Circuit affirmed, holding that while only the federal government can decide who is allowed to enter and leave the country, each individual State can decide who can be licensed to work inside its borders.[433]

In its appeal to the Supreme Court, the Chamber argues that state regulatory schemes like Arizona's conflict with the comprehensive system that Congress crafted in IRCA.[434] In the Chamber's view, IRCA represents a careful compromise among multiple interests and objectives beyond enforcement—preventing discrimination, protecting privacy, and avoiding undue burdens on business. The Chamber also argues that Arizona's decision to make E-Verify mandatory conflicts directly with Congress's election to leave it voluntary.

The State of Arizona argues in response that there remains room for state legislation that touches on immigration, particularly in the area of employment,[435] relying on the Supreme Court's opinion in *De Canas v. Bica* for the proposition that "states possess broad authority under their police powers to regulate the employment relationship to protect workers within the State."[436] Arizona

425. *Chicanos Por La Causa*, 558 F.3d at 862.
426. *Candelaria*, 534 F. Supp. 2d at 1043.
427. 2007 Ariz. Sess. Laws Ch. 279 (eff. Jan. 1, 2008).
428. Ariz. Rev. Stat. § 23-212.
429. *Id.* at § 23-214(A).
430. *Id.* at § 23-212(J).
431. *Ariz. Contrs. Ass'n, Inc. v. Candelaria*, 534 F. Supp. 2d 1036 (D. Ariz. 2008).
432. *Id.* at 1045-1046.
433. *Chicanos Por La Causa, Inc. v. Napolitano*, 558 F.3d 856, 869 (9th Cir. 2009).
434. *See* Petition for Writ of Certiorari, filed in No. 09-115, in the U.S. Supreme Court, *available at* http://www.scotusblog.com/wp-content/uploads/2009/10/09-115_pet.pdf.
435. *See* Brief in Opposition to Petition for Writ of Certiorari, filed in No. 09-115, in the U.S. Supreme Court, *available at* http://www.scotusblog.com/wp-content/uploads/2009/10/09-115_bio.pdf.
436. *De Canas v. Bica*, 424 U.S. 351, 356 (1976).

urges that in enacting IRCA, Congress specifically preserved for the States the authority to impose sanctions "through licensing and similar laws."[437] Under Arizona's view, state laws regulating unauthorized workers through licensing sanctions are within the mainstream of state police power, and rejecting the Chamber's preemption argument would respect the States' traditional responsibility over state business licenses while recognizing the federal government's exclusive authority to impose other types of sanctions against employers who hire unauthorized aliens.

The Chamber responds that under Arizona's theory, a state may regulate work-authorization status in whatever fashion it wishes—so long as, at the end of the day, it enforces its regulation through the granting or revocation of licenses. In the Chamber's view, this conclusion would subvert congressional intent by rendering the IRCA preemption clause meaningless because virtually any state action could be effected through licensing.

*Whiting* was argued before the Court on December 8, 2010.[438] Although speculating about the Court's ruling based on oral argument is always tricky, there is some anticipation that Arizona may prevail on the preemption issue in *Whiting*—at least temporarily.[439] Justice Kennedy asked questions at oral argument that implied his indecision, suggesting he may cast the deciding vote in *Whiting* (as he often does since Justice O'Connor's retirement).[440] Because Justice Kagan is recused in *Whiting*, if Justice Kennedy votes to uphold LAWA the Court could split 5-3.[441] If, however, Justice Kennedy sides with the Chamber of Commerce, the Court would likely evenly split 4-4, which would have the effect of summarily affirming the Ninth Circuit's holding that the Arizona law is not preempted, but would not set precedent beyond the individual case. In that event, Judge Kagan could well be the swing vote *in favor* of preemption in a subsequent case raising similar issues. As the next subsection discusses, Arizona appears willing to provide the vehicle to test that hypothetical in the *United States v. Arizona* case.

## § 3.8.7 The Arizona Legislature tempts preemption fate in 2010 with more controversial immigration reform measures. *United States v. Arizona*

*Whiting* is not the only significant immigration/preemption case to arise from Arizona legislative initiatives. As *Whiting* was winding its way to the Supreme Court, the Arizona Legislature passed yet another controversial immigration

437. 8 U.S.C. § 1324a(h)(2).

438. The transcript for the *Whiting* argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-115.pdf.

439. *See* Lyle Denniston, *On Aliens, Arizona May Win—For Now*, posted in SCOTUSblog.com (Dec. 8, 2010), *available at* http://www.scotusblog.com/?p=110330.

440. *Id.*

441. *Id.*

bill that has been the subject of frenzied media coverage and political debate.[442] Arizona's Support Our Law Enforcement and Safe Neighborhoods Act[443] (commonly referred to as Arizona's "Senate Bill 1070") was signed into law on April 23, 2010. Among other things, Senate Bill 1070 makes it a crime for an alien to be present in Arizona without carrying required documents, and requires police "when practicable" to detain a person without a warrant if they reasonably suspect the pertain is in the country without authorization.[444] In addition to raising the same concerns about conflicts with federal immigration law that arose in *Whiting*, Senate Bill 1070 has been widely criticized as encouraging racial profiling and violating individual due process rights.[445]

According to Erwin Chemerinsky, a renowned expert in constitutional law and Dean of the University of California, Irvine School of Law, Senate Bill 1070 "is clearly pre-empted by federal law under Supreme Court precedents."[446] Adopting this view, on July 6, 2010 the United States DOJ took the rare step of filing a lawsuit directly challenging the constitutionality of Senate Bill 1070 in *United States v. Arizona*, in which the DOJ sought a preliminary injunction preventing Arizona from enforcing the law on the ground that it interfered with federal immigration law and was thus preempted.[447] On July 28, 2010, the day before Senate Bill 1070 was scheduled to go into effect, the United States District Court for the District of Arizona granted the DOJ's motion in part, enjoining Arizona from enforcing the most controversial portions of Senate Bill 1070 on the ground that the DOJ is likely to succeed in its preemption argument.[448] The

442. *See, e.g.*, Randal C. Archibold, *Arizona's Effort to Bolster Local Immigration Authority Divides Law Enforcement*, N.Y. Times (April 21, 2010), *available at* http://www.nytimes.com/2010/04/22/us/22immig.html?_r=1.

443. Arizona Laws 2010, 2nd Reg. Sess., Ch. 113, § 2; Laws 2010, 2nd Reg. Sess., Ch. 211, § 3. (S.B. 1070, amended by H.B. 2162).

444. *See* Ariz. Rev. Stat. § 11-1051(B) (requiring that an officer make a reasonable attempt to determine the immigration status of a person stopped, detained or arrested if there is a reasonable suspicion that the person is unlawfully present in the United States, and requiring verification of the immigration status of any person arrested prior to releasing that person); Ariz. Rev. Stat. § 13-1509 (creating a crime for the failure to apply for or carry alien registration papers); Ariz. Rev. Stat. § 13-2928(C) (creating a crime for an unauthorized alien to solicit, apply for, or perform work); Ariz. Rev. Stat. § 13-3883(A)(5) (authorizing the warrantless arrest of a person where there is probable cause to believe the person has committed a public offense that makes the person removable from the United States).

445. *See, e.g.*, Randal C. Archibold, *Arizona Enacts Stringent Law on Immigration*, N.Y. Times (April 23, 2010), *available at* http://www.nytimes.com/2010/04/24/us/politics/24immig.html.

446. John Schwartz & Randal C. Archibold, *A Law Facing a Tough Road Through the Courts*, N.Y. Times (April 27, 2010), *available at* http://www.nytimes.com/2010/04/28/us/28legal.html (quoting Dean Chemerinsky).

447. *See United States v. Arizona*, 703 F. Supp. 2d 980, 986 (D. Ariz. 2010).

448. *Id.* at 987, 1008 (enjoining the State of Arizona from enforcing the provisions described *supra*, note 444).

DOJ's lawsuit is viewed by some as a preemptive measure (no pun intended) to discourage other states from enacting similar laws.[449]

The success of the DOJ's strategy, however, remains to be seen: *United States v. Arizona* remains pending in the district court, and will most certainly be influenced by the Supreme Court's imminent decision in *Whiting.* Whatever the Supreme Court decides in *Whiting*, the preemption issue is likely to be revisited again in *United States v. Arizona*. In the wake of the district court's injunction barring enforcement of portions of Senate Bill 1070, Arizona Governor Jan Brewer promised to appeal, and vowed to "battle all the way to the Supreme Court, if necessary, for the right to protect the citizens of Arizona."[450] Indeed, on July 29, 2010, Arizona filed an interlocutory appeal in the Ninth Circuit, seeking relief from the injunction.[451] Oral argument was held on November 1, 2010. However the Ninth Circuit, rules many anticipate the losing party may seek review in the Supreme Court on the merits of the preemption issue. Should *Arizona* make its way to the Supreme Court, Justice Kagan will not be recused as she was for *Whiting*—a difference that could materially alter the Court's majority on the preemption issue.

## § 3.8.8 A settlement forestalls the Supreme Court's resolution of a circuit split over whether the Federal Employees Health Benefits Act preempts state law tort claims—and illustrates an effective "complete preemption" removal and dismissal strategy for defendants. *Health Care Service Corp. v. Pollitt*

The Federal Employee Health Benefits Act of 1959 (FEHBA) established a comprehensive program to provide federal employees, federal retirees, and their eligible family members with subsidized healthcare benefits.[452] In *Health Care Services Corp. v. Pollitt*[453]—a case of considerable significance for government contractors that administer health care plans for federal employees—the Supreme Court was primed to clarify the FEHBA's preemptive scope in state

449. *See, e.g.*, Julia Preston, *Justice Dept. Sues Arizona Over Its Immigration Law*, N.Y. Times (July 6, 2010), *available at* http://www.nytimes.com/2010/07/07/us/07immig.html.

450. Stephen Dinan, *Feds Win Round 1 Against Arizona*, The Washington Times (July 28, 2010), *available at* http://www.washingtontimes.com/news/2010/jul/28/judge-blocks-key-parts-ariz-immigration-law/.

451. *See United States v. Arizona*, No. 10-16645, pending in the United States Court of Appeals for the Ninth Circuit.

452. 5 U.S.C. §§ 8901-8913.

453. *Pollitt v. Health Care Serv. Corp.*, 558 F.3d 615 (7th Cir. 2009), *cert. granted*, 130 S. Ct. 396 (2009), *cert. dismissed per Rule 46.1*, 130 S. Ct. 1574 (2010).

bad-faith-insurance practice cases. The Supreme Court dismissed *Pollitt* from its docket, however, when the parties settled on the eve of oral argument.[454] Despite the dismissal, *Pollitt* is worth summarizing not only for the FEHBA preemption issue, but because it illustrates a strategy by which a defendant may assert preemption as a ground to invoke federal jurisdiction to avoid a state court forum—and then immediately seek dismissal from the federal court after removal.

Defendants facing tort claims in state courts—which are often perceived as plaintiff-friendly—often remove cases to federal court if the plaintiff's claims can be characterized as "arising under" federal law.[455] Federal preemption is an affirmative defense that bars state law tort claims, and, just like any other affirmative defense, it is subject to the well-pleaded complaint rule.[456] Where preemption is asserted as a federal defense to a state law cause of action, therefore, it does not arise under federal law and removal is not permitted.[457]

In a narrow class of cases involving "complete preemption," however, a defendant's preemption argument is not classified as a defense for the purposes of the well-pleaded complaint rule.[458] Complete preemption occurs when federal law has occupied a field so thoroughly that it leaves no room for any claims under state law.[459] Complete preemption is not a defense; instead, it embodies congressional policy that all claims on the topic inherently arise under federal law, permitting removal to federal court.[460] Where Congress intended complete preemption, "there is . . . no such thing as a state-law claim."[461]

The Supreme Court appeared primed to clarify the distinction between preemption defenses and complete preemption in the context of FEHBA when it granted certiorari in the *Pollitt* case.[462] Juli Pollitt, a federal employee, sued

454. 130 S. Ct. 1574.

455. Federal district courts are vested with jurisdiction over "all civil actions *arising under* the Constitution, laws, or treaties of the United States." 28 U.S.C. § 1331 (emphasis added). A defendant may remove a case to federal court where the plaintiff's claims arising under federal law. 28 U.S.C. § 1441.

456. "Under the longstanding well-pleaded complaint rule, a suit 'arises under' federal law 'only when the plaintiff's statement of his own cause of action shows that it is based upon [federal law].'" *Vaden v. Discover Bank*, 129 S. Ct. 1262, 1272 (2009) (quoting *Louisville & Nashville R. Co. v. Mottley*, 211 U.S. 149, 152 (1908)). "Federal jurisdiction cannot be predicated on an actual or anticipated defense: 'It is not enough that the plaintiff alleges some anticipated defense to his cause of action and asserts that the defense is invalidated by some provision of [federal law].'" *Id*. (quoting *Louisville & Nashville R. Co*.). "Nor can federal jurisdiction rest upon an actual or anticipated counterclaim." *Id.*

457. *Metro. Life Ins. Co. v. Taylor*, 481 U.S. 58, 63 (1987) ("Federal pre-emption is ordinarily a federal defense to the plaintiff's suit. As a defense, it does not appear on the face of a well-pleaded complaint, and, therefore, does not authorize removal to federal court.") (citing *Gully v. First Nat'l Bank*, 299 U.S. 109 (1936)).

458. *Pollitt*, 558 F.3d at 616.

459. *Id.* (citing *Franchise Tax Board of California v. Construction Laborers Vacation Trust*, 463 U.S. 1 (1983)).

460. *Metro. Life Ins. Co.*, 481 U.S. at 63-64.

461. *Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 11 (2003).

462. 130 S. Ct. 396.

her health care insurance carrier, Health Care Service Corporation (HCSC) in state court for bad faith insurance practices after HCSC terminated insurance coverage for Pollitt's son.[463] HCSC removed the case to federal court on the basis of complete preemption, after which the district court dismissed Pollitt's bad faith claim on the same basis.[464]

On appeal, the Seventh Circuit vacated the district court's opinion, holding that removal was improper because FEHBA "does not completely occupy the field of health-insurance coverage for federal workers."[465] The Seventh Circuit relied on the case of *Empire HealthChoice Assurance, Inc. v. McVeigh*, which also arose in the context of removal jurisdiction, but instead addressed the issue of whether FEHBA preempts state law contract (as opposed to tort) claims asserted by an insurance carrier against third party beneficiaries.[466] Holding that FEHBA's interests in the welfare of federal employees did not warrant federal jurisdiction over a state-law contract case, the Supreme Court in *Empire HealthChoice* rejected the notion that the state contract claim "arose under" FEHBA on the basis of complete preemption, and thus the case was not removable to federal court.[467]

The Supreme Court did not have the opportunity to review the Seventh Circuit's holding due to the settlement, but by granting review the Court expressed an interest in clarifying FEHBA preemption and federal removal based on the complete preemption doctrine—both of which are significant for administrators of FEHBA health plans and federal employees seeking to assert claims against those administrators.

# § 3.9 Labor and Employment

## § 3.9.1 Plaintiffs may assert disparate-impact claims based on the application of an employment practice, even if the practice was not challenged when implemented. *Lewis v. City of Chicago*

The Supreme Court decided just one employment litigation decision in the 2009-10 term, *Lewis v. City of Chicago*.[468] At issue in *Lewis* was how to calculate the limitations period for filing a charge of discrimination with the Equal Employment Opportunity Commission (EEOC) in a disparate impact case—a

463. *Pollitt*, 2008 U.S. Dist. LEXIS 110827 at *1-2.
464. *Id.* at *5-4.
465. *Pollitt v. Health Care Serv. Corp.*, 558 F.3d 615, 616 (7th Cir. 2009).
466. *Empire HealthChoice Assurance, Inc. v. McVeigh*, 547 U.S. 677 (2006).
467. *Id.* at 698-699.
468. 130 S. Ct. 2191 (2010).

prerequisite to initiating a lawsuit under Title VII of the Civil Rights Act of 1964 (Title VII).[469] The Supreme Court held that a plaintiff who fails to file a timely charge challenging the *adoption* of an employment practice may assert a disparate impact claim in a timely charge challenging the employer's later *application* of that practice.

This case arose in the context of testing applicants for selection and the subsequent use of the test results to fill open slots. In January 1996, the City of Chicago announced the results of a written examination administered in July 1995 to approximately 26,000 applicants for firefighting positions, and issued a press release stating that it would randomly select candidates who scored at least 89 out of 100, i.e., "well-qualified" applicants, to proceed through the hiring process. The City individually notified applicants who scored between 65 and 88, i.e., "qualified" applicants, that they were eligible for a firefighter position and would remain on the City's eligibility list, but likely would not be called for further processing due to the number of well-qualified applicants.

The City ran a lottery to select applicants from the well-qualified scorers eleven times over a six-year period beginning on May 16, 1996. On March 31, 1997, Crawford Smith, an African-American applicant who scored in the qualified range, filed a charge of discrimination with the EEOC, alleging that the City's practice of selecting only well-qualified applicants caused a disparate impact on African-Americans in violation of Title VII. Subsequently, five other qualified applicants filed similar charges, and the EEOC issued all six right-to-sue letters. The six individuals filed a disparate-impact lawsuit against the City, and the federal district court certified a class of more than 6,000 African-American qualified scorers whom the City never hired.

The City moved for summary judgment on the ground that the applicants had failed to file EEOC charges within the required 300 days after their claims had accrued, but the district court denied the motion, reasoning that the City's "ongoing reliance" on the 1995 test results constituted a continuing violation of Title VII.[470] The Seventh Circuit reversed, holding that the plaintiffs untimely filed their EEOC charge more than 300 days after the only discriminatory act: sorting the test scores into the well-qualified, qualified, and not qualified categories. According to the Seventh Circuit, the subsequent hiring of only

469. Title VII requires an employee to file a charge of discrimination with the EEOC within 180 days of the alleged "unlawful employment practice," or 300 days if the discrimination occurs in a state with an agency that shares the investigatory work with the EEOC. 42 U.S.C. § 2000e-5(e)(1).

470. The continuing violation doctrine allows a plaintiff to challenge a series of related acts of discrimination so long as at least one occurred within the limitations period. *See, e.g.*, *McGregor v. La. State Univ. Bd. of Supervisors*, 3 F.3d 850, 866 (5th Cir. 1993). This doctrine does not apply to discrete acts of discrimination, which must be challenged within 180/300 days of their occurrence. *Nat'l R.R. Passenger Corp. v. Morgan*, 536 U.S. 101, 114 (2002). Wrongful termination, failure to promote, denial of transfer, retaliation, and failure to hire constitute discrete discriminatory acts, while hostile work environment sexual harassment may be challenged under the continuing violation theory.

well-qualified applicants was the automatic consequence of the scores, rather than a new act of discrimination.[471]

In a unanimous opinion authored by Justice Scalia, the Supreme Court reversed the Seventh Circuit, holding that each time the City selected a class of candidates from the well-qualified pool, the City "used" a practice that caused a disparate impact. The Court reached this conclusion by analyzing and relying on the statutory text of Title VII, which states that a plaintiff establishes a prima facie disparate impact claim by showing that the employer "uses a particular employment practice that causes a disparate impact" on the basis of a protected category. Recognizing that Title VII does not define "employment practice," the Court reasoned that the term encompasses the conduct of which plaintiffs complained—the City's exclusion of applicants who scored below 89 each time it filled a new class of firefighters. This definition of "employment practice" preserved the plaintiffs' ability to sue, despite their EEOC charges being filed more than 300 days after the City first announced the test results, because each selection round gave rise to a new disparate impact claim and triggered another 300-day limitations period.

The Supreme Court's holding in *Lewis* allows for a plaintiff to timely assert a charge for disparate-impact discrimination based upon the employer's later application, or repeated use, of a practice, even if the plaintiff did not timely file a charge challenging the implementation of that practice, so long as the plaintiff can allege the elements of a disparate-impact claim. The Court acknowledged that as a result of its holding, employers may face new disparate-impact suits for regularly used practices adopted in prior years.

While the *Lewis* decision clearly applies to Title VII disparate-impact claims, legal scholars have expressed doubt that its logic can be extended to Title VII disparate-treatment claims, which require proof of discriminatory intent. The Court expressly noted the requirement that a Title VII plaintiff show a "present violation" within the limitations period. For disparate-treatment claims, therefore, the plaintiff must show discriminatory intent within the limitations period. Because later effects of a discriminatorily motivated action lack the requisite discriminatory intent, the Supreme Court's decision in *Lewis* likely is confined to disparate-impact claims.

471. On appeal to the Supreme Court, the City made the same argument (which the Supreme Court rejected), claiming that the only actionable discrimination occurred when the City used the test scores to create the hiring eligibility list and to notify applicants and that the subsequent exclusion of plaintiffs when selecting candidates inevitably followed from the earlier decision to adopt the cutoff score.

## § 3.9.2 The Supreme Court will consider the meaning of the phrase "filed a complaint" in the Fair Labor Standards Act's anti-retaliation provision. *Kasten v. Saint-Gobain Performance Plastics Corp.*

Turning to the current 2010-11 term, the Supreme Court is poised to shed light on the meaning of the phrase "filed a complaint" in a provision of the Fair Labor Standards Act (FLSA) that protects employees from retaliation by their employers for complaining about violations of the statute. The circuit courts have split over whether the FLSA's anti-retaliation protection applies only to written complaints or whether oral complaints are equally protected. On October 13, 2010, the Supreme Court heard oral argument in *Kasten v. Saint-Gobain Performance Plastics Corp.*, No. 09-834, a case from the Seventh Circuit addressing whether an oral complaint of a violation of the FLSA is protected activity under the FLSA's anti-retaliation provision.[472]

Kasten alleged that he verbally complained to his supervisors and the company's human resources department for months about the legality of the location of the company's time clocks because it prevented employees from being paid for time spent donning and doffing required protective gear. Saint-Gobain later suspended Kasten on the ground that he had violated company policy regarding time clock punching. Kasten alleged that he complained yet again about the time clocks' placement during his suspension meeting. Saint-Gobain denied that Kasten ever complained about the time clocks either before or during the suspension meeting and subsequently terminated his employment. Kasten filed suit under the FLSA, claiming that Saint-Gobain terminated him in retaliation for his verbal complaints regarding the time clocks' placement. The district court granted Saint-Gobain's motion for summary judgment, finding that Kasten had not engaged in protected activity because he had not "filed any complaint" about the allegedly illegal location of the time clocks.

The Seventh Circuit affirmed the district court's judgment, holding that while internal company complaints may be protected activity for purposes of the FLSA's anti-retaliation provision, purely verbal complaints—

472. *Kasten v. Saint-Gobain Performance Plastics Corp.*, 570 F.3d 834, 837 (7th Cir. 2009), *cert. granted*, 130 S. Ct. 1890 (2010).

whether in person or by telephone—are not.[473] The Seventh Circuit based its decision on the text of the FLSA retaliation provision, which prohibits "discharg[ing] . . . any employee because such employee has filed any complaint. . . ." 29 U.S.C. § 215(a)(3) (2006). According to the Seventh Circuit, the statutory phrase "filed any complaint" means to file a *written* complaint with the employer, not to merely submit an oral complaint to one's supervisor as Kasten did.[474]

A clear circuit split emerged upon the Seventh Circuit's resolution of *Kasten*, prompting Supreme Court review.[475] The Justice Department filed an amicus brief in support of Kasten, arguing that serious practical consequences would result if the Supreme Court decides that the FLSA's anti-retaliation provision does not encompass oral complaints.[476]

*Kasten* will come down to a statutory interpretation of the phrase "filed any complaint" and whether public policy concerns should guide the Supreme Court's decision.[477] If the Supreme Court decides that intra-company *oral* complaints are protected activity under the FLSA's anti-retaliation provision, the Court's interpretation would align with the interpretations of anti-retaliation provisions contained in other labor and employment statutes. Further, such a

473. *Kasten v. Saint-Gobain Performance Plastics Corp.*, 570 F.3d 834, 837 (7th Cir. 2009), *cert. granted*, 130 S. Ct. 1890 (2010). The Seventh Circuit's threshold holding—that intra-company complaints that are not formally filed with a judicial or administrative body are protected activity under the FLSA's anti-retaliation provision—was in line with the majority of other circuit courts. *See Hagan v. Echostar Satellite, LLC*, 529 F.3d 617, 625-26 (5th Cir. 2008); *Pacheco v. Whiting Farms, Inc.*, 365 F.3d 1199, 1202, 1206 (10th Cir. 2004); *Moore v. Freeman*, 355 F.3d 558, 562-63 (6th Cir. 2004); *Lambert v. Ackerley*, 180 F.3d 997, 1004-05 (9th Cir. 1999); *Valerio v. Putnam Assocs., Inc.*, 173 F.3d 35, 41-44 (1st 1999); *EEOC v. White & Son Enters.*, 881 F.2d 1006, 1011-12 (11th Cir. 1989); *Brennan v. Maxey's Yamaha, Inc.*, 513 F.2d 179, 181 (8th Cir. 1975). *But see Ball v. Memphis Bar-B-Q Co.*, 228 F.3d 360, 364 (4th Cir. 2000) (holding that the testimony clause of the FLSA's anti-retaliation provision does not protect internal complaints); *Lambert v. Genesee Hosp.*, 10 F.3d 46, 55 (2d Cir. 1993) (concluding that the anti-retaliation provision of the FLSA does not encompass informal workplace complaints).

474. *Kasten*, 570 F.3d at 839.

475. *See EEOC v. Romeo Cmty. Schs.*, 976 F.2d 985 (6th Cir. 1992) (plaintiff's oral complaints to supervisors were protected activity); *EEOC v. White & Son Enters.*, 881 F.2d 1006 (11th Cir. 1989) (plaintiffs' oral complaints were protected activity); *Brock v. Richardson*, 812 F.2d 121 (8th Cir. 1987) (defendant's mistaken belief that plaintiff apparently had made oral complaints to supervisors was grounds for suit); *Brennan v. Maxey's Yamaha*, 513 F.2d 179 (8th Cir. 1975) (employee's "voicing" of concern was protected activity). *But see Ball v. Memphis Bar-B-Q Co., Inc.*, 228 F.3d 360, 364 (4th Cir. 2000) (holding that the FLSA does not prohibit retaliation for "an employee's voicing of a position on working conditions in opposition to an employer"); *Lambert v. Genesee Hosp.*, 10 F.3d 46 (2d Cir. 1993) (concluding that the plain language of the statute limits the cause of action to retaliation for filing formal complaints, instituting a proceeding, or testifying, but does not encompass complaints made to a supervisor).

476. Brief for the United States as Amicus Curiae Supporting Petitioner at 22-28, *Kasten v. Saint-Gobain Performance Plastics Corp.*, No. 09-834 (filed June 2010).

477. In *Lewis v. City of Chicago*, the Supreme Court declined to consider public policy concerns, emphasizing that the duty of the Court is to give effect to the law Congress enacted. *Lewis v. City of Chicago*, 130 S. Ct. 2191, 2200 (2010).

decision would incentivize employees to report FLSA violations by removing the formality of filing a written complaint and prevent employers from discharging employees who orally report violations that are of serious public concern.

## § 3.9.3 The Supreme Court is scheduled to consider whether the anti-retaliation protection under Title VII applies to third parties associated with targeted employee. *Thompson v. North American Stainless, LP*

The Supreme Court also will consider the scope of anti-retaliation protection under Title VII in *Thompson v. North American Stainless, LP*, No. 09-291, a case that was argued on December 7, 2010.[478] Section 704(a) of Title VII prohibits an employer from retaliating against an employee because he or she engaged in certain protected activity.[479] The Court will determine whether Section 704(a) prohibits an employer from retaliating against a third party who has a close relationship with the employee who engaged in protected activity, and if so, whether the third party has a cause of action for a violation of such a prohibition.

The petitioner in *Thompson* argued that he was terminated solely because his fiancée brought a gender discrimination complaint with the EEOC against their mutual employer.[480] The district court granted the employer's motion for summary judgment[481] and the Sixth Circuit, sitting en banc, affirmed. In the majority opinion authored by Judge Griffin and joined by eight other justices, the court concluded that there was no third-party retaliation cause of action under Section 704 because Thompson did not personally (1) engage in any activity that could be construed as opposing the alleged discrimination, (2) make a charge of discrimination, or (3) assist or participate in an investigation of the alleged

478. The transcript of the oral argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-291.pdf.

479. Title VII, which was enacted by the Civil Rights Act of 1964, created a new and limited cause of action for retaliation in the employment setting. The relevant language of the statute provides:

> It shall be an unlawful employment practice for an employer to discriminate against any of his employees or applicants for employment . . . because he has opposed any practice made an unlawful employment practice by this subchapter, or because he has made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under this subchapter.

Title VII of the Civil Rights Act of 1964, § 704(a), 42 U.S.C. § 2000e-3(a).

480. *See* Brief of Petitioner, No. 09-291, filed in the U.S. Supreme Court (Sept. 3, 2010), *available at* http://www.americanbar.org/content/dam/aba/publishing/preview/publiced_preview_briefs_pdfs_09_10_09_291_Petitioner.authcheckdam.pdf.

481. *Thompson v. N. Am. Stainless, LP*, 435 F. Supp. 2d 633 (E.D. Ky. 2006).

discrimination.[482] In so holding, the Sixth Circuit "join[ed] the Third, Fifth, and Eighth Circuits in limiting the authorized class of claimants to those who have personally engaged in protected activity by opposing a practice, making a charge, or assisting or participating in an investigation."[483]

Judge Rogers concurred with the result, but disagreed with the majority's reasoning.[484] Specifically, he disagreed with the majority's reliance on statutory language that discussed what is unlawful rather than the statutory language that established who can sue. Only a "'person[s] claiming to be aggrieved' and 'person[s] aggrieved' may sue for Title VII violations."[485] According to the concurrence, discrimination against an employee in violation of Title VII should be construed much more broadly to encompass harmful actions taken against a person with a close relationship to the protected employee.[486] The concurrence concluded, however, that only employees who had been retaliated against were aggrieved persons who could sue, not those "who are incidentally hurt by the retaliation."[487] Therefore, a person in a close relationship with the employee who was retaliated against could not be an aggrieved person and, consequently, could not sue. In the context of the case, Judge Rogers concluded that only the fiancée could sue.

Six judges dissented and three authored separate dissenting opinions. Judge Moore's dissent, which the other five dissenting judges joined, criticized the majority for disregarding Supreme Court precedents that "highlight the primacy of statutory purpose[488]. . .—maintaining unfettered access to statutory remedial mechanisms."[489] Judge Moore remarked that the majority's "narrow interpretation of § 704(a) squarely contradicts this purpose."[490] The dissent argued that the majority's opinion could not reflect Congress' intent because that opinion would permit employers to use people in close relationships with protected employees "as swords to keep employees from invoking their statutory rights with no redress for the harms suffered by those individuals."[491] Likewise, Judge Moore disagreed with the concurring opinion's assertion that Thompson could not sue for a Title VII violation because he was not an "aggrieved" person.[492] Judge Moore argued that Thompson was an "aggrieved" person because, while the employer retaliated against his fiancée, Thompson suffered direct harm at the hands of the employer through the termination of his employment.

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482. *Thompson v. N. Am. Stainless, LP*, 567 F.3d 804, 806 (6th Cir. 2009) (en banc), *cert. granted*, 130 S. Ct. 3542 (2010).

483. *Id.*

484. *Id.* at 816 (Rogers, J., concurring).

485. *Id.* at 817 (quoting Title VII, 42 U.S.C. §§ 2000e-5(b), -5(e)(1)).

486. *Id.* at 816.

487. *Id.* at 817.

488. *Id.* at 820, 824 (Moore, J., dissenting) (citing *Bob Jones Univ. v. United States*, 461 U.S. 547 (1983)).

489. *Id.* at 820-821 (citing *Burlington N. & Santa Fe Ry. Co. v. White*, 548 U.S. 53, 64 (2006) (quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997))).

490. *Id.* at 821.

491. *Id.* at 822.

492. *Id.* at 825.

The U.S. Government filed an amicus brief and participated in oral argument in support of Thompson, urging the Court to adopt the reasoning of Judge Moore's dissenting opinion.[493] If the Court were to agree, employers should exercise extra caution in contemplating termination of an employee who has a close relationship with a protected employee.

*Update: On January 24, 2011, the Supreme Court did in fact agree with the government's amicus brief, and reversed the Sixth Circuit in a unanimous opinion by Justice Scalia, holding that Title VII's ban on workplace retaliation is broad enough to apply to third parties associated with the targeted employee.*[494] *The Court had "no difficulty concluding" that third-party retaliation is prohibited by Title VII, which "cover[s] a broad range" of employer misconduct. "We think it obvious," the Court explained, "that a reasonable worker might be dissuaded from engaging in protected activity if she knew that her fiancé would be fired."*

## § 3.9.4 The Supreme Court will address the scope of employers' liability for supervisors' discriminatory acts. *Staub v. Proctor Hospital*

In *Staub v. Proctor Hospital*,[495] the Supreme Court is poised to provide guidance on the scope of employer liability for the discriminatory acts of supervisors who do not themselves make employment decisions but who do influence the decision makers.[496] While every circuit court has generally recognized this theory of employer liability, referred to as the "cat's paw" theory,[497] the circuits are split on its application to discrimination claims and the standard for when courts should allow cat's paw evidence. The question presented to the Supreme Court is: "In what circumstances may an employer be held liable based on the unlaw-

493. *See* Brief for the United States as Amicus Curiae Supporting Petition, No. 09-291, in the U.S Supreme Court (May 25, 2010), *available at* http://www.americanbar.org/content/dam/aba/publishing/preview/publiced_preview_briefs_pdfs_09_10_09_291_PetitionerAmCuUSA.authcheckdam.pdf.

494. *Thompson v. N. Am. Stainless, LP*, 131 S. Ct. 863 (2011).

495. *Staub v. Proctor Hosp.*, 560 F.3d 647 (7th Cir. 2009), *cert. granted*, 130 S. Ct. 2089 (2010).

496. The Supreme Court tried to review this doctrine in 2007 in the Title VII context in *BCI Coca Cola Bottling Company of Los Angeles v. EEOC*, 450 F.3d 476 (10th Cir. 2006), *cert. granted*, 127 S. Ct. 852 (2007), but the case was voluntarily dismissed by the petitioner prior to oral argument and ultimately settled.

497. The cat's paw theory took root in the Seventh Circuit decision of *Shager v. Upjohn Company*, written by Judge Posner, in which the court found that the termination committee's decision to fire the plaintiff was tainted by the discriminatory acts of the plaintiff's manager who set the plaintiff up to fail by assigning him to unpromising sales areas and writing an unfavorable evaluation. *See Shager v. Upjohn Co.*, 913 F.2d 398, 404-05 (7th Cir. 1990).

ful intent of officials who caused or influenced but did not make the ultimate employment decision?"

Derived from the 17th Century fable "The Monkey and the Cat" by French poet Jean de La Fontaine, in which a monkey uses an unwitting cat to pull chestnuts from a hot fire, the cat's paw theory captures the notion of one person using another to accomplish his ulterior motives. In employment cases, the cat's paw theory is used to prove discrimination when the actual decision maker is unbiased by imputing on the decision maker the discriminatory animus of a nondecision maker.

The circuits are split into three camps on the appropriate level of control a biased supervisor must exert over the ultimate decision maker for liability to be imputed to the employer. The Fourth and Seventh Circuits apply the strictest, most employer-friendly approach of the cat's paw theory, requiring that the biased supervisor singularly influence the employment decision while the ultimate decision maker blindly relies on, or rubber-stamps, the supervisor's recommendation.[498] The Sixth, Ninth, Tenth, and Eleventh Circuits apply the intermediate "causation" standard in which the nondecision maker's discriminatory animus can provide a basis for employer liability if the employee can show that the nondecision maker "caused" the formal decision maker to take the adverse action, e.g., by providing false, incomplete, or adverse information.[499] As long as the unlawfully motivated actions of the biased supervisor *caused* the decision, the formal decision maker's partial reliance on information from independent sources will not shield the employer from liability. Finally, the First, Second, Third, Fifth, Eighth, and D.C. Circuits apply the most lenient, employee-friendly "influence" standard, under which an employee may prevail simply by proving that individuals acting with a discriminatory animus participated in or influenced the decision.[500] The standard adopted by these circuits reflects the belief that the input of discriminators inevitably will affect a seemingly independent decision maker's decision.

In *Staub*, the Seventh Circuit reversed a judgment in favor of a U.S. army reservist who alleged he was fired because his two immediate supervisors resented his military service, an act that he claimed was illegal under the uniformed services Employment and Reemployment Rights Act of 1994, 38U.S.C. § 4301 *et seq*. (USERRA). The hospital executive who fired the reservist harbored no anti-military animus; nevertheless, the trial court allowed the introduction of cat's paw evidence that the reservist's supervisors were biased and influenced the decision. The Seventh Circuit held that a trial judge must determine whether a reasonable jury could find that an allegedly biased nondecision maker exerted a "singular influence" over the unbiased decision maker before admitting evidence of the nondecision maker's animus. The Seventh

498. *See Hill v. Lockheed Martin Logistics Mgmt., Inc.*, 354 F.3d 277, 290-91 (4th Cir. 2004); *Staub*, 560 F.3d at 659.

499. *See, e.g., EEOC v. BCI Coca-Cola Bottling Co.*, 450 F.3d 476 (10th Cir. 2006); *Stimpson v. City of Tuscaloosa*, 186 F.3d 1328, 1332 (11th Cir. 1999).

500. *See, e.g., Abramson v. William Paterson Coll. of N.J.*, 260 F.3d 265, 286 (3d Cir. 2001); *Russell v. McKinney Hosp. Venture*, 235 F.3d 219 (5th Cir. 2000).

Circuit further held that if the unbiased decision maker conducts an independent investigation before acting, the necessary singular influence is lacking and the employer is not liable.

During oral argument on November 2, 2010, the Supreme Court justices expressed skepticism regarding the positions of both parties and inquired as to whether a reasonable middle position exists on the interpretation of cat's paw liability. The outcome of this case could have widespread ramifications for employers and employees in the modern workplace, given that most employers use a multilevel personnel process for employment decisions. Further, as employers continue to implement workforce reductions in a down economy, employers must be aware of their potential liability for decisions resulting from hidden motives of supervisors and managers who lack final authority over adverse employment decisions. If the Supreme Court adopts a true cat's paw theory, insulating employers from liability as long as the ultimate decision maker lacked a discriminatory animus and acted independently, the Court could invite employers to create a system of decision-making that allows for illegal discrimination at every step but the last one.

*Update: On March 1, 2011, the Supreme Court reversed and remanded in a 6-2 opinion written by Justice Scalia. Staub v. Proctor Hosp., No. 09-400, 2011 U.S. LEXIS 1900 (U.S. Mar. 1, 2011). The Court upheld the "cat's paw" theory, holding "that if a supervisor performs an act motivated by antimilitary animus that is intended by the supervisor to cause an adverse employment action, 3 and if that act is a proximate cause of the ultimate employment action, then the employer is liable under USERRA. Id. at *19-20 (emphasis in original).*

## § 3.9.5 What standard applies to ERISA claims alleging discrepancies between an employee benefit plan description and the plan's actual terms? *CIGNA Corp. v. Amara*

Finally, rounding out the 2010-11 employment docket, the Supreme Court will address, in *CIGNA Corp. v. Amara*,[501] No. 09-804, the applicable standard for recovery in ERISA cases involving discrepancies between summary plan descriptions for employee benefit plans and the actual plan benefit terms. The Court heard oral argument in this case on November 30, 2010.

The Employee Retirement Income Security Act (ERISA) protects the interests of participants and their beneficiaries in employee benefit plans and seeks to ensure that participants in and beneficiaries of ERISA plans receive accurate and comprehensible information regarding their rights and obligations under the plan. To this end, ERISA requires plan administrators to provide every plan participant and beneficiary with a copy of a summary plan description

501. *Amara v. Cigna Corp.*, 559 F. Supp. 2d 192 (D. Conn. 2008) and *Amara v. Cigna Corp.*, 534 F. Supp. 2d 288 (D. Conn. 2008), *aff'd*, 348 Fed. App'x 627 (2d Cir. 2009), *cert. granted*, 130 S. Ct. 3500 (2010).

(SPD) and, when material changes are made to the plan, a summary of material modifications (SMM).[502] The SPD must be "written in a manner calculated to be understood by the average plan participant" and "sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of their rights and obligations under the plan."[503]

In *CIGNA Corp.*, the Court will address whether participants in an employee benefit plan covered by ERISA who make an unrebutted showing of "likely harm" from a discrepancy between the SPD (or SMM) description of benefits and the description in other plan documents may recover benefits as promised in the SPD (or SMM).

This case arose out of CIGNA's conversion of its defined benefit plan to a cash balance plan. Plan beneficiaries sued CIGNA, claiming that the company violated ERISA by failing to disclose information about the effects of the plan conversion. The Second Circuit summarily affirmed the district court's use of a "likely harm" standard, in which plan participants and beneficiaries may recover benefits if they were likely to have been harmed as a result of the deficient SPD. A plan participant (or beneficiary) can establish the necessary "likely harm" by showing that the SPD likely led a reasonable participant (or beneficiary) to expect materially more favorable benefits than those described in the formal plan documents. The plan administrator can rebut the showing of likely harm by demonstrating that disregarding the SPD would not harm the participant (or beneficiary) because a reasonable person in the participant's (or beneficiary's) position would not have expected to receive more favorable benefits (e.g., the participant had actual knowledge of the inadequacies in the SPD). Based on this standard, where a SPD clearly promises materially greater benefits than the actual plan terms, the SPD controls unless the plan administrator can show that failing to follow the SPD was harmless.

The Second Circuit's "likely harm" standard conflicts with the standards adopted by other circuits. While eleven of the courts of appeals have found that the summary description can control when a description of benefits in a SPD conflicts with the terms of the formal plan documents, the circuits have disagreed on what the participant/beneficiary must demonstrate for the summary description to control and, consequently, to be entitled to the benefits promised in the SPD. In the Third, Fifth, and Sixth Circuits, for example, a plan participant or beneficiary suing based on a discrepancy between the SPD and the actual plan terms must only demonstrate a clear and material conflict between the SPD and the plan, not that the beneficiary was likely harmed by the discrepancy.[504] In the First, Fourth, Seventh, Eighth, Tenth, and Eleventh Circuits, the participant

502. 29 U.S.C. § 1024(b)(1).

503. 29 U.S.C. § 1022(a).

504. *See Burstein v. Ret. Account Plan for Employees of Allegheny Health Educ. & Research Found.*, 334 F.3d 365, 381 (3d Cir. 2003); *Washington v. Murphy Oil USA, Inc.*, 497 F.3d 453, 458-59 (5th Cir. 2007); *Edwards v. State Farm Mut. Auto. Ins. Co.*, 851 F.2d 134, 137 (6th Cir. 1988).

or beneficiary must demonstrate some degree of detrimental reliance on or prejudice from the inadequate SPD.[505]

*CIGNA* presents the Supreme Court with the opportunity to decide the reliance interests, if any, that ERISA plan participants and beneficiaries must show when suing based on alleged inconsistencies between a SPD and the plan's terms. Those employers who maintain benefit plans for their employees should pay close attention to this decision as it could affect the costs and liabilities associated with creating, maintaining, and amending ERISA plans.

It is worth noting that Justice Kagan has recused herself in three of the four employment-related cases on the 2010-11docket, including *Kasten*, *Thompson*, and *Staub*, because of her prior work as the U.S. Solicitor General. Kagan's absence raises the prospect of a deadlock in one or more of these cases, with an evenly divided court keeping the lower court's ruling in place.

# § 3.10 Arbitration

During the 2009-10 term, the Supreme Court continued its active supervision of arbitration law, deciding three arbitration cases and adding another important class arbitration case to its 2010-11 docket. Two of the three decided cases addressed the question of whether the court or the arbitrator should adjudicate a challenge to the enforceability of an arbitration clause. The third case discussed whether parties can be compelled to class arbitration when the arbitration agreement is silent on the question.

## § 3.10.1 A clause delegating contract enforceability questions to the arbitrator is presumptively valid. *Rent-A-Center, West, Inc. v. Jackson*

In *Rent-A-Center, West, Inc. v. Jackson*, the Court held that a clause in an arbitration agreement that delegated to an arbitrator the power to decide challenges to the enforceability of the arbitration agreement (a "delegation clause") was presumptively valid. When an arbitration agreement contains such a delegation clause, the arbitrator should decide all challenges to the enforceability of the arbitration agreement unless the challenge is specifically directed to the delegation clause.[506] In light of the Court's decision, many companies undoubtedly will incorporate delegation clauses into their arbitration agreements, if they have

505. *See Govoni v. Bricklayers, Masons & Plasterers Int'l Union of Am., Local No. 5 Pension Fund*, 732 F.2d 250, 252 (1st Cir. 1984); *Aiken v. Policy Mgmt. Sys. Corp.*, 13 F.3d 138, 141 (4th Cir. 1993); *Hightshue v. AIG Life Ins. Co.*, 135 F.3d 1144, 1149 (7th Cir. 1998); *Greeley v. Fairview Health Servs.*, 479 F.3d 612, 614-15 (8th Cir. 2007); *Chiles v. Ceridian Corp.*, 95 F.3d 1505, 1519 (10th Cir. 1999); *Branch v. G. Bernd Co.*, 955 F.2d 1574, 1578-79 (11th Cir. 1992).

506. *Rent-A-Center, West, Inc. v. Jackson*, 130 S. Ct. 2772, 2780 (2010).

not already, in an effort to avoid having to litigate the arbitrability of disputes arising under the contract before proceeding to arbitration.

The delegation clause at issue provided the arbitrator with the "exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement."[507] Despite this clause, Jackson filed suit against his former employer, Rent-A-Center, in federal district court. In response to Rent-A-Center's motion to dismiss the lawsuit and compel arbitration, Jackson argued that the arbitration agreement was unconscionable under state law. The district court granted Rent-A-Center's motion, holding that the arbitrator must determine enforceability under the terms of the delegation clause. The Ninth Circuit reversed in part and held, in conflict with other circuits, that Jackson's unconscionability claim was for the court to decide. In a 5-4 decision authored by Justice Scalia and joined by the rest of the conservative bloc, the Supreme Court reversed the Ninth Circuit.

The majority and the dissenters (led by Justice Stevens) parted ways over whether the Court's decision was an extension of, or departure from, the long-standing *Prima Paint*[508] rule, which provides that a challenge to the enforceability of an arbitration provision (which is severable from the contract in which it sits) is for a court to decide, whereas a challenge to the enforceability of the contract as a whole must be decided by the arbitrator. The dissent argued that because the entire contract at issue was an arbitration agreement, application of the *Prima Paint* rule required that the enforceability challenge be adjudicated by a court. The majority, though, treated the delegation clause as severable from the rest of the arbitration agreement, and concluded that it had to be specifically challenged to trigger court review. Significantly, the four dissenters did not simply criticize the Court for improperly extending *Prima Paint*, they also suggested that *Prima Paint* was "likely erroneous."[509] This development bears watching. However, with Justice Stevens's retirement, it seems unlikely that the foundational *Prima Paint* framework could be successfully challenged in the near future.

## § 3.10.2 The question of agreement formation is for the court to decide—not the arbitrator. *Granite Rock Co. v. International Brotherhood of Teamsters*

In the second case involving whether a court or arbitrator was the proper decision maker, *Granite Rock Co. v. International Brotherhood of Teamsters*, the Court held that the question of whether and when parties formed an agreement

507. *Id.* at 2775.
508. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).
509. *Rent-A-Center*, 130 S. Ct. at 2785 (Stevens, J., dissenting).

containing an arbitration clause is generally an "issue for judicial determination," not an arbitrator.[510]

Granite Rock and the local union chapter ("Local") were parties to a collective bargaining agreement ("CBA"). When the CBA expired and negotiations for a new CBA stalled, Local's members went on strike. The strike continued until the parties agreed to a new CBA, one that included a no-strike clause but did not waive liability for any previous strike-related damages. Local's international chapter ("IBT") instructed Local's members not to return to work until Granite Rock agreed to waive past damages. When Granite Rock refused, Local's members refused to return to work on the agreed date. Granite Rock sued Local and IBT in federal district court. The parties disputed when the new CBA was ratified. After other procedural issues were resolved, Local moved to arbitrate the ratification date. The district court denied the request, holding it was a decision for the court. The Ninth Circuit reversed. In an opinion drafted by Justice Thomas and joined on this issue by all but Justices Sotomayor and Stevens, the Court again reversed the Ninth Circuit.

The Court's discussion of the arbitration issue did not break any significant new ground. The Court held that disputes regarding contract formation are generally for the courts—not arbitrators—to decide.[511] It determined that the case, despite the "unusual facts," fell within its existing "arbitrability" precedents, which it summarized as follows:

> [C]ourts should order arbitration of a dispute only where the court is satisfied that neither the formation of the parties' arbitration agreement *nor* (absent a valid provision specifically committing such disputes to an arbitrator) its enforceability or applicability to the dispute is in issue. Where a party contests either or both matters, "the court" must resolve the disagreement.[512]

## § 3.10.3 Class arbitration is permissible only if specifically authorized by an arbitration agreement. *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*

The third arbitration case decided by the Court, *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, may turn out to be the most significant of the three.[513] The Court held that class arbitration is permissible only if specifically authorized in the arbitration agreement. Because the arbitration agreement at issue was silent as

510. 130 S. Ct. 2847 (2010).

511. *Id.* at 2855-56 (noting the rule is "well-settled" and citing other Supreme Court precedence).

512. *Id.* at 2857-58 (citations omitted).

513. 130 S. Ct. 1758 (2010).

to the availability of class arbitration, the Supreme Court vacated an arbitration panel's determination that class arbitration was available.

AnimalFeeds entered into a form shipping contract with Stolt-Nielsen to deliver goods. After a government investigation revealed that shipping companies were involved in a price-fixing conspiracy, AnimalFeeds filed a putative class action against various shipping companies, including Stolt-Nielsen, in federal district court. Other customers brought similar suits. These suits were consolidated and, based on an arbitration clause contained in the form shipping contract, it was determined that AnimalFeeds' claims were subject to arbitration. AnimalFeeds served a demand for class arbitration, but the shippers argued that class arbitration was not authorized under the arbitration clause. The litigants agreed in a supplemental contract to let an arbitration panel decide the threshold question of whether class arbitration was available. The arbitration panel determined that class arbitration was available even though it was undisputed that the arbitration clause was "silent" on the question. The district court vacated the panel's award on the ground that it was made in "manifest disregard of the law"—a common law ground for vacatur. The Second Circuit reversed, finding that there was no manifest disregard in this case.

In a 5-3 decision authored by Justice Alito and joined by the rest of the conservative bloc, the Supreme Court reversed the Second Circuit and again vacated the arbitration panel's class arbitration determination. Significantly, it did not vacate under the "manifest disregard" ground utilized by the district court, and specifically avoided the question of whether this ground survived its prior decision in *Hall Street Associates, L.L.C. v. Mattel, Inc*.[514]

Instead, the Court invoked 9 U.S.C. § 10(a)(4)—a statutory ground for vacatur under the Federal Arbitration Act (FAA) that applies when "arbitrators exceed[] their powers." But the Court's decision was not predicated on a conclusion that the panel exceeded any limitation on its authority contained in the arbitration clause or submission agreement—the typical grounds for vacatur under § 10(a)(4). Instead, the majority found that the arbitration panel had exceeded its powers by supporting its decision on public policy grounds and failing to anchor its legal analysis to FAA, maritime law, or New York law precedents. The dissent, in an opinion authored by Justice Ginsburg and joined by Justices Stevens and Breyer, pointed out that the question under § 10(a)(4) is "whether the arbitrators had the power, based on the parties' submissions or the arbitration agreement, to reach a certain issue, not whether the arbitrators correctly decided that issue."[515] The parties' specific agreement to arbitrate the issue of whether class arbitration was available made this question "scarcely debatable" in the eyes of the dissenters. The Court's decision may have created new uncertainty as to the proper bounds of the § 10(a)(4) vacatur ground.

In its discussion of the merits, the Court tried to clarify its 2003 plurality decision in *Green Tree Financial Corp. v. Bazzle*[516]—a case that spawned

514. *Id.* at 1768 n.3 (citing *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 585 (2008)).

515. *Id.* at 1780.

516. 539 U.S. 444 (2003).

confusion in the lower courts and dramatically increased the frequency of class arbitrations.[517] In *Bazzle*, the Court raised (without apparently resolving) three issues: (1) who decides whether a contract is "silent" as to class arbitration, (2) what standard applies in determining whether a contract allows class arbitration, and (3) was class arbitration properly ordered in that instance.[518] Many incorrectly interpreted *Bazzle* to have at least answered the first question—namely, that the arbitrator, not the court, is the proper decision maker. Because of the plurality, however, "*Bazzle* did not yield a majority decision on any of the three questions."[519] The first question was not even addressed in *AnimalFeeds* because the parties agreed to arbitrate. Therefore, the first question, previously thought resolved, remains open.

*AnimalFeeds*, however, addressed the second question, and the Court grounded its approach in the contractual nature of arbitration. A party may be compelled to class arbitration only where "there is a contractual basis for concluding the party agreed to do so."[520] Given the relationship between the parties and the nature of class arbitration, silence is not sufficient to establish an agreement to class arbitration. Nor are public policy rationales a substitute for such an agreement. Parties, however, are free to expressly agree that class arbitration will be available.[521]

## § 3.10.4 The Supreme Court weighs the validity of express agreements to waive class arbitration. *AT&T Mobility LLC v. Concepcion*

The Court may decide in the 2010-11 term whether express agreements to waive class arbitration are valid. In *AT&T Mobility LLC v. Concepcion*, the Ninth Circuit held the express waiver of class arbitration was unconscionable under California law because (1) the agreement at issue was a contract of adhesion; (2) the dispute involved predictably small amounts of damages; and (3) it was alleged that the party with superior bargaining power carried out a scheme deliberately to cheat large numbers of consumers out of individually small amounts of money.[522]

The Supreme Court, which granted certiorari and heard oral arguments on November 9, 2010, has been asked to determine whether the FAA preempts such a result, which would be the case if it finds that California applies its

517. *See AnimalFeeds*, 130 S. Ct. at 1768 n.4.

518. *Id.* at 1771.

519. *Id.* at 1772.

520. *Id.* at 1775.

521. *Id.* at 1774 (stating "[w]e think it is also clear from our precedents and the contractual nature of arbitration that parties may specify *with whom* they choose to arbitrate their disputes." (emphasis in the original)).

522. *Laster v. AT&T Mobility*, 584 F.3d 849, 854 (9th Cir. 2009), *cert. granted sub nom. AT&T Mobility LLC v. Concepcion*, 130 S. Ct. 3322 (2010).

unconscionability doctrine differently to arbitration agreements than it does to contracts generally. More than 20 amicus briefs were filed in the case, and the Court's decision will bear heavily on the future utility of class arbitration waiver provisions.

# § 3.11 Class Actions

## § 3.11.1 States do not have the authority to limit when a class action may be filed in federal court. *Shady Grove Orthopedic Associates, P.A. v. Allstate Insurance*

Business advocates have long argued that the class action device is prone to misuse and creates unfair pressure to settle, particularly given the device's ability to exponentially increase a potential damages award. In response to these concerns, state legislatures increasingly have adopted various restrictions on the use of, or available remedies under, class actions. One such New York statute came under fire this year in *Shady Grove Orthopedic Associates*, the sole class action case decided by the Court in the 2009-10 term.[523]

Shady Grove sued Allstate in the Eastern District of New York to recover—on behalf of itself and a class of all others similarly situated—the past due interest owed by Allstate under New York law for failure to timely pay insurance benefits.[524] Shady Grove's individual claim was only $500, but aggregating all potential plaintiffs' claims raised the damages sought to $5 million, the minimum amount required to bring a class action based on diversity in federal court.[525] In dismissing the case for lack of jurisdiction, the district court relied on Section 901(b) of the New York Civil Practice Law and Rules, which precludes a suit brought to recover a statutory penalty from being maintained as a class action.[526] Classifying the interest payments sought by Shady Grove as a "penalty," the district court held that Section 901(b) prohibited the lawsuit from proceeding as a class action despite the existence of Federal Rule of Civil Procedure 23, which generally governs class actions in federal court. Because Shady Grove's particularized damages of $500 were well below the threshold required for a separate diversity action, the judge dismissed the case.

523. *Shady Grove Orthopedic Associates, P.A. v. Allstate Insurance Co.*, 130 S. Ct. 1431 (2010).

524. *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 466 F. Supp. 2d 467 (E.D.N.Y. 2006), *aff'd*, 549 F.3d 137 (2d Cir. 2008), *rev'd*, 130 S. Ct. 1431 (2010).

525. 28 U.S.C. § 1332(d)(2).

526. N.Y. C.P.L.R. 901(b) (Consol. 2010).

In a two-step analysis, the Second Circuit affirmed.[527] First, the circuit court reasoned that while a federal rule would control in a diversity case if it directly conflicted with a state procedural law, it held there was no conflict between Rule 23 and Section 901(b) because the former addressed "certifiability" of a class action while the latter addressed "eligibility" for certification itself. Next, the circuit court conducted an *Erie*[528] analysis and held that, because Section 901(b) was "substantive" as opposed to "procedural," the federal court was bound to apply the New York law, and thus the suit was prohibited from being brought as a class action.

A sharply divided Supreme Court reversed and remanded, finding that "the line between eligibility and certifiability is entirely artificial."[529] Writing for a plurality of the Court, Justice Scalia instead declared that "[b]oth of § 901's subsections undeniably answer the same question as Rule 23: whether a class action may proceed for a given suit."[530] Because the two laws were contradictory, Rule 23 must govern unless it violated the Rules Enabling Act, which prohibits federal rules from abridging, enlarging, or modifying any substantive right.[531] Like other rules governing joinder, Rule 23 did not violate the Rules Enabling Act and therefore applied in this case.

Justice Stevens, while concurring in that opinion and concurring in the judgment, struck a more nuanced approach.[532] In his narrower opinion—which provided the deciding fifth vote for the Court's judgment—Justice Stevens argued that "[a] federal rule . . . cannot govern a particular case in which the rule would displace a state law that is procedural in the ordinary use of the term but is so intertwined with a state right or remedy that it functions to define the scope of the state-created right."[533] But "there must be more than just a possibility that the state rule is different than it appears": "[t]here must be little doubt."[534] Because Justice Stevens agreed that Section 901(b) was strictly procedural, resort to his "balancing" test was unnecessary in this instance.

527. *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 549 F.3d 137 (2d Cir. 2008).
528. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938).
529. 130 S. Ct. at 1438.
530. *Id.* at 1443.
531. 28 U.S.C. § 2072.
532. 130 S. Ct. at 1448 (Stevens, J., concurring).
533. *Id.* at 1452 (Stevens, J., concurring).
534. *Id.* at 1457 (Stevens, J., concurring).

## § 3.11.2 The Supreme Court considers certification of a class of unprecedented size in a nationwide gender discrimination class action. *Wal-Mart v. Dukes*

In *Wal-Mart v. Dukes*, No. 10-277, the Supreme Court will decide whether a district court properly certified a nationwide class of female Wal-Mart employees, under Federal Rule of Civil Procedure 23(b)(2), who assert claims for injunctive relief, declaratory relief, and back pay arising from allegations of systemic sex discrimination.[535] In a sharply-divided 6-5 decision, the Ninth Circuit, sitting en banc, affirmed the district court's certification of a Rule 23(b)(2) class—which, if it stands, would be the largest certified employment class in history, consisting of hundreds of thousands of employees at 3,400 stores in 41 regions.[536]

The Supreme Court's grant of certiorari is limited to the first question in the petition—whether claims for monetary relief can be certified under Federal Rule of Civil Procedure 23(b)(2) (which by its terms is limited to injunctive or corresponding declaratory relief) and, if so, under what circumstances.[537] The Ninth Circuit's decision left a three-way circuit split of significance in class-action litigation. As one law review article described the split,

> [t]he dispute between the *Dukes* court and other circuits thus is joined: On a motion for class certification, does the judicial role consist exclusively of identifying questions said by class counsel to be common across the proposed class, or does it instead entail an obligation actually to assess their common character for the limited purpose of class certification—again, with no preclusive effect on the merits? The disagreement surrounding this question is no minor technicality. As a descriptive matter, class certification stands not as a mere judicial byway on the road toward full-fledged trial on the merits but, almost invariably, as the last significant judicial checkpoint on the road toward settlement. When the pre-trial determination of whether to certify the class effectively is the trial, both sides—not surprisingly—understand full well how much rides on the parameters for that determination.[538]

Given the stakes in the class and the implications for Rule 23 practice nationwide, Wal-Mart likely is correct in asserting that this case could culminate in

535. *Dukes v. Wal-Mart Stores, Inc.*, 603 F.3d 571 (9th Cir. 2010) (en banc), *cert. granted in part*, 131 S. Ct. 795 (2010).

536. *Id*.

537. *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 795 (2010).

538. Richard Nagareda, *Common Answers for Class Certification*, 63 VAND. L. REV. EN BANC 149, 152 (2010) (discussing the circuit split at issue in *Dukes*).

"one of the most important class-action decisions since the modern Rule 23 was adopted in 1966 . . . ."[539]

As such, the decision is sure to have significant implications for businesses facing large class actions. Indeed, some observers have commented on the "David and Goliath" character of the case: "While many commentators have noted that the current Court is quite friendly to big business, others, like Dahlia Lithwick, have noted that the three women on the Court may want the class to be certified so as to reach the gender discrimination claims at the heart of the case."[540] Oral argument is scheduled for March 29, 2011.

## § 3.11.3 Does denial of class certification in a federal lawsuit allow a federal court to enjoin other plaintiffs from seeking certification in state court? *Smith v. Bayer Corp.*

In *Smith v. Bayer Corp.*, No. 09-1205, the Supreme Court will decide whether principles of collateral estoppel allow a federal court to enjoin parties from seeking class certification in a state court lawsuit when certification previously had been denied to a different group of plaintiffs in the federal lawsuit.[541] As a practical matter, the Court's ruling in *Smith* will significantly impact consumer class actions because it will determine whether consumers who are unaware of pending class action lawsuits can raise additional issues in their own class action suits against corporate wrongdoers.

The class action arises from Bayer's withdrawal in 2001of the cholesterol drug Baycol following reports of serious side effects.[542] After the withdrawal, thousands of lawsuits were filed, leading to multidistrict litigation[543] intended to coordinate and supervise discovery and other pretrial matters in federal courts. In one of these cases, the plaintiffs sought class certification—which the district court denied in 2008 on the basis that common issues did not predominate, and due to a lack of uniformity in state laws governing the plaintiffs' claims.[544] After the dismissal of the class action, a second group of plaintiffs

539. Petition for a Writ of Certiorari, *Wal-Mart Stores, Inc. v. Dukes*, No. 10-277, at 8 (U.S. Aug. 25, 2010), *available at* http://sblog.s3.amazonaws.com/wp-content/uploads/2010/09/Brief-09-23-10-093139.pdf.

540. Lisa McElroy, *This Week at the Court—In Plain English*, posted on SCOTUSblog.com (Dec. 9. 2010), *available at* http://www.scotusblog.com/?p=110397 (citing Dahlia Lithwick, *Wal-Mart Going to the High Court*, slate.com (Dec. 6, 2010), *available at* http://www.doublex.com/blog/xxfactor/wal-mart-going-high-court)).

541. *Smith v. Bayer Corp. (In re Baycol Prods. Litig.)*, 593 F.3d 716 (8th Cir. 2010), *cert. granted*, 131 S. Ct. 61 (2010).

542. *In re Baycol Prods. Litig.*, 532 F. Supp. 2d 1029, 1035 (D. Minn. 2007).

543. *See* 28 U.S.C. § 1407.

544. *In re Baycol Prods. Litig.*, 218 F.R.D. 197, 202, 213-214 (D. Minn. 2003).

sought class certifications asserting economic loss claims.[545] The district court denied certification, and issued an injunction against a similar class action filed in state court, holding that the prior order denying certification barred the second request for class certification.[546]

Relying on the Anti-Injunction Act,[547] the Eighth Circuit affirmed the district court's injunction barring a second class action, reasoning that: (1) the certification issues presented in both the state and federal lawsuits were sufficiently identical because they both required proof of physical harm or injury to recover under the West Virginia Consumer Credit and Protection Act, regardless of whether certification was being sought under either Rule 23 or the state's certification rule;[548] and (2) the parties in the state court suit were in privity with those in the original federal suit and therefore were adequately represented because both proposed classes would be comprised of West Virginians who had purchased a recalled drug and were seeking recovery of purely economic losses.[549] The Eighth Circuit further held that due process concerns were satisfied because the state court parties still had the ability to pursue their individual claims in state court—similar to putative class members who choose to opt out of the class.[550]

An interesting wrinkle raised by the petitioners in the Supreme Court is whether the injunction can attach when the federal class action never actually existed precisely because the district court had denied class certification and, thus, due process protections never had been afforded the absent members.[551]

If *Shady Grove* is any indication, the Court appears to be walking a very fine line between pro-consumer and pro-business interests in the class action context. It will be interesting to see whether *Wal-Mart* and *Smith* pull the Court strongly in one direction or the other. In the meantime, in light of *Shady Grove*, class-action plaintiffs may be emboldened to test whether state restrictions on class actions are preempted by federal rules.

*Update: The Supreme Court heard oral argument on January 18, 2011.*[552]

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545. *In re Baycol Prods. Litig., McCollins v. Bayer Corp., et al.*, MDL No. 1431, No. 02-0199, 2008 U.S. Dist. LEXIS 112036, *2 (D. Minn. Aug. 25, 2008).

546. 593 F.3d at 721.

547. The Anti-Injunction Act generally prohibits federal courts from interfering in state proceedings, but permits injunctions necessary to "protect or effectuate its judgments." 28 U.S.C. § 2283; *see also* All Writs Act, 28 U.S.C. § 1651 (providing statutory authority to issue injunction when justified).

548. 593 F.3d at 721-724.

549. *Id.* at 724-725.

550. *Id.* at 725.

551. *See* Petition for Writ of Certiorari, No. 09-1205, filed in the U.S. Supreme Court (April 5, 2010), *available at* http://sblog.s3.amazonaws.com/wp-content/uploads/2010/09/09-1205-Petition.pdf.

552. The transcript for the oral argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-1205.pdf.

# § 3.12 Constitutional Law

The Supreme Court ventured into new constitutional territory in the 2009-10 term, recognizing the concept of judicial takings in violation of the Takings Clause and finding in one of the most significant cases of the year that the Second Amendment could be used, via incorporation by the Due Process Clause, to strike down gun regulations implemented by state or local governments.

## § 3.12.1 Florida's scheme for rebuilding eroded beaches is not an unconstitutional taking. *Stop the Beach Renourishment, Inc. v. Florida Department of Environmental Protection*

In *Stop the Beach Renourishment, Inc. v. Florida Department of Environmental Protection*, the Supreme Court considered whether a Florida statute that altered the boundary between privately owned and state-owned oceanfront lands following state restoration of eroded beaches constituted an unconstitutional taking.[553]

Under Florida common law, the boundary between state-owned land and private land is the mean high water line, which is a 19-year average; the state owns all land seaward of the mean high water line. Under the doctrine of accretion, if dry land builds up gradually over time, the boundary moves with the water line, giving the private landowner the benefit of the accumulated dry land. Under the doctrine of avulsion, on the other hand, if dry land builds up or erodes suddenly, such as when a hurricane hits the shore, the boundary between state-owned and privately owned land remains the same as before the avulsive event; thus, land that was previously submerged remains property of the state even though it is dry land after avulsion. The statute at issue—the Florida Beach and Shore Preservation Act[554]—allowed the state to fix the boundary at a state-determined "erosion control line," rather than at the common law mean high water line.

Stop the Beach Renourishment (STBR), a group of beachfront landowners affected by a beach renourishment project, argued that this fixed boundary interfered with their right of accretion. The landowners argued that as the state builds up the shore, the mean high water line shifts seaward, but the buildup of dry land beyond the erosion control line boundary is still state property and therefore cuts off their right of accretion.

553. *Stop the Beach Renourishment, Inc. v. Fla. Dep't of Envtl. Prot.*, 130 S. Ct. 2592 (2010).

554. Beach and Shore Preservation Act, 1961 Fla. Laws ch. 61-246, as amended, Fla. Stat. §§ 161.011-161.45 (2007).

The Florida Supreme Court first weighed in on the dispute, holding that the statute was not facially unconstitutional under the Florida Constitution because the statute did not alter private property owners' traditional common law rights.[555] The Florida high court explained that a statute is only facially unconstitutional if "'no set of circumstances exists under which the statute would be valid.'"[556] This test was not satisfied because the statute could be validly applied to beach restoration after a hurricane. A hurricane is an avulsive event, and under Florida common law, the boundary between government property and privately owned land remains the same as before the avulsive event, but a party that has lost land has a right to reclaim that land. The court held that the statute authorized the state to reclaim land that it had lost due to erosion, particularly erosion caused by hurricanes, and the statute did not authorize the state to take any action that it could not take under the common law.

On appeal to the Supreme Court, STBR argued that the Florida court's decision was an unconstitutional judicial taking of their property because the decision was an unpredictable change in Florida's common law.[557] The Supreme Court rejected this argument, concluding that the Florida Supreme Court had not taken an established property right from private landowners. The Supreme Court explained that the decision was in accordance with two principles of Florida common law: (1) the state has a right to fill in submerged land that it owns, as long as it does not interfere with private landowners' property rights; and (2) if an avulsion exposes land that was previously submerged, that land still belongs to the state. Under Florida common law, there is no exception where the state causes the avulsion; if the state fills in submerged land, the adjacent landowner's right of accretion is cut off and is thus subordinate to the state's right to fill in its land. Because the private landowner's right of accretion was subordinate to the state's right to fill in submerged land, the decision of the Florida Supreme Court did not alter private landowners' property rights and thus did not effect a taking of their property.

Most notably in this case, a plurality of the Supreme Court (Justice Scalia, joined by Justices Roberts, Thomas, and Alito) opined that the judiciary could effect a taking of property in violation of the Constitution. Justice Scalia explained, "It would be absurd to allow a State to do by judicial decree what the Takings Clause forbids it to do by legislative fiat."[558] Justice Kennedy, joined by Justice Sotomayor, rejected this argument in a concurring opinion, finding instead that judicial decisions affecting established property rights could be overturned as "arbitrary or irrational" under the Due Process Clause. Justice Breyer, joined by Justice Ginsburg, argued that it was unnecessary to reach the

555. *Walton County v. Stop the Beach Renourishment, Inc.*, 998 So. 2d 1102, 1117-18 (Fla. 2008).

556. 998 So. 2d at 1109 (quoting *Fla. Dep't of Revenue v. City of Gainesville*, 918 So. 2d 250, 256 (Fla. 2005)).

557. *See* Petition for Writ of Certiorari, No. 08-1151, filed in the U.S Supreme Court (March 13, 2009), *available at* http://www.scotusblog.com/wp-content/uploads/2009/06/08-1151_pet.pdf.

558. 130 S. Ct. at 2601.

question to decide the case. It bears close watching whether the plurality can get a fifth vote in a future case.

## § 3.12.2 In a seminal gun rights case, the Supreme Court holds that the Second Amendment applies to state and local governments. *District of Columbia v. Heller*

The Supreme Court also expanded constitutional jurisprudence in finding that the Second Amendment right to bear arms applies to state and local governments. In the wake of the Court's decision in *District of Columbia v. Heller*, 554 U.S. 570 (2008), in which it held that the Second Amendment includes the right of individuals to own handguns for the purpose of self-defense, gun owners and gun rights groups filed suits against the cities of Chicago and Oak Park, Illinois, seeking to strike down the cities' ban on handguns. *McDonald v. City of Chicago*, 130 S. Ct. 3020 (June 28, 2010). Both the district court and the Seventh Circuit upheld the ban, explaining that they were bound by longstanding Supreme Court precedent that the Second Amendment did not apply to the states.[559]

The Court did not explicitly overrule these Reconstruction-era cases, but still cobbled together five votes for applying the Second Amendment to the states. A plurality of the Court (Justice Alito, joined by Chief Justice Roberts, Justice Scalia, and Justice Kennedy) relied upon the doctrine of "selective incorporation," under which most of the Bill of Rights has been held to be "incorporated" into the Due Process Clause and thereby deemed applicable to the states. The Court explained that the earlier precedents "preceded the era in which the Court began the process of 'selective incorporation' under the Due Process Clause, and we have never previously addressed the question whether the right to keep and bear arms applies to the States under that theory."[560] The fifth vote in support of the Court's judgment was provided by Justice Thomas, who opined that an individual's right to bear arms was protected from state and local encroachment through the Fourteenth Amendment's Privileges or Immunities Clause, rather than the Due Process Clause.

In the plurality's analysis, whether Due Process protection was available depended on whether "the right to keep and bear arms is fundamental to *our* scheme of ordered liberty," or whether the right is "deeply rooted in this Nation's history and tradition."[561] The plurality noted that an individual's right of self-defense is the "central component" of the Second Amendment right and stated that "*Heller* makes it clear that this right is 'deeply rooted in this Nation's history

559. *See United States v. Cruikshank*, 92 U.S. 542 (1876); *Presser v. Illinois*, 116 U.S. 252 (1886); *Miller v. Texas*, 153 U.S. 535 (1894).

560. 130 S. Ct. at 3031.

561. *Id.* at 3036 (citations and internal quotation omitted).

and tradition.'"[562] The plurality also examined the history of the right to bear arms and concluded that the framers of the Fourteenth Amendment intended to protect the right to bear arms. For these reasons, the plurality held that the Second Amendment right to bear arms is a fundamental right that is incorporated by the Due Process Clause of the Fourteenth Amendment, and therefore applies to state governments.

Notably, the Court did not address the Chicago handgun ban directly, nor did it announce a standard by which it would evaluate the constitutionality of gun control laws. The Supreme Court noted that the Second Amendment merely limits states' ability to regulate handguns, but states are still free to enact gun control measures. This vagueness in the opinion may lead to further confusion among the lower courts, which will undoubtedly struggle to answer various questions posed by Justice Breyer in his dissenting opinion:

> Does the right to possess weapons for self-defense extend outside the home? To the car? To work? What sort of guns are necessary for self-defense? Handguns? Rifles? Semiautomatic weapons? When is a gun semi-automatic? . . . When do registration requirements become severe to the point that they amount to an unconstitutional ban? . . . How would the right interact with a state or local government's ability to take special measures during, say, national security emergencies?[563]

## § 3.12.3 Does a law banning violent video games violate the First Amendment? *Schwarzenegger v. Entertainment Merchants Association*

The Supreme Court added two constitutional cases of significance to its 2010-11 docket. The first, *Schwarzenegger v. Entertainment Merchants Ass'n*,[564] arises from a challenge to a California law banning the sale or rental of violent video games to minors and requiring explicit labeling on the packages of games falling within the purview of the statute. The Ninth Circuit struck down the law on First Amendment grounds, holding that, as a content-based restriction, the law must be reviewed under the strict scrutiny standard. In so concluding, the Ninth Circuit rejected California's argument that *Ginsberg v. New York*[565] required rational basis review. The sexual materials at issue in *Ginsberg* traditionally have been considered an unprotected category of speech, and the Ninth

562. *Id.*

563. *Id.* at 3126-27.

564. *Video Software Dealers Ass'n v. Schwarzenegger*, 556 F.3d 950 (9th Cir. 2009), *cert. granted*, 130 S. Ct. 2398 (2010).

565. 390 U.S. 629 (1968).

Circuit expressed wariness of extending *Ginsberg* and creating an entirely new category of unprotected speech for violent materials.

The regulation did not survive the Ninth Circuit's strict scrutiny review for two reasons. First, California failed to demonstrate a compelling interest because the studies relied on by the California legislature in passing the statute did not establish a causal connection between playing video games and psychological or physical harm to minors. Second, the Ninth Circuit found that the statute was not narrowly tailored to serve the state's interest in protecting minors because there were less restrictive alternatives, including an education campaign about the existing video game rating system utilized by the Entertainment Software Rating Board (the ESRB), or the parental controls that most gaming consoles now offer.

On appeal to the Supreme Court, California argued that *Ginsberg* should apply to violent material as well as sexual material because there is no rational reason to treat violence as protected speech and sexual material as unprotected speech, when violent material can be just as harmful, if not more harmful, to minors as sexual material.[566] Further, California argued that the statute was the only effective means of ensuring that minors do not have access to violent video games. During the oral argument on November 2, 2010, the Supreme Court justices seemed torn between their concern over setting a precedent that could extend restrictions on violent material beyond video games to movies and books, and their concern over striking down a regulation that seems to be "common sense."[567]

If the statute is upheld and the Ninth Circuit's decision reversed, more states could be expected to follow California and add similar restrictions and labeling requirements for violent video games. Video games could be considered violent in one state and not in another, leading to differing labeling requirements and enforcement standards in different states and resulting in substantial costs to the video game industry. The impact also may be felt in other industries, such as the film and print media industries, which may face similar restrictions on violent content.

566. *See* Petition for Writ of Certiorari, No. 08-1448, filed in the U.S. Supreme Court (May 19, 2009), *available at* http://www.scotusblog.com/wp-content/uploads/2010/04/08-1448_pet1.pdf.

567. The transcript from the oral argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/08-1448.pdf.

## § 3.12.4 Do tax credits for private school tuition violate the Establishment Clause? *Arizona Christian School Tuition Organization v. Winn*

The second constitutional case on the 2010-11 docket is *Arizona Christian School Tuition Organization v. Winn*,[568] in which the Supreme Court will consider (1) whether taxpayers have standing to challenge an Arizona state tuition tax credit they claim violates the Establishment Clause; and (2) whether a state program that gives parents tax credits for private school tuition violates the Establishment Clause. While at first blush *Winn* may appear to fall more in line with the "culture war" cases that have dominated the headlines in recent years, it may also have a major impact on tax policy and tax liability for businesses and individuals that regularly receive tax deductions or credits for charitable giving.

The case is based on a state tax credit passed by the Arizona Legislature in 1997, which gives taxpayers a dollar-for-dollar tax credit for contributions to "school tuition organizations."[569] These organizations are private, nonprofit groups that distribute funds to scholarships for students enrolled in a "nongovernmental primary or secondary school or a preschool for handicapped students" in the state of Arizona.[570] Individual taxpayers can claim a tax credit of up to $500 (with married couples filing jointly able to claim up to $1,000). The tax credit is available to all taxpayers in Arizona, regardless of whether they are parents of school-age children or pay any private school tuition themselves.

After the Arizona Legislature passed the credit, but before it was put into effect, certain Arizona taxpayers challenged the law as unconstitutional. The Arizona Supreme Court rejected the challenge, holding that the credit did not violate the Establishment Clause or the Arizona Constitution.[571] After the law took effect, a different group of taxpayers filed suit, claiming the law was unconstitutional as applied. The federal district court in Arizona hearing the case dismissed the taxpayers' claim for failure to state a claim under the Establishment Clause, and the taxpayers appealed to the Ninth Circuit.

The Ninth Circuit began its analysis by noting that generally, individual taxpayers "do not . . . have standing to challenge governmental spending."[572] However, the court noted "a narrow exception to the general constitutional prohibition against taxpayer standing" when a plaintiff contends that a use of taxpayer funds violates the Establishment Clause.[573] The supporters of the credit again argued that the taxpayer challengers lacked standing, even under

568. *Winn v. Ariz. Christian Sch. Tuition Org.*, 562 F.3d 1002 (9th Cir. 2009), *cert. granted*, 130 S. Ct. 3350 (2010).

569. *See* Ariz. Rev. Stat. Ann. § 43-1089.

570. *See* Ariz. Rev. Stat. Ann. § 43-1089(G)(2)-(3).

571. *See Kotterman v. Killian*, 972 P.2d 606 (Ariz. 1999).

572. *Winn v. Ariz. Christian Sch. Tuition Org.*, 562 F.3d 1002, 1008 (9th Cir. 2009).

573. *Id.* (quoting *Flast v. Cohen*, 392 U.S. 83, 88 (1968)).

*Flast*, because the money directed by taxpayers to scholarship groups under the tax credit program never passed through the state treasury and therefore never involved any "expenditure" of public funds. However, the Ninth Circuit rejected this argument, stating "we reject the suggestion that this money is not publicly subsidized simply because it does not pass through the treasury."[574] On the standing issue, the Ninth Circuit concluded that "[b]y structuring the program as a dollar-for-dollar tax credit, the Arizona legislature has effectively created a grant program whereby the state legislature's funding of [scholarships] is mediated through Arizona taxpayers."[575]

After spending much of its opinion dealing with the standing argument, the Ninth Circuit proceeded to find that the taxpayers' allegations regarding the nonsecular purpose and discriminatory effect, if proven true, could be a valid claim. Therefore, the Ninth Circuit reversed the district court's dismissal of the taxpayers' claim and remanded the case.

The case was then appealed to the Supreme Court, with oral arguments held on November 3, 2010.[576] The focus of the argument was almost exclusively on the issue of taxpayer standing—and, more specifically, the difference between a "tax credit" and a "tax deduction." Justices Sotomayor, Kagan, and Kennedy peppered the attorneys with questions on the distinction between credits and deductions. From the standpoint of the challengers to the tax scheme, the distinction between credits and deductions is an important one, as the federal Tax Code has allowed for deductions to 501(c)(3) groups for decades, and that practice has never been successfully challenged. One commentator noted that the justices' leading questions regarding the difference between deductions and credit demonstrate a potential new "alliance" between Justices Kagan and Kennedy.[577] On the other end of the spectrum, Justice Scalia pointedly remarked to counsel for the tax challengers' argument that tax credits are essentially government funds, stating "[t]his money has never been in the government's coffers. The government has declined to take this money." Justice Kennedy agreed with Scalia on this point, stating "I have some difficultly that any money that the government doesn't take from me is still the government's money."

While no decision has yet been issued, the outcome of this case may well turn on "how one [of the Justices] understands the tax codes," and may either shake or bolster the foundation of standard 501(c)(3) tax deductions in this country.[578] The case may also have an impact on private funding of for-profit schools and universities that rely on private scholarship assistance.

574. *Id.* at 1009.

575. *Id.* at 1010.

576. The transcript of the oral argument in *Winn* is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-987.pdf.

577. *See* Lyle Denniston, *Argument Recap: A Kennedy-Kagan axis?*, posted in SCOTUSblog.com (Nov. 3, 2010), *available at* http://www.scotusblog.com/?p=107827.

578. *Id.*

# § 3.13 Bankruptcy

## § 3.13.1 Anna Nicole Smith is heard once more in a case addressing the bankruptcy court's jurisdiction to decide compulsory counterclaims. *Stern v. Marshall*

While the Supreme Court did not decide any bankruptcy cases in the 2009-10 term, it will revisit Anna Nicole Smith's bankruptcy case in the current term to opine on the scope of a bankruptcy court's jurisdiction to enter final judgments on compulsory counterclaims filed by a debtor against a creditor.[579] Specifically, in *Stern v. Marshall*,[580] the Court will review the Ninth Circuit's holding that the bankruptcy court did not have jurisdiction to enter a final judgment on a compulsory counterclaim asserted by Smith to a proof of claim filed in her bankruptcy case.

Shortly after Smith (whose real name was Vickie Lynn Marshall) married J. Howard Marshall II, Marshall revised the documents governing a trust holding most of his property to make the trust irrevocable and to effectively make it impossible for Smith to be named as a beneficiary of the trust. Smith believed that her stepson, E. Pierce Marshall, influenced her husband to make the change and fraudulently altered the trust documents himself. After her husband passed away, Smith contested the validity of the trust documents in a Texas probate court. Smith later filed for bankruptcy in California.

Pierce filed an adversary proceeding in Smith's bankruptcy case seeking a declaration that if Smith were found liable for defamation, her liability for the damages arising from the defamation would be nondischargeable in her bankruptcy case. Pierce also filed a proof of claim in Smith's bankruptcy case for an unliquidated amount of damages arising from his defamation claim. Smith, in turn, filed a counterclaim against Pierce in the adversary proceeding, alleging tortious interference with her expectation of a gift or inheritance from her late husband.

The litigation in the bankruptcy court and the Texas probate court proceeded simultaneously. The bankruptcy court entered a final judgment on Smith's counterclaim, finding that Pierce tortiously interfered with Smith's expectation of an inheritance or gift from her late husband, and awarded her over $449

579. The Supreme Court first considered Anna Nicole Smith's bankruptcy case four years ago, when it overturned the Ninth Circuit's ruling that it lacked standing to decide the dispute over her late husband's estate under the probate exception to federal jurisdiction. *Marshall v. Marshall*, 547 U.S. 293 (2006). The Supreme Court remanded the case to the Ninth Circuit to consider the compulsory counterclaim issue that is the subject of the current proceeding. Both Smith and her stepson E. Pierce Marshall have died since the Supreme Court's first decision.

580. *Marshall v. Stern (In re Marshall)*, 600 F.3d 1037 (9th Cir. 2010), *cert. granted in part*, 131 S. Ct. 63 (2010).

million in damages. Subsequently, Smith non-suited all of her claims against Pierce in the Texas probate court. The Texas probate court then entered a final judgment in favor of Pierce and held that Pierce was entitled to his full inheritance, free of all claims by Smith. Pierce also appealed the bankruptcy court's judgment to a district court in the Central District of California. The district court held that the bankruptcy court did not have jurisdiction to enter a final judgment on Smith's counterclaim because it was not a "core proceeding" under 28 U.S.C. § 157(b)(2). However, the district court reviewed the case de novo, took additional evidence, and ruled in favor of Smith, awarding her $88 million in damages. Pierce appealed the district court's judgment to the Ninth Circuit, and Smith cross-appealed.

The central issue before the Ninth Circuit was whether Smith's counterclaim, which was compulsory, was also a "core proceeding" under 28 U.S.C. § 157(b)(2). Section 157(b)(1) gives a bankruptcy court jurisdiction to enter a final judgment in all core proceedings "arising under" the Bankruptcy Code, or "arising in" a case under the Bankruptcy Code. Section 157(b)(2), in turn, provides a nonexhaustive list of the types of matters that are considered core proceedings, including "counterclaims by the estate against persons filing claims against the estate." If the claim is noncore, however, the bankruptcy court can only issue proposed findings of fact and conclusions of law, which then must be reviewed de novo by the district court.

If Smith's compulsory counterclaim was a core proceeding, then the bankruptcy court properly entered a final judgment on the counterclaim, and the bankruptcy court's award of $449 million to Smith likely would be reinstated. If the compulsory counterclaim was noncore, however, then the final judgment entered by the Texas probate court was the earliest final determination of her claim and likely would be found to have precluded the district court's consideration of Smith's counterclaim. Even though § 157(b)(2) seems to classify Smith's counterclaim as a core proceeding, the Ninth Circuit found that Smith's counterclaim was noncore "because it is not so closely related to Pierce Marshall's defamation claim that it must be resolved in order to determine the allowance or disallowance of his claim against her bankruptcy estate."[581]

If the Supreme Court finds that Smith's counterclaim is noncore, parties in bankruptcy adversary proceedings still would have to bring compulsory counterclaims in the bankruptcy court, even though the court may not have jurisdiction to enter final judgments on those counterclaims. Bankruptcy practitioners are no doubt hoping for a clear standard for determining whether and when a debtor's counterclaim constitutes a core proceeding to avoid confusion and unpredictability in the bankruptcy courts.

581. 600 F.3d at 1059.

Oral argument was heard on January 18, 2011.[582] The U.S. Government filed a brief in support of Smith, advocating reversal of the Ninth Circuit's decision.[583]

# § 3.14 Corporate Privacy

## § 3.14.1 Do corporations have "personal privacy" rights? *Federal Communications Commission v. AT&T, Inc.*

Just a year after deciding that corporations have broad First Amendment rights in *Citizens United*,[584] the Supreme Court is now poised to decide whether corporations have "personal privacy" rights within the meaning of the Freedom of Information Act[585] (FOIA) in the *Federal Communications Commission v. AT&T, Inc*.[586] Section 7(C)—known as Exemption 7(C)—of the FOIA exempts from mandatory disclosure "records or information compiled for law enforcement purposes . . . to the extent that the production of such law enforcement records or information . . . could reasonably be expected to constitute an unwarranted invasion of personal privacy."[587] The Third Circuit held that AT&T, a corporation, could invoke this "personal privacy" exception to block disclosure of documents it produced in a government investigation.[588] The Supreme Court granted certiorari to review this conclusion, and heard argument on January 19, 2011.[589]

The case arose from AT&T's participation in a federal program administered by the Federal Communications Commission (FCC), that was designed to increase schools' access to advanced telecommunications technology. AT&T discovered that it might have overcharged the government for work it performed for a New London, Connecticut, school district. AT&T's report to the FCC spurred an FCC investigation that resulted in an agreed resolution between the parties without an admission of guilt by AT&T. During the course of the

582. The transcript from the oral argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/10-179.pdf.

583. Brief of the United States as Amicus Curiae Supporting Petitioner, No. 10-179, filed in the U.S. Supreme Court (Nov. 19, 2010), *available at* http://sblog.s3.amazonaws.com/wp-content/uploads/2010/11/AmicusUS.10-179.pdf.

584. *Citizens United v. Federal Election Comm'n*, 130 S. Ct. 876 (2010).

585. *See* 5 U.S.C. §§ 551-59.

586. *AT&T, Inc. v. Fed. Comm'cns Comm'n*, 582 F.3d 490 (3d Cir. 2009), *cert. granted*, 131 S. Ct. 61 (2010).

587. 5 U.S.C. § 552(b)(7)(C).

588. 582 F.3d 490.

589. The transcript from the oral argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-1279.pdf.

investigation, AT&T complied with FCC requests to produce a wide range of documents related to its work with the New London schools.

CompTel, a trade association representing some of AT&T's competitors, submitted a FOIA request for some of the documents produced to the government in the investigation. AT&T opposed the release, asserting that the documents were produced as a result of a law enforcement investigation and fell within the scope of Exemption 7(C). The FCC issued a letter-ruling rejecting AT&T's Exemption 7(C) request, which held that Exemption 7(C) does not apply to corporations because corporations lack "personal privacy." After losing an administrative appeal, AT&T appealed to the Third Circuit Court of Appeals.

The Third Circuit reversed the FCC decision, based largely on the fact that the FOIA defines "person" to include "an individual, partnership, corporation, association, or public or private organization other than an agency."[590] Even though the statute does not define the word "personal," the court concluded that "[i]t would be very odd indeed for an adjectival form of a defined term not to refer back to the defined term."[591]

In its Supreme Court briefing, the FCC contends that the Third Circuit erred in its statutory construction, and that the logical implication of the court's decision would bestow "personal privacy" rights on state, local, and foreign governmental entities as well.[592] The FCC emphasized that "personal privacy," under its ordinary meaning, encompasses only the privacy of individual human beings.

It will be interesting to see whether the Supreme Court decides the question on narrow statutory interpretation grounds, or whether it opines more broadly on corporate privacy rights. Any Supreme Court majority will have to be assembled without Justice Kagan, who recused herself because, as Solicitor General, she represented the FCC in its petition for writ of certiorari.

*Update: On March 1, 2011, the Supreme Court issued a unanimous opinion by Chief Justice Roberts, reversing the Third Circuit. FCC v. AT&T Inc., No. 09-1279, 2011 U.S. LEXIS 1899 (U.S. Mar. 1, 2011). The Court "reject[d] the argument that because 'person' is defined for purposes of FOIA to include a corporation, the phrase 'personal privacy' in Exemption 7(C) reaches corporations as well. The protection in FOIA against disclosure of law enforcement information on the ground that it would constitute an unwarranted invasion of personal privacy does not extend to corporations." Id. at *22. With unusual judicial humor, the Court concluded its opinion with the following sentiment: "We trust that AT&T will not take it personally." Id.*

590. 5 U.S.C. § 551(2).

591. 582 F.3d at 497.

592. *See* Brief for Petitioners, filed in No. 09-1279, U.S Supreme Court (Nov. 9, 2010), *available at* http://www.americanbar.org/content/dam/aba/publishing/preview/publiced_preview_briefs_pdfs_09_10_09_1279_Petitioner.authcheckdam.pdf.

# § 3.15 Environmental

## § 3.15.1 The Supreme Court tackles global warming. *American Electric Power Co. v. Connecticut*

On the heels of the 2008-09 term—which, because of five unfavorable decisions, was described as "'the worst term ever' for environmental interests,"[593]—the Supreme Court decided only one relatively uncontroversial environmental case in the 2009-10 term (the *Monsanto* case discussed below). The current term was shaping up to be a quiet one as well,[594] until the Court granted the petition for writ of certiorari in *American Electric Power Co. v. Connecticut*[595] on December 6, 2010. This case presents the Court with an opportunity to address the rapidly growing number of global warming tort cases that are being filed against companies that emit greenhouse gases, including carbon dioxide.

In *American Electric Power*, eight states (California, Connecticut, Iowa, New Jersey, New York, Rhode Island, Vermont, and Wisconsin), the City of New York, and three land trusts sued six electric companies on the basis of the federal common law of nuisance or, in the alternative, state nuisance law, seeking to require the electric companies to cap and ultimately reduce their carbon emissions.[596] The plaintiffs alleged that the electric companies were "'substantial contributors to elevated levels of carbon dioxide and global warming,' as their annual emissions comprise 'approximately one quarter of the U.S. electric power sector's carbon dioxide emissions and approximately ten percent of all carbon dioxide emissions from human activities in the United States.'"[597]

The Southern District of New York dismissed the plaintiffs' complaints, finding that they presented nonjusticiable political questions left to the discre-

593. Adam Liptak, *Environment Groups Find Less Support on Court*, N.Y. TIMES (July 3, 2009), *available at* http://www.nytimes.com/2009/07/04/us/04scotus.html.

594. The Court declined to hear several significant environmental cases. *See, e.g., City of Dallas v. United States Dep't of Interior*, 562 F.3d 712 (5th Cir. 2009), *cert. denied sub nom Texas Water Development Board v. DOI*, 2010 U.S. LEXIS 1291 (Feb. 22, 2010) (rejecting City's argument that the agency's establishment of a conservation easement over a vast area of Texas wetlands precluded the City from moving forward with the planned construction of a water reservoir to avoid water shortages in the region); *Nat'l Cotton Council of Am. v. U.S. EPA*, 553 F.3d 927 (6th Cir. 2009), *pet. denied sub nom Am. Farm Bureau Fed v. Baykeeper*, 2010 U.S. LEXIS 1409 (Feb. 22, 2010) (upholding rule in Sixth Circuit that EPA is required to regulate and permit farmers' use of certain pesticides under both the Clean Water Act and the Federal Insecticide, Fungicide and Rodenticide Act).

595. *Connecticut v. Am. Elec. Power Co.*, 582 F.3d 309 (2d Cir. 2009), *cert. granted*, 131 S. Ct. 813 (2010).

596. *Id.* at 314.

597. *Id.* at 316 (quoting plaintiffs' alligations).

tion of the legislative and executive branches.[598] In a lengthy and reasoned opinion, the Second Circuit reversed, noting, in particular, that "federal courts have successfully adjudicated complex common law public nuisance cases for over a century" and that the plaintiffs' case appeared to be "an ordinary tort suit."[599] The Second Circuit also found that the Clean Air Act did not displace federal common law in the area of greenhouse gas emissions.

The Supreme Court granted certiorari to address three questions: (1) whether states and private parties have standing to seek judicially fashioned emissions caps on five utilities for their alleged contribution to harms claimed to arise from global climate change; (2) whether a cause of action to cap carbon dioxide emissions can be implied under federal common law where no statute creates such a cause of action, and the Clean Air Act speaks directly to the same subject matter and assigns federal responsibility for regulating such emissions to the Environmental Protection Agency (EPA); (3) whether the claims presented nonjusticiable political questions. Justice Sotomayor, who sat on the Second Circuit panel but was elevated before the decision was reached, recused herself from the Supreme Court proceedings.

The Supreme Court's resolution of these questions will be closely watched around the country. Numerous lawsuits alleging public or private torts against emitters of greenhouse gases have begun appearing nationwide.[600] A reversal of the Second Circuit's decision by the Supreme Court likely would deal the plaintiffs in these suits a fatal blow. Trade groups representing automakers, oil companies, farmers, mining companies, chemical companies, and manufacturers have urged the Supreme Court to reverse the Second Circuit. The Obama Administration also urged reversal on the ground that courts should defer to Congress and the executive branch on combating climate change.

598. *See Connecticut v. Am. Elec. Power Co.*, 406 F. Supp. 2d 265, 270-72 (S.D.N.Y. 2005).

599. 582 F.3d at 328, 331.

600. *See, e.g.*, *Comer v. Murphy Oil USA*, 585 F.3d 855 (5th Cir. 2009) (pet. for reh'g en banc granted) (finding that plaintiffs, residents and landowners, properly presented public and private nuisance, trespass, and negligence claims against defendants—energy and chemical companies—in relation to the defendants' emission of greenhouse gases); *Native Village of Kivalina v. ExxonMobil Corp.*, 663 F. Supp. 2d 863 (N.D. Cal. 2009) (granting defendants' motion to dismiss plaintiffs' federal claims for nuisance as presenting a nonjusticiable federal question); *California v. Gen. Motors Corp.*, No. C06-05755, 2007 U.S. Dist. LEXIS 68547 (N.D. Cal. Sept. 17, 2007) (same); *Barasich v. Columbia Gulf Transmission Co.*, 467 F. Supp. 2d 676 (E.D. La. 2006) (dismissing nuisance claims against company alleged to have caused deterioration of Louisiana marshlands through emission of greenhouse gases on the basis that plaintiffs failed to state a claim for nuisance under Louisiana state law).

## § 3.15.2 The Supreme Court bars deregulation of genetically modified alfalfa. *Monsanto Co. v. Geertson Seed Farms*

The lone environmental case decided by the Supreme Court in the 2009-10 term, *Monsanto Co. v. Geertson Seed Farms*,[601] involved a skirmish between advocates and opponents of genetically modified plants. In *Monsanto*, the Court held that a district court abused its discretion by enjoining the Animal and Plant Health Inspection Service (APHIS) from deregulating a genetically modified alfalfa until the agency completed an environmental impact statement. Justice Alito wrote the opinion of the Court, from which only Justice Stevens dissented. Justice Breyer recused himself.

At issue were regulations propounded by APHIS, a division of the Department of Agriculture, which are intended to prevent the introduction and dissemination of "plant pests" within the United States. Certain genetically modified plants are presumed to be plant pests and cannot be freely released into the environment. However, any person may petition APHIS to deregulate these plants.

APHIS's deregulation procedure must comply with the National Environmental Policy Act of 1969 (NEPA). NEPA requires that federal agencies complete an environmental impact statement for every action that "significantly affect[s] the quality of the human environment."[602] A full environmental impact statement is not required if an agency concludes that a proposed action will not significantly affect the environment on the basis of a simpler environmental assessment.[603] An agency can still proceed with some action in furtherance of a proposal, despite the requirement of an environmental impact statement, provided certain conditions are met.[604]

Petitioners in *Monsanto* asked APHIS to deregulate two strands of Roundup Ready Alfalfa (RRA) in 2004. The alfalfa strands had been genetically modified for tolerance to Roundup's active agent, glyphosate. APHIS concluded, on the basis of an environmental assessment, that RRA would not significantly affect the environment and issued a Finding of No Significant Impact. APHIS then granted RRA an unconditional deregulated status without completing an environmental impact statement. Respondents, growers of conventional alfalfa seeds and environmental groups, challenged the deregulation on various grounds, including the claim that the deregulation violated NEPA.

The district court found the environmental assessment deficient because it had not answered questions of import to growers of organic and conventional alfalfa, primarily the possibility that RRA could pass its genes to unmodified alfalfa. On this conclusion, the court held that APHIS violated NEPA when it deregulated RRA without completing an environmental impact statement. The

601. 130 S. Ct. 2743 (2010).
602. 42 U.S.C. § 4332(2)(C).
603. 40 C.F.R. §§ 1508.9, 13.
604. 40 C.F.R. §§ 1506.1(a), (c).

district court also enjoined *any* deregulation of RRA until APHIS completed the environmental impact statement, and enjoined further planting of any RRA until then. The Ninth Circuit affirmed on appeal, and the Supreme Court granted certiorari.

The Supreme Court reversed the Ninth Circuit, struck down the district court's injunctions, and remanded the case. In the Court's view, the district court, having held that the complete deregulation of RRA violated NEPA, should have left APHIS free to "pursue a *partial* deregulation." The agency could partially deregulate RRA, even before the completion of a full environmental impact statement, if it found that a partial deregulation met statutory and regulatory requirements. Any party injured by a partial deregulation could then bring a new action at law to stop the attempted deregulation. Until APHIS attempted a partial deregulation of RRA, the district court's intervention, enjoining *any* deregulation, including a partial deregulation, was premature and failed the traditional test for granting permanent injunctions.

The injunction against any planting of RRA pending the completion of an environmental impact statement fared no better under the Supreme Court's analysis. First, this injunction infringed on APHIS's authority to partially deregulate RRA and allow some planting. Second, this injunction was unnecessary because the very act of vacating APHIS's complete deregulation decision effectively barred any unauthorized planting of RRA.

*Monsanto* is perhaps most significant for the question that it left unanswered, and the door that it left open to opponents of genetically modified crops. The case stems, in part, from respondents' fear that the complete deregulation of RRA will eventually cause the contamination of their unmodified crops with RRA's glyphosate-tolerant gene. The district court concluded that APHIS violated NEPA because it failed to answer this key question and that, under the circumstances, the agency's decision to completely deregulate RRA was arbitrary and capricious. Because that issue was not before the Supreme Court, the Court's silence on this point should not be seen as an endorsement of the district court's holding.[605] Nonetheless, *Monsanto* arguably favors opponents of genetically modified crops, given that APHIS's deregulation followed eight years of field trials with nearly 300 plantings. A neutral observer reasonably could expect that petitioners' issues would have been resolved by then. Common sense also suggests that if bees pollinate alfalfa, complete deregulation of RRA will eventually result in contamination of unmodified alfalfa strands, resulting in the significant environmental and economic harms that respondents invoked in their arguments.[606] Under these facts and current legislation, and if the alleged harms are genuine, a real obstacle remains before RRA can be completely deregulated.

The Supreme Court also observed that it would "be hard to see how respondents" would be injured by a partial deregulation that confined RRA to specific geographic areas. However, the district court found that most alfalfa seed is

605. 130 S. Ct. at 2752.

606. *Id.* at 2755 (the district court found that the deregulation "gives rise to a significant risk of gene flow to nongenetically-engineered varieties of alfalfa").

grown in just four states in the Northwestern United States. Even if a partial deregulation order protected respondents' alfalfa fields, the intense cultivation of the crop implies that other alfalfa growers' fields will lie within a bee's flight of a RRA field. Necessarily, geographic proximity and the presence of bees will result in cross-pollination and spread the RRA gene to genetically unmodified alfalfa crops. The same should be true of any other bee-pollinated crop.

# § 3.16 Franchise

## § 3.16.1 The Supreme Court addresses the rights of retail gasoline franchisees. *Mac's Shell Service, Inc. v. Shell Oil Products*

In *Mac's Shell Service, Inc. v. Shell Oil Products Co., LLC*, 131 S. Ct. 1251 (2010), a unanimous opinion authored by Justice Alito, the Supreme Court narrowly defined the contours of a claim for constructive termination of the franchise and constructive nonrenewal of the franchise relationship under the Petroleum Marketing Practices Act (PMPA), 15 U.S.C. §§ 2801, *et seq.* Assuming that the PMPA allows for claims of constructive termination and constructive nonrenewal, the Court specified what threshold requirements must be satisfied before franchisees can proceed with such claims under the PMPA.

Congress enacted the PMPA in 1978 in response to widespread concern over increasing numbers of allegedly unfair franchise terminations and nonrenewals in the petroleum industry. The PMPA governs franchise agreements between petroleum companies and independent petroleum retailers by establishing minimum federal standards for the termination and nonrenewal of petroleum franchise agreements. In the typical petroleum franchise agreement, the franchisor leases the service-station premises to the franchisee, grants the franchisee the right to use the franchisor's trademark, and agrees to sell motor fuel to the franchisee for resale. Franchise agreements stay in effect for a specific term, after which the franchisor and franchisee may elect to renew the franchise relationship by executing a new agreement.

Under the PMPA, a franchisor may "terminate" a "franchise" during the term of the franchise agreement and may "fail to renew" a "franchise relationship" at the end of the term only if the franchisor provides written notice and takes the action for a reason specifically recognized in the PMPA. Accordingly, if the franchisor terminates the franchise or fails to renew the franchise relationship for a reason not provided for in the PMPA or after not providing the required notice, the franchisor is in violation of the PMPA. A franchisee may bring suit in federal court against any franchisor that fails to comply with the PMPA's termination and nonrenewal restrictions and seek an array of remedies, including a preliminary injunction (under relaxed standards), compensatory and punitive damages, attorneys' fees and expert costs, and equitable relief.

In *Mac's Shell Service*, sixty-three Shell Oil Company franchisees sued Shell Oil Company (Shell), the franchisor, and Motiva Enterprises LLC (Motiva), the franchisor's assignee, alleging violations of the PMPA and breach of contract under state law. For many years, Shell had offered the franchisees a rent subsidy for every gallon of motor fuel a franchisee sold above a specified threshold. When Shell assigned to Motiva its rights and obligations under the franchise agreements, Motiva ended the rent subsidy, thereby increasing the franchisees' rent, and, upon expiration of the agreements, offered the franchisees new agreements with a different formula for calculating rent, which the franchisees signed under protest.

In response to Motiva's actions, the franchisees brought PMPA claims against Shell and Motiva, asserting that the elimination of the rent subsidy amounted to a constructive termination of their franchises and that the offering of new franchise agreements with a different (and for most franchisees higher) method of calculating rent amounted to a constructive nonrenewal of their franchise relationships. The Supreme Court flatly rejected the franchisees' claims by analyzing the ordinary meaning of the term "termination" and interpreting the PMPA's definition of "fail to renew."

First, the Court held that a necessary element of *any* constructive termination claim under the PMPA is a showing that the franchisor's conduct forced the franchisee to abandon its franchise, which occurs when the franchisee must stop using the franchisor's trademark, purchasing the franchisor's fuel, or occupying the franchisor's service station. The Court reasoned that its interpretation of constructive termination under the PMPA is consistent with the general understanding of the doctrine of constructive termination in analogous legal contexts, such as employment law, where the employee must quit, and landlord-tenant law, where the tenant must vacate the premises. As emphasized by the Supreme Court, a termination is "constructive" not because of a lack of an actual end to the relationship, but because the plaintiff, as opposed to the defendant, severed the legal relationship. Because Shell and Motiva did not force the franchisees to abandon their franchise operations, the franchisees lacked an actionable PMPA constructive termination claim.

Second, the Court held that a franchisee that is offered and signs a renewed franchise agreement cannot maintain a claim for constructive nonrenewal under the PMPA. For a franchisor to violate the PMPA's nonrenewal provisions, it must "fail to renew" a franchise relationship, defined as a "failure to reinstate, continue, or extend the franchise relationship." 15 U.S.C. § 2801(14). Accordingly, the Supreme Court reasoned that the threshold requirement of an unlawful nonrenewal claim is that the franchisor did not continue the franchise relationship upon expiration of the franchise agreement. Because the PMPA prohibits only unlawful failures to renew, not renewals on unfavorable terms to the franchisee, a franchisee that signs a renewal agreement, even under protest, cannot establish that the franchisor violated the PMPA. Franchisees are now on notice that courts likely will be unsympathetic to any disparity of bargaining power argument if the franchisee elects to continue its relationships under a renewal franchise agreement.

Impressing upon the franchisees that Congress purposely enacted the PMPA to regulate only a franchisor's termination or nonrenewal of a franchise agreement, the Court emphasized that the PMPA was not meant to cover "simple breaches of contract" properly adjudicated under state law. The Court also reserved judgment on whether the PMPA even recognizes claims for constructive termination (if the franchisee ends the franchise) and constructive nonrenewal (if the franchisee refuses to sign a new franchise agreement), because the Court was able to resolve the case on narrower grounds based on the franchisees' continued relationships with Shell/Motiva. Thus, while some courts of appeals have held that the PMPA does create a cause of action for constructive termination and constructive nonrenewal, the question remains open for the Supreme Court to decide otherwise in the future.[607]

# § 3.17 Healthcare

## § 3.17.1 Is a common-law private right of action available for third-party beneficiaries to sue drug companies for overcharging under pharmaceutical pricing agreements where the federal statute is silent? *Astra USA, Inc. v. County of Santa Clara*

On January 19, 2011, the Supreme Court heard oral arguments in *Astra USA, Inc. v. County of Santa Clara*,[608] a case that raises the issue of whether, as a matter of federal common law, there is a private right of action upon which third-party beneficiaries can sue to enforce a government contract that is statutorily-mandated, even though the statute lacks an implied or express right of action.

Certain federally funded clinics (largely public hospitals and community health centers that focus on serving the poor) are able to purchase discounted prescription drugs from drug manufacturers under standardized contracts—known as Pharmaceutical Pricing Agreements (PPAs)—between the U.S. Secretary of Health and Human Services (the Secretary) and drug companies. Created pursuant to the Public Health Service Act of 1992, this drug discount

607. *See, e.g., Clark v. BP Oil Co.*, 137 F.3d 386, 390-91 (6th Cir. 1998); *Shukla v. BP Exploration & Oil, Inc.*, 115 F.3d 849, 852-53 (11th Cir. 1997).

608. *County of Santa Clara v. Astra United States*, 588 F.3d 1237 (9th Cir. 2009), *cert. granted*, 131 S. Ct. 61 (2010). The transcript for the oral argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-1273.pdf.

program is called the "Section 340B program."[609] In response to a series of government reports finding that the drug companies were not complying with price ceilings in the Section 340B Program, the County of Santa Clara, California (Santa Clara), brought a class action on behalf of 340B Program clinics in California alleging that drug companies operating under PPAs overcharged the clinics for drugs.[610]

The district court dismissed the contract claims, holding that there is no federal common law cause of action for breach of the PPAs. The district court looked to the structure of the PPAs noted that because the PPAs assigned reimbursement issued to the Secretary, "they intended to deny it to all others."[611] The court reasoned that "[i]f all of the more than 12,000 covered entities had standing to enforce the price controls, manufacturers would be subject to a crushing number of lawsuits, all arising out of the same contract."[612]

Reversing, the Ninth Circuit held that covered entities are intended direct beneficiaries of the PPAs and thus have the right to enforce the discount provisions against drug makers and sue for reimbursement of excess payments.[613] The Ninth Circuit further concluded that "allowing such suits under the PPA is consistent with Congress' intent in enacting the Section 340B program, even though the statute itself does not create a federal private cause of action."[614]

The drug makers filed a petition for writ of certiorari, arguing that the Supreme Court should resolve a split among the circuits on the issue of the federal courts' common law authority to confer a private right of action to enforce a statute when the statutory requirement is embodied in a contract.[615] The U.S. Chamber of Congress filed an amicus brief arguing that a large number of federal statutes implement congressional mandates through contracts between the United States and private parties, and that those private parties will be exposed to burdensome and expensive litigation if the Ninth Circuit's decisions stands.[616] In another amicus brief, the Pharmaceutical Research and

609. 42 U.S.C. § 256b. Section 256B was enacted via section 602 of the Veterans Health Care Act of 1992, Pub. L. No. 102-585, 106 Stat. 4943, 4967. Section 602 added a new Section 340B to Part D of Title III of the Public Health Service Act. *See* 106 Stat. at 4967. The Public Health Service Act is codified at Chapter 6A of Title 42 of the United States Code. *See* National Institutes of Health Revitalization Act of 1993 § 2008(i)(1)-(2), Pub. L. No. 103-43, 107 Stat. 122, 212-13.

610. *County of Santa Clara v. Astra USA, Inc.*, No. C-05-03740 WHA, 2006 U.S. Dist. LEXIS 33047 (N.D. Cal. May 17, 2006).

611. *Id.* at *26.

612. *Id.* at *26-27.

613. *County of Santa Clara*, 588 F. 3d at 1243.

614. *Id.*

615. *See* Petition for Writ of Certiorari, No. 09-1273, filed in the U.S. Supreme Court (April 21, 2010), *available at* http://www.scotusblog.com/wp-content/uploads/2010/05/09-1273_pet.pdf.

616. *See* Brief for the Chamber of Commerce of the United States of America as Amicus Curiae Supporting Petitioners, No. 09-1273, filed in the U.S. Supreme Court (May 20, 2010), *available at* http://sblog.s3.amazonaws.com/wp-content/uploads/2010/09/AmicusCoC.09-1273.pdf.

Manufacturers of America argue that the Ninth Circuit's decision exposes pharmaceutical companies to an onslaught of litigation that will in turn increase drug prices for consumers.[617]

*Update: at the argument on January 19, 2011, questions from the Justices suggested to at least one court observer that the Supreme Court may seek to avoid the broader common law question of whether a cause of action exists, and instead focus on the more limited question of whether the petitioner clinics qualify as third-party beneficiaries at all.*[618]

## § 3.17.2 Constitutional challenges to "Obamacare" expeditiously make their way to the Supreme Court

On March 23, 2010, President Obama signed into law the controversial Patient Protection and Affordable Care Act of 2010[619] (PPACA), which has garnered national attention as "the most expansive social legislation enacted in decades,"[620] and has been described as the "largest single legislative achievement of [President Obama's] first two years in office, and the most controversial."[621] Within hours of its signing, attorneys general in dozens of states (mostly Republican) began filing lawsuits challenging PPACA as unconstitutional.[622]

The purpose of PPACA is to extend health insurance to more than 30 million Americans by expanding Medicaid and providing federal subsidies to help lower and middle-income Americans buy private coverage. PPACA includes, among other provisions, a requirement that every U.S. citizen (with some exceptions) maintain a minimum level of health insurance coverage, tax incentives for small businesses to purchase health insurance for their employees, and a

617. *See* Brief of Pharmaceutical Research and Manufacturers of America (PhRMA) as Amicus Curiae in Support of Petitioners, No. 09-1273, filed in the U.S. Supreme Court (May 21, 2010), *available at* http://www.americanbar.org/content/dam/aba/publishing/preview/publiced_preview_briefs_pdfs_09_10_09_1273_PetitionerAmCuPhRMA.authcheckdam.pdf.

618. *See* Kevin Russell, *Argument Recap: Challenge to Suits on Drug Price Limits*, posted on SCOTUSblog.com (Jan. 20, 2011), *available at* http://www.scotusblog.com/?p=112500 ("[I]t seemed likely that the Court will focus on the question of whether Congress intended to permit private suits under this particular statute (and, in all likelihood, it looked like a majority of the Court would conclude that it did not).").

619. Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029. A copy of the 974-page PPACA is available at http://docs.house.gov/energycommerce/ppacacon.pdf.

620. Sheryl Gay Stolberg & Robert Pear, *Obama Signs Health Care Overhaul Bill, With a Flourish*, N.Y. TIMES (March 23, 2010), *available at* http://www.nytimes.com/2010/03/24/health/policy/24health.html.

621. *Overview: Healthcare Reform*, N.Y. TIMES (updated Feb. 3, 2011), *available at* http://topics.nytimes.com/top/news/health/diseasesconditionsandhealthtopics/health_insurance_and_managed_care/health_care_reform/index.html?scp=1-spot&sq=healthcare%20reform&st=cse.

622. *See, e.g.*, Sheryl Gay Stolberg & Robert Pear, *Obama Signs Health Care Overhaul Bill, With a Flourish*, *supra*, note 620.

ban on discrimination based on pre-existing conditions. One district court has discussed the overall aim of PPACA as follows:

> The lofty goals of the law are to mend the nation's broken health care system and curtail the spiraling costs of health care, to provide affordable health insurance, and to reduce the number of uninsured individuals. To underscore the urgent need for this legislation, Congress made numerous findings with respect to health insurance and health services markets, with particular emphasis on the rising costs associated with health care. For example, Congress found that national health expenditures in 2009 represented 17.6 percent of the economy, and such expenditures will increase dramatically within the next ten years. In 2008, the uncompensated medical costs of the uninsured amounted to $43 billion dollars. Health care providers pass on these unpaid costs to insurers, who in turn, pass on the cost to the insured in the form of higher premiums. The resulting higher premiums increases the number of uninsured individuals.[623]

By the end of 2010, a number of district courts had already issued decisions concerning the constitutionality of PPACA, many of which are headed in a beeline for the Supreme Court. In *State of Florida v. U.S. Department of Health and Human Services*, a case that the Wall Street Journal called "most closely watched case in the ongoing political battle over the health-care overhaul,"[624] the State of Florida has been joined by over 25 other state attorneys general in its lawsuit seeking an injunction and declaration that PPACA constitutes an unlawful federal mandate forcing individuals to purchase health insurance in violation of the Commerce Clause, among other challenges.[625] In late 2010, the district court dismissed some claims, but declined to dismiss the states' Commerce Clause challenge.

*Update: on January 31, 2011, the district court granted the states' motion for summary judgment that PPACA violates the Commerce Clause.*[626] *The district court concluded that PPACA's requirement that most Americans buy health insurance is unconstitutional and cannot be struck out to preserve the rest of*

623. *Goudy-Bachman v. United States HHS*, No. 1:10-CV-763, 2011 U.S. Dist. LEXIS 6309, at *3-4 (M.D. Pa. Jan. 24, 2011) (statutory citations omitted; citing Congressional Budget Office, *Key Issues in Analyzing Major Health Insurance Proposals 11* (2008) (projecting that the number of uninsured will rise from at least 45 million in 2009 to 54 million by 2019), *available at* http://www.cbo.gov/ftpdocs/99xx/doc9924/12-18-KeyIssues.pdf)).

624. Ashby Jones, *Conservative Duo Tests Health Law*, Wall Street Journal (Sept. 13, 2010), . *available at* http://online.wsj.com/article/SB10001424052748703897204575487963449135280.html.

625. *Florida v. United States Dep't of Health & Human Servs.*, 716 F. Supp. 2d 1120 (N.D. Fla. 2010).

626. *Florida v. United States Dep't of Health & Human Servs.*, No. 3:10-cv-91, 2011 U.S. Dist. LEXIS 8822 (N.D. Fla. Jan. 31, 2011).

*the law—resulting in a holding that the entire PPACA is unconstitutional. A Supreme Court appeal is anticipated.*

In *Commonwealth ex rel. Cuccinell v. Sebelius*, the district court for the Eastern District of Virginia also ruled that PPACA's requirement that individuals purchase health insurance is an unconstitutional violation of the Commerce Clause.[627] However, unlike the *Florida* case described above, the district court in *Sebelius* held that the unconstitutional portion of PPACA could severed, thus preserving the remainder of PPACA, and declined to enjoin the implementation of PPACA while the ruling is appealed. Both sides have brought an expedited appeal to the Fourth Circuit Court of Appeals, with the federal government appealing the narrow Commerce Clause holding, and Virginia appealing the district court's refusal to reject the full PPACA as unconstitutional.

Other district courts have rejected constitutional challenges to PPACA entirely. In *Thomas More Law Center v. Obama*, for example, Thomas More Law Center and several of its members brought a declaratory judgment action asserting that PPACA is unconstitutional under the Commerce Clause and as an unconstitutional tax.[628] The district court granted the defendants' motion to dismiss, holding that the federal government has the authority under the Commerce Clause to require the purchase of minimum levels of insurance because an individual's decision *not* to purchase health insurance has a substantial effect on interstate commerce. The district court did not address the tax argument. A notice of appeal has been filed in the Sixth Circuit.[629] It is anticipated that the case will be scheduled for oral argument during the Sixth Circuit's May-June session.

Similarly, in *Liberty University, Inc. v. Geithner*, a lawsuit filed by a college founded by the conservative evangelical leader Jerry Falwell, the district court for the Western District of Virginia upheld as constitutional the individual insurance mandate and a requirement that some employers buy coverage for employees.[630] Two other district courts have dismissed constitutional challenges on standing grounds without reaching the merits of the constitutional arguments.[631]

*Update: the constitutionality of President Obama's historic healthcare reform legislation promises to be a major political, legislative, and judicial*

627. *Commonwealth ex rel. Cuccinell v. Sebelius*, 728 F. Supp. 2d 768 (E.D. Va. 2010) (holding that the Minimum Essential Coverage Provision, § 1501 of PPACA, exceeds the constitutional boundaries of congressional power).

628. *Thomas More Law Ctr. v. Obama*, 720 F. Supp. 2d 882 (E.D. Mich. 2010).

629. *Thomas More Law Center v. Obama*, No. 10-2388, pending in the United States Court of Appeals for the Sixth Circuit.

630. *Liberty Univ., Inc. v. Geithner*, No. 6:10-cv-00015-nkm, 2010 U.S. Dist. LEXIS 125922 (W.D. Va. No. 30, 2010).

631. *New Jersey Physicians, Inc. v. Obama*, No. 10-1489, 2010 U.S. Dist. LEXIS 129445 (D.N.J. Dec. 8, 2010) (holding that the plaintiff's claims were "conjectural and speculative," because that "there is a real possibility that [the plaintiff] will neither have to pay for insurance nor be subject to the penalty"); *see also Shreeve v. Obama*, No. 1:10-CV-71, 2010 U.S. Dist. LEXIS 118631 (E.D. Tenn. Nov. 4, 2010); *Baldwin v. Sebelius*, No. 10CV1033, 2010 U.S. Dist. LEXIS 89192 (S.D. Cal. Aug. 27, 2010).

*issue in 2011, with far-reaching implications not only for consumers, but for virtually every U.S. business. District courts continue to address the constitutionality of PPACA and its various provisions.*[632] *In addition to challenges already asserted, some legal observers anticipate that PPACA may implicate antitrust concerns.*[633] *So far, many of the cases have fallen along political lines, with Republican-appointed judges rejecting at least portions of PPACA as unconstitutional, and Democratic-appointed judges rejecting constitutional challenges.*[634] *Consistent with that partisan split, on January 19, 2011, the U.S. House voted along party lines in favor of repealing PPACA, in what observers view as largely a symbolic act.*[635]

*On February 7, 2001, constitutional scholar and Harvard law professor Laurence Tribe published an essay in which he predicted that the Supreme Court will uphold the constitutionality of PPACA.*[636] *In Professor Tribe's view, however, "the predictions of a partisan 5-4 split rest on a misunderstanding of the court and the Constitution."*[637]

*The State of Virginia has expressed an eagerness to test that theory—on February 8, 2011, the Virginia Attorney General filed a petition for writ of certiorari in the Supreme Court in* Virginia v. Sebelius, *hoping to bypass Fourth Circuit review.*[638] *Virginia has asked the Supreme Court to consolidate all of the cases that have been decided in the federal district courts. As one Supreme Court observer recently wrote, Virginia's*

> *main reason for asking the Justices to bypass not just one but at least four federal appeals courts, in order to get one final, nationwide and comprehensive ruling, was that conflicting*

632. *See, e.g.*, *Goudy-Bachman v. United States HHS*, No. 1:10-CV-763, 2011 U.S. Dist. LEXIS 6309 (M.D. Pa. Jan. 24, 2011) (holding that the plaintiffs had standing to challenge PPACA, but reserving the question of whether PPACA violates the Commerce Clause for a subsequent decision, which remains pending).

633. Robert Pear, *Health Law Provision Raises Antitrust Concerns*, N.Y. TIMES (Feb. 8, 2011), *available at* http://www.nytimes.com/2011/02/09/health/policy/09health.html?ref=healthcarereform ("The new health care law encourages collaboration by doctors and hospitals for cost savings, but a split has developed here as to just how far they can go without running afoul of antitrust laws.").

634. Adam Liptak, *Doing the Judicial Math on Health Care*, N.Y. TIMES (Feb. 5, 2011), *available at* http://www.nytimes.com/2011/02/06/weekinreview/06liptak.html?ref=healthcarereform ("Perhaps this is happenstance that reflects only a random array of differing judicial philosophies. Perhaps it tells us nothing about the role partisan affiliation plays in constitutional adjudication. But the suspicion that something political is afoot is unlikely to go away.").

635. *See, e.g.*, Chris McGreal, *Republicans repeal healthcare reforms in symbolic vote*, THE GUARDIAN (Jan. 20, 2011), *available at* http://www.guardian.co.uk/world/2011/jan/20/republicans-repeal-healthcare-reforms-vote.

636. Laurence H. Tribe, *On Health Care, Justice Will Prevail*, N.Y. TIMES (op-ed) (Feb. 7, 2011), *available at* http://www.nytimes.com/2011/02/08/opinion/08tribe.html?_r=2&ref=opinion.

637. *Id.*

638. *See* Petition for Writ of Certiorari Before Judgment, No. 10-1014, filed in the U.S. Supreme Court (Feb. 8. 2011), *available at* http://www.oag.state.va.us/press_releases/Cuccinelli/24454%20pdf%20McCullough.pdf.

*rulings by four federal judges so far have already plunged the nation into deep uncertainty over a historically important policy and legal issue.*[639]

# § 3.18 Jurisdiction

## § 3.18.1 The Supreme Court clarifies meaning of "principal place of business" for purposes of diversity jurisdiction. *Hertz Corp. v. Friend*

In the 2009-10 term, the Supreme Court answered the question of where a corporation's "principal place of business" is for diversity jurisdiction purposes—a question that had generated much confusion in the lower courts. In the current term, it has turned its attention from subject-matter jurisdiction to personal jurisdiction, revising the "stream of commerce" theory for the first time since 1987.

Since Congress passed an amendment to the federal diversity statute in 1958 that made corporations citizens of the state in which they have their "principal place of business," federal courts have struggled with how to define the phrase.[640] Courts of appeals had adopted various overlapping and imprecise tests, including tests focusing on the corporation's "nerve center," "locus of operations," "center of corporate activities," or "total activity of the company considered as a whole."[641]

In a seminal diversity jurisdiction case, *Hertz Corporation v. Friend*,[642] the Supreme Court cleared up this confusion in a unanimous opinion authored by Justice Breyer. The Court concluded that the phrase "'principal place of business' refers to the place where the corporation's high level officers direct, control and coordinate the corporation's activities," which will typically be found at the company's headquarters.[643]

The case arose in September 2007, when two California citizens sued Hertz in California state court for wage and hour law violations on behalf of them-

639. Lyle Denniston, *One Giant Health Care Care?*, posted on SCOTUSblog.com (Feb. 10, 2011), *available at* http://www.scotusblog.com/2011/02/one-giant-health-care-case/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+scotusblog%2FpFXs+%28SCOTUSblog%29&utm_content=Google+Reader.

640. 28 U.S.C. § 1332(c)(1) ("[A] corporation shall be deemed to be a citizen of any state by which it has been incorporated and of the State where it has its principal place of business.").

641. *Hertz Corp. v. Friend*, 130 S. Ct. 1181, 1191-92 (2010) (citing 15 J. Moore *et al.*, Moore's Federal Practice § 102.54 (3d ed. 2009)).

642. 130 S. Ct. 1181 (2010).

643. *Id*. at 1186.

selves and a putative class of other California citizens. Hertz removed the case to federal court, claiming that diversity jurisdiction existed because it was not a citizen of California but rather of New Jersey, which is home to its corporate headquarters and is where its core executive and administrative functions are carried out. Both the district court and Ninth Circuit rejected Hertz's argument, applying prior Ninth Circuit precedent. That precedent required an examination of a corporation's business activity on a state-by-state basis, and if the amount of a corporation's business activity is "significantly larger" or "substantially predominates" in one state, then that state is the corporation's "principal place of business." Because Hertz conducted more business in California than in any other state, the lower courts concluded that Hertz was a citizen of California and that diversity jurisdiction did not exist.

The Supreme Court's adoption of what has been called the "nerve center" test required reversal of the lower courts, since Hertz's nerve center was in New Jersey. The Court's scholarly opinion discussed the history regarding how corporations have been treated under the federal diversity statute, congressional adoption of the "principal place of business" test, and the divergent and complex interpretations of the test utilized by lower courts. Its decision was driven by the need for administrative simplicity, predictability, and a uniform, bright-line rule. The Court recognized that there will still be hard cases, for example, where corporations "divide their command and coordinating functions among officers who work at several different locations, perhaps communicating over the Internet."[644] Still, the Court observed that its test "nonetheless points courts in a single direction, towards the center of overall direction, control, and coordination."[645]

## § 3.18.2 In companion cases, the Supreme Court will revisit the "stream of commerce" long-arm jurisdiction analysis in the context of the global economy. *Goodyear Luxembourg Tires, S.A. v. Brown and J. McIntyre Machinery v. Nicastro*

For the first time since 1987, the Court will revisit the "stream of commerce" theory of long-arm jurisdiction in *Goodyear Luxembourg Tires, S.A. v. Brown*[646]

644. *Id.* at 1194.
645. *Id.*
646. No. 10-76. (U.S., cert. granted Sept. 28, 2010).

and *J. McIntyre Machinery v. Nicastro*,[647] both of which were argued together on January 11, 2011.[648]

This doctrine originated in *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 298 (1980), in which the Supreme Court held that the purposeful availment requirement to establish personal jurisdiction over a nonresident defendant may be satisfied where a corporation "delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum State."[649]

The Court addressed the "stream of commerce" doctrine again in 1987 in *Asahi Metal Indus. Co. v. Superior Court of California*, 480 U.S. 102 (1987), where two competing opinions, each supported by four members of the Court, propounded two separate versions of the "stream of commerce" theory. Justice O'Connor, joined by three justices, announced what is now commonly referred to as the "stream of commerce plus" doctrine. Under this view, the exercise of personal jurisdiction is proper when a defendant not only places a product into the stream of commerce with the expectation that it would be sold in the forum, but also engages in other conduct that evidences "an intent or purpose to serve the market in the forum state."[650] Such additional conduct could be advertising in the forum state, designing the product for the forum state's market, establishing channels for providing advice to customers in the forum state, or marketing the product through a distributor who has agreed to serve as the sales agent for that state. Justice Brennan, joined by three other justices, rejected this modified test and asserted that personal jurisdiction is proper as long as a participant in the process is aware that the product is being marketed in the forum state. Courts have since applied the O'Connor theory, the Brennan theory, and hybrids of both when assessing "stream of commerce" jurisdiction.

In the first case at issue, *J. McIntyre Machinery v. Nicastro*, the Supreme Court may shed light on its preference for Justice O'Connor's or Justice Brennan's theory in determining whether the New Jersey Supreme Court properly found personal jurisdiction to exist over a United Kingdom-based manufacturer.

The underlying dispute in *McIntyre* arose in 2001 when Robert Nicastro severed four of his fingers using a shearing machine that had been manufactured by J. McIntyre Machinery, Ltd., a company incorporated and operating in the United Kingdom.[651] J. McIntyre did not directly sell its machines into the United States, but instead sold them to its Ohio distributor, a distinct corporate entity that was independently owned and controlled. J. McIntyre and its distributor both attended trade shows in a number of cities in the United States, and the

647. No. 09-1343 (U.S., cert. granted Sept. 28, 2010).

648. The transcript of the oral argument in the *Goodyear* case is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/10-76.pdf. The transcript in the *Nicastro* argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-1343.pdf.

649. 444 U.S. at 298.

650. 480 U.S. at 112.

651. *Nicastro v. McIntyre Machinery Am., Ltd.*, 987 A.2d 575, 577 (N.J. 2010).

distributor distributed products nationally. But neither J. McIntyre nor its distributor specifically targeted the State of New Jersey.

The New Jersey Supreme Court, purporting to side with Justice Brennan, held that "a foreign manufacturer that places a defective product in the stream of commerce through a distribution scheme that targets a national market, which includes New Jersey, may be subject to *in personam* jurisdiction of a New Jersey court in a product liability action."[652] It concluded that as long as a foreign manufacturer knew or should have known that its products would be sold in New Jersey through its distribution scheme, personal jurisdiction would exist.[653] The ruling was met by a scathing dissent, which criticized the majority of ignoring the "realities of the global marketplace."[654]

The second case before the Court, *Goodyear Luxembourg*, involved two 13-year-old boys from North Carolina who were injured in a bus crash in Paris, France.[655] The guardians of the injured boys sued various nonresident foreign defendants in North Carolina state court, including Goodyear Luxembourg, Goodyear Turkey, and Goodyear France, alleging that one of the bus tires involved in the accident was defectively designed, manufactured, or distributed by the defendants.[656] The nonresident defendants moved to dismiss on the grounds that the court lacked personal jurisdiction.[657]

The trial court denied the motions to dismiss, primarily because defendants' tires featured markings in English that were required under U.S. law, and because several thousands of tires manufactured by each of the defendants had been shipped into North Carolina for sale.[658] The trial court also noted that each of the nonresident defendants was a wholly owned subsidiary of Goodyear Tire and Rubber Company, a U.S. corporation with extensive business contacts in North Carolina.[659]

The North Carolina Court of Appeals affirmed the trial court's denial of the nonresident defendants' motions to dismiss, noting that North Carolina courts have not adopted the "stream of commerce plus" doctrine announced by Justice O'Connor in *Asahi*.[660] Instead, the court framed the question, under North Carolina law, as "whether Defendants have 'purposefully injected [their] product into the stream of commerce without any indication that [they] desired to limit the area of distribution of [their] product so as to exclude North Carolina.'"[661] The court did not find any evidence that the Goodyear Luxembourg defendants had affirmatively excluded North Carolina from their area of distribution.[662]

652. *Id.* at 589.
653. *Id.* at 591.
654. *Id.* at 595.
655. *Brown v. Meter*, 681 S.E.2d 382, 384 (N.C. Ct. App. 2009).
656. *See id.*
657. *Id.*
658. *Id.* at 385–87.
659. *Id.* at 386.
660. *Id.* at 390.
661. *Id.* at 391.
662. *Id.* at 391–92.

Significantly, though, the court noted that "the record appears to be devoid of any evidence that defendants took any affirmative action to cause tires which they had manufactured to be shipped into North Carolina."[663]

The stream of commerce rule in North Carolina appears to be one of the broadest rules in the United States—even broader than the rule proposed by Justice Brennan—requiring a nonresident company to affirmatively exclude North Carolina from a product's distribution area in order to avoid being subjected to general personal jurisdiction under the stream of commerce doctrine. At least on its face, this rule appears to conflict with the traditional standard for general personal jurisdiction that requires the relevant contacts to result from the conduct of a defendant, as opposed to the conduct of others.[664]

Whether the Supreme Court will follow the reasoning of Justice O'Connor or Justice Brennan, or simply reverse the state supreme courts for following neither, remains to be determined. Given the evolution of long-arm jurisdiction, the globalization of industry, and the explosion of online commerce since 1987, it is possible that the Supreme Court could establish a new standard. Whatever the outcome, the Court's decisions in *Goodyear Luxembourg* and *McIntyre* should provide some desperately needed clarity for international companies that wish to avoid being subjected to jurisdiction in the United States, but whose goods may reach various states despite their best efforts.

# § 3.19 Maritime Law

## § 3.19.1 COGSA governs inland cargo damage claims where shipment originated overseas under a single through bill of lading. *Kawasaki Kisen Kaisha Ltd. v. Regal-Beloit Corp.*

The Supreme Court decided one maritime law case in the 2009-10 term, *Kawasaki Kisen Kaisha Ltd. v. Regal-Beloit Corp.*,[665] which impacts businesses that ship cargo from overseas to inland U.S. locations. The Court held that the Carriage of Goods by Sea Act[666] (COGSA) applies to a shipment originating overseas under a single through bill of lading, rather than the Carmack

663. *Id.* at 392. The court continued "[o]n the contrary the available evidence tends to show that other entities were responsible for the shipment of tires manufactured by Defendants to the United States and, as part of that process, the tires arrived in North Carolina." *Id.*

664. *See, e.g., Asahi Metal Indus. Co.*, 480 U.S. at 112.

665. *Kawasaki Kisen Kaisha Ltd. v. Regal-Beloit Corp.*, 130 S. Ct. 2433, 2449 (2010).

666. 49 Stat. 1207, as amended, note following 46 U.S.C. § 30701.

Amendment[667] to the Interstate Commerce Act, which governs the terms of bills of lading issued by domestic rail carriers.

In *Kawasaki*, cargo owners shipped goods from China to inland U.S. locations. The petitioners, K-Line, issued four "through bills of lading" to the cargo owners, which contained all relevant contract terms and covered both the ocean and inland portion of the journey from China to inland United States in a single document. Because the bills covered the entire journey, they required that K-Line arrange delivery of the goods from China to their final destination in the United States. K-Line could choose the mode of transportation needed to complete the journey.

Significant terms in the through bills included an extension of the bills' defenses and limitations on liability to subcontractors under the bills. Second, the bills allowed K-Line to enter into subcontracts on any terms necessary to complete the journey. Third, the bills stated that the entire journey would be governed by COGSA's terms. Fourth, the bills provided that any dispute would be resolved based on Japanese law. Finally, the bills required that any suit concerning the shipments be brought in Tokyo District Court in Japan. The dispute in this case resulted from the provision requiring suit in Japan.

K-Line subcontracted with Union Pacific Railroad Company for rail shipment in the United States. K-Line transferred the goods from Chinese ports to Union Pacific at a port in Long Beach, California. A Union Pacific train derailed in Oklahoma and allegedly destroyed the cargo. The cargo owners sued K-Line and Union Pacific in California state court, and Union Pacific removed the suit to federal court. Then, Union Pacific and K-Line moved to dismiss based on the parties' Tokyo forum-selection clause. The district court granted the motion to dismiss. The U.S. Court of Appeals for the Ninth Circuit reversed and remanded, holding that the Carmack Amendment applied to the rail portion of an international shipment under a through bill of lading and trumped the parties' forum-selection clause.[668] The Supreme Court granted certiorari to resolve a circuit split on this question.[669]

In a unanimous opinion authored by Justice Kennedy, the Supreme Court reversed the Ninth Circuit and held that COGSA, rather than the Carmack Amendment, applied to the through bill of lading. Preliminarily, COGSA "governs the terms of bills of lading issued by ocean carriers engaged in foreign trade."[670] Carriers must issue bills of lading that provide certain terms. Under COGSA, the parties are limited in their efforts to adjust liability, but, as to forum-selection clauses, they are not so limited. Moreover, although COGSA only applies to shipments between U.S. ports and ports of foreign countries, parties may extend the terms of their contract to include the "entire period in

667. 49 U.S.C. § 11706(a).

668. *Regal-Beloit Corp. v. Kawasaki Kisen Kaisha LTD*, 557 F.3d 985 (9th Cir. Cal. 2009), *rev'd*, 130 S. Ct. 2433.

669. *Kawasaki Kisen Kaisha Ltd. v. Regal-Beloit Corp.*, 130 S. Ct. 459 (U.S. 2009).

670. 130 S. Ct. at 2440.

which the goods would be under a carrier's responsibility, including a period of . . . inland transport."[671]

The Carmack Amendment, on the other hand, governs the terms of bills of lading issued by domestic rail carriers. The Carmack Amendment requires rail carriers that "receive[] property for transportation under this part to issue a bill of lading."[672] All carriers, whether receiving or delivering rail carriers, can be liable for damage caused during rail routes under bills of lading, regardless of which carrier caused the damage. The cargo owners argued that Carmack applied and, therefore, its venue provisions controlled—not the bills' Tokyo forum-selection clauses. But, because the parties here contracted to extend COGSA's terms to inland portions of the overseas journey, the court concluded that "the cargo owners must abide by the contracts they made,"[673] including the Tokyo forum-selection clause.

Because the Court determined that the parties' contracts governed, cargo owners and rail carriers can seek to prevent application of undesirable forum-selection clauses through their contracts. Business owners arranging overseas cargo shipments can contract to limit forum-selection clauses to locations in the United States. Further, subcontractor rail carriers can require that through bills of lading specify that the Carmack Amendment applies to the rail portions of the journey, thereby limiting venue to a U.S. district court or a state court in the United States.

# § 3.20 Taxation

The Supreme Court decided one tax case in the 2009-10 term involving the comity owed by federal courts in challenges to state tax laws. It is poised to decide two other cases with tax implications, one involving a railroad's challenge to Alabama's sales and use tax and another case involving the taxes paid by hospitals and medical residents.

## § 3.20.1 The Supreme Court resolves a circuit split and adopts a broad view on the "comity doctrine." *Levin v. Commerce Energy, Inc.*

In *Levin v. Commerce Energy, Inc.*,[674] the Supreme Court resolved a circuit split regarding the scope of the "comity doctrine," under which federal courts have declined to exercise jurisdiction over challenges to state tax laws where the asserted federal right may be preserved without federal intervention. In a

671. *Id.* (internal quotations marks and citation omitted).
672. *Id.* at 2441.
673. *Id.* at 2442, 2449.
674. 130 S. Ct. 2323 (June 1, 2010).

unanimous opinion, the Court propounded a broad view of comity, rejecting a narrower view adopted by most circuit courts.

The breadth of the comity doctrine had been in question since 1937, when Congress enacted the Tax Injunction Act (TIA), 28 U.S.C. § 1341, which prohibits federal district courts from enjoining, suspending, and restraining the assessment, levy, and collection of state taxes where a plain, speedy, and efficient remedy may be had in state courts. Recently, four circuits have held that comity precludes only those cases where plaintiffs have sought district-court aid in order to arrest or countermand state tax collection—a narrow view of comity generally in line with the scope of the TIA.[675] One circuit, adopting the broad traditional view of comity, held that federal relief is barred so long as plain, adequate, and complete remedies are available in state courts.[676]

The differing perspectives stem from two prior Supreme Court cases decided after the enactment of the TIA: *Fair Assessment in Real Estate Association, Inc. v. McNary*, 454 U.S. 100 (1981) and *Hibbs v. Winn*, 542 U.S. 88 (2004). In *Fair Assessment*, the Supreme Court, finding, through a review of the legislative history of the TIA, that Congress did not intend to limit the amount of federal deference in state tax matters, declined to hear a Section 1983 claim based on the unconstitutional administration of St. Louis County taxes. Twenty-three years later, in *Hibbs*, Arizona taxpayers filed suit to enjoin the operation of a state law allowing income tax credits for payments to nonprofit organizations that awarded scholarships to private schools, some of which provided religious education. The Court, in a footnote, acknowledged that it had relied on comity principles "to preclude original federal-court jurisdiction only when plaintiffs have sought district-court aid in order to arrest or countermand state tax collection" and ultimately held the TIA did not bar an exercise of the federal court's jurisdiction.[677] Since *Hibbs*, the First, Sixth, Seventh, and Ninth Circuits have interpreted this footnote as limiting comity.[678]

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675. *See Coors Brewing Co. v. Méndez-Torres*, 562 F.3d 3 (1st Cir. 2009) ("In sum, *Hibbs* effected a change in the law such that neither the Butler Act nor related principles of comity serve to bar Coor's complaint."), *Commerce Energy, Inc. v. Levin*, 554 F.3d 1094 (6th Cir. 2009) ("[W]e reject an excessively expansive reading of the older cases discussing comity. . ."), *Levy v. Pappas*, 510 F.3d 7555 (7th Cir. 2007) ("When a plaintiff alleges that the state tax collection or refund process is singling her out for unjust treatment, then the Act and comity bar the federal action, as in *Fair Assessment*. When a plaintiff alleges that the state tax collection or refund process is giving unfair benefits to someone else, then according to *Hibbs* the Act and comity are not in play."), *Wilbur v. Locke*, 423 F.3d 1101 (9th Cir. 2005) ("The Supreme Court has relied on such principles 'to preclude original federal-court jurisdiction only when plaintiffs have sought district-court aid in order to arrest or countermand state tax collection.'").

676. *See DIRECTV, Inc. v. Tolson*, 513 F.3d 119 (4th Cir. 2008) ("[N]othing in the Supreme Court's conclusion that § 1341 was motivated by the specter of federal court challenges to state tax liabilities suggests that broader *comity* principles would not bar suits attempting to force state tax collection. . . . The question was simply not before the Court in *Hibbs*.").

677. *Hibbs v. Winn*, 542 U.S. 88, 107 n. 9, 112 (2004).

678. *See supra* note 675.

The *Levin* case involved the taxation of certain sellers of natural gas. Natural gas is sold by both local distribution companies (LDCs), which distribute gas using their own pipelines, and independent marketers (IMs), which sell gas while utilizing the pipelines of LDCs. The IMs brought suit in federal district court alleging that the tax exemptions received only by the LDCs were discriminatory and violated the Commerce and Equal Protection Clauses.[679] In order to remedy this alleged discrimination, the IMs requested declaratory and injunctive relief invalidating the exemptions received by the LDCs.[680] The district court dismissed the suit on the grounds that it was barred by comity, although not by the TIA.[681] The Sixth Circuit, agreeing with the majority of other circuit courts, reversed, holding that comity principles (as well as the TIA) did not prohibit the court from hearing the merits of the case because the IMs challenged tax exemptions affecting only four entities and therefore "would not significantly intrude upon traditional matters of state taxation."[682]

In a unanimous opinion written by Justice Ginsburg, the Supreme Court reversed the Sixth Circuit decision and precluded the exercise of federal jurisdiction.[683] Explaining its footnote in *Hibbs*, the Court stated that it "did not deploy the footnote to recast the comity doctrine, it intended the note to convey only that the Establishment Clause-grounded case cleared both the TIA and comity hurdles."[684] Applying this view of comity to the facts at hand, the Court, fearing that the relief requested by the IMs was not intended by the Ohio legislature and that reshaping the tax provisions would result in the type of interference comity aims to prevent, deferred to the state court system. Because comity precluded federal consideration of the merits, the Court declined to decide whether the TIA also precluded consideration of the case.[685]

The Supreme Court's adoption (or perhaps reinforcement) of the broad view of comity means ultimately that more challenges to state tax laws must be resolved in state courts rather than in the federal system. This decision gives strength to traditional comity principles and stresses that comity considerations, in spite of the TIA, will continue to be an important jurisdictional aspect of cases challenging state tax schemes. As for the significance of *Hibbs*, the Court distinguished it on the grounds that only invalidation of the credit would cure the violation and, therefore, state autonomy could not be lost or interfered with in federal court.[686]

679. *Levin v. Commerce Energy, Inc*., 130 S. Ct. 2323, 2328-29 (2010).

680. *Id.* at 2329.

681. *Id*.

682. *Commerce Energy, Inc. v. Levin*, 554 F.3d 1094, 1102 (6th Cir. 2009).

683. *Levin*, 130 S. Ct. at 2337. Justice Kennedy filed a concurring opinion. Justice Thomas filed an opinion concurring in the judgment and was joined by Justice Scalia. Justice Alito also filed an opinion concurring in the judgment.

684. *Id*. at 2335-36.

685. *Id.* at 2337.

686. *Id.* at 2328.

## § 3.20.2 Is a state's exemption of nonrail transportation—but not railroads—from sales and use tax discriminatory under the 4-R Act? *CSX Transportation, Inc. v. Alabama Department of Revenue*

The Supreme Court also is considering two cases with tax implications in the current term. First, in *CSX Transportation, Inc. v. Alabama Department of Revenue*,[687] a case argued on November 10, 2010, the Court will decide whether a state's exemption of a railroad's competitors (e.g., trucks, ships) but not railroads from a generally applicable sales and use tax violates § 306(1)(d) of the Railroad Revitalization and Regulatory Reform Act of 1976, 49 U.S.C. § 11501(b)(4) (the 4-R Act).

Congress enacted the 4-R Act in an effort "to provide the means to rehabilitate and maintain the physical facilities, improve the operations and structure, and restore the financial stability of the railway system of the United States, and to promote the revitalization of such railway system, so that this mode of transportation will remain viable in the private sector of the economy and will be able to provide energy-efficient, ecologically compatible transportation services with greater efficiency, effectiveness, and economy."[688] Certain subsections of the 4-R Act, now codified at 49 U.S.C. § 11501(b)(1)-(3), prohibit imposition of higher assessment ratios or tax rates upon rail transportation property than those imposed upon other "commercial and industrial property."[689] Another subsection, § 11501(b)(4) (hereinafter, "subsection (b)(4)"), prohibits imposition of "another tax that discriminates against a rail carrier providing transportation."[690]

Prior to enactment of the 4-R Act, property taxes imposed upon rail carriers were challenged under the Commerce Clause and the Due Process Clause.[691] The 4-R Act provided an additional avenue to challenge discriminatory tax schemes. In *Department of Revenue v. ACF Industries*, 510 U.S. 332 (1994), the Supreme Court considered the application of subsection (b)(4) to an Oregon property tax scheme that exempted certain commercial and industrial property, but not railroad cars. The Court held that subsection (b)(4) did not apply to the property tax exemptions as a matter of statutory construction. Because Congress placed exempt property beyond the reach of subsections (b)(1)-(3), the Court concluded that allowing examination of exemptions under (b)(4) would nullify Congressional intent. The Court also noted that its decision was supported by the long-standing practice of property tax exemptions at the time of enactment of the 4-R Act, as well as by principles of federalism.

687. No. 09-520 (U.S. cert. granted in part, June 14, 2010).
688. Railroad Revitalization and Regulatory Reform Act of 1976 § 101, 45 U.S.C. § 801.
689. 49 U.S.C. § 11501(b).
690. *Id.* § 11501(b)(4).
691. *See Dep't of Revenue v. ACF Indus.*, 510 U.S. 332, 334-35 (1994).

In *Norfolk Southern Railway Company v. Alabama Department of Revenue*, 550 F.3d 1306 (11th Cir. 2008), the Eleventh Circuit extended *ACF*'s reach, finding that the prohibition against challenging exemptions under subsection (b)(4) in the property tax context also applied to nonproperty taxes. *Norfolk* arose from a challenge to Alabama's sales and use tax, which generally exempted water carriers and motor carriers that paid an excise tax on fuel. Relying on *ACF*'s rationale, the Eleventh Circuit concluded that nothing in the plain text of subsection (b)(4) prohibited a discriminatory tax exemption, that the Supreme Court did not limit its holding in *ACF*, that sales and use tax exemptions similarly were prevalent at the time of the 4-R Act's enactment, and that federalism principles were still as important.[692] Based on *Norfolk*, the Eleventh Circuit in *CSX Transportation, Inc. v. Alabama Department of Revenue*,[693] affirmed a district court order dissolving a preliminary injunction relating to Alabama's sales and use tax sought by CSX Transportation, Inc., in a challenge identical to the one brought in *Norfolk*.

On June 14, 2010, the Supreme Court granted in part CSX Transportation's petition for writ of certiorari for the following question: "Whether a State's exemptions of rail carrier competitors, but not rail carriers, from generally applicable sales and use taxes on fuel subject the taxes to challenge under 49 U.S.C. § 11501(b)(4) as 'another tax that discriminates against a rail carrier.'"[694] The limited scope of the writ was attributable to an amicus brief filed by the Solicitor General, which was solicited by the Court.[695] The Solicitor General not only suggested a limited scope of review, but opined that the Eleventh Circuit's decision should be reversed because its reliance on *ACF* was misplaced, because *ACF* established nondiscrimination requirements only for property taxes under subsection (b)(4), not nonproperty taxes.[696]

CSX Transportation also argued for reversal on the grounds that subsection (b)(4) prohibits all taxes if they discriminate against a rail carrier, including nonproperty taxes and their exemptions, as such a decision is mandated by both the plain language of the statute and the fact that Congress chose the broader language over a version of (b)(4) covering only "in lieu" taxes.[697] The Alabama Department of Revenue, on the other hand, argued that the legislative history indicates that the purpose of subsection (b)(4) was to cover states that did not have a property tax, but instead had "in lieu" taxes, and that the *ACF* rationale

692. *Norfolk S. Ry. Co. v. Ala. Dep't of Revenue*, 550 F.3d 1306, 1314-15 (11th Cir. 2008).

693. 350 Fed. App'x 318 (11th Cir. 2009) (per curiam).

694. *CSX Transp. v. Ala. Dep't of Revenue*, 130 S. Ct. 3409 (2010).

695. Brief for the United States as Amicus Curiae, *CSX Transp. v. Ala. Dep't of Revenue*, 130 S. Ct. 3409 (Aug. 19, 2010) (No. 09-520), *available at* http://www.americanbar.org/content/dam/aba/publishing/preview/publiced_preview_briefs_pdfs_09_10_09_520_PetitionerAmCuUnitedStates.authcheckdam.pdf.

696. *Id*. at 1, 11-15.

697. Brief for Petitioner, *CSX Transp. v. Ala. Dep't of Revenue*, 130 S. Ct. 3409 (Aug. 19, 2010) (No. 09-520), *available at* http://www.americanbar.org/content/dam/aba/publishing/preview/publiced_preview_briefs_pdfs_09_10_09_520_Petitioner.authcheckdam.pdf.

is still applicable to generally applicable taxes because rail carriers are placed "on equal footing with the general mass of other taxpayers."[698]

If the Supreme Court rules for CSX, taxpayers will have another basis for challenging discriminatory treatment of railroads and Alabama schools could lose considerable revenue that is currently generated from the sales and use tax.[699] Reading subsection (b)(4) to encompass exemptions in the nonproperty tax context opens up sales, income, franchise taxes, and other nonproperty taxes to allegations of discrimination.

*Update: On February 22, 2011, the Supreme Court reversed and remanded in a 7-2 opinion by Justice Kagan, holding that the railroad can challenge the sales and use taxes as discriminatory under the 4-R Act. CSX Transp., Inc. v. Ala. Dep't of Revenue, No. 09-520, 2011 U.S. LEXIS 1084 (U.S. Feb. 22, 2011).*

## § 3.20.3 The Supreme Court will decide whether the stipends medical students receive as residents qualify them as students under FICA. *Mayo Foundation for Medical Education & Research v. United States*

The second case on the 2010-11 docket with tax implications is *Mayo Foundation for Medical Education & Research v. United States*,[700] in which the Court will decide whether the stipends that medical students receive from their schools for serving as "residents" qualify for the student exception to the Federal Insurance Contribution Act (FICA). The student exception to FICA provides an exemption to any wages received for any "service performed in the employ of . . . a school, college, or university . . . if such service is performed by a student who is enrolled and regularly attending classes at such school, college, or university."[701] Numerous schools have recently challenged the IRS's assessment of FICA taxes on medical residents' stipends, arguing that the residents are students, and that the residents' employers are schools.[702]

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698. *See* Brief of Respondents, *CSX Transp. v. Ala. Dep't of Revenue*, 130 S. Ct. 3409 (Sept. 27, 2010) (No. 09-520), *available at* http://www.americanbar.org/content/dam/aba/publishing/preview/publiced_preview_briefs_pdfs_09_10_09_520_Respondent.authcheckdam.pdf.

699. *See* Brief of Alabama Education Association *et al.* as Amici Curiae in Support of Respondents, *CSX Transp. v. Ala. Dep't of Revenue*, 130 S. Ct. 3409 (Oct. 4, 2010) (No. 09-520), *available at* http://www.americanbar.org/content/dam/aba/publishing/preview/publiced_preview_briefs_pdfs_09_10_09_520_RespondentAmCu12EduGrpsforETF.authcheckdam.pdf.

700. No. 09-837 (U.S., cert. granted June 1, 2010).

701. 26 U.S.C. § 3121(b)(1).

702. *See United States v. Mount Sinai Med. Ctr. of Florida, Inc.*, 486 F.3d 1248, 1251-52 (11th Cir. 2007); *United States v. Mem'l Sloan-Kettering Cancer Ctr.*, 563 F.3d 19, 27 (2d Cir. 2009); *United States v. Detroit Med. Ctr.*, 557 F. 3d 412, 417-18 (6th Cir. 2009); *Univ. of Chi. Hosps. v. United States*, 545 F.3d 564, 567 (7th Cir. 2009).

The genesis of the dispute in *Mayo* can be traced back to a lawsuit filed by the state of Minnesota against the Commissioner of Social Security in 1997.[703] In ruling in favor of the state of Minnesota, the Minnesota district court held that the services of medical residents fell within the student exception of the Social Security Act.[704] This ruling prompted the filing of more than 7,000 claims with the IRS on the basis that medical residents' wages were exempt from FICA taxes under the student exception.[705] The Mayo Foundation for Medical Education and Research ("Mayo") filed one of these refund claims, ultimately leading to litigation with the IRS that resulted in a judgment in favor of Mayo.[706] In response to the ruling, the IRS promulgated amended regulations that explicitly excluded full-time employees (i.e., employees whose normal work schedule is 40 hours or more per week) from the student exception to FICA.[707]

Mayo brought and prevailed in a second lawsuit in Minnesota federal district court, with the court holding the IRS's amended regulation invalid.[708] Specifically, the district court found that the amended regulations were inconsistent with the plain meaning of the FICA statute, and that the full-time employee exclusion was arbitrary, capricious, and unreasonable.[709]

The Eighth Circuit reversed, deferring to the IRS's amended regulations under the authority of *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984),[710] and noting that the amended regulations harmonized with the plain language of the statute and with the legislative history of FICA (which, in the Eighth Circuit's analysis, historically has been focused only on exempting part-time student employees).[711]

The Eighth Circuit further defended the IRS's interpretation of the language of the statute, noting that the Supreme Court has, on numerous occasions, "upheld Treasury Regulations construing words in tax statutes that may have a common or plain meaning in other contexts."[712] Thus, while some might consider that medical residents are students who are enrolled and regularly attending classes, the Eighth Circuit concluded that it is not unreasonable for

703. *Minnesota v. Chater*, No. 4-96-756, 1997 U.S. Dist. LEXIS 7506, **7–8 (D. Minn. May 21, 1997), *aff'd sub nom Minnesota v. Apfel*, 151 F.3d 742 (8th Cir. 1998).

704. *Id.* at **30-31.

705. *Mayo Found. for Med. Educ. & Research v. United States*, 568 F.3d 675, 676 (8th Cir. 2009).

706. *United States v. Mayo Found. for Med. Educ. & Research*, 282 F. Supp. 2d 997, 1011-18 (D. Minn. 2003).

707. *See* 26 C.F.R. § 31.3121(b)(10).

708. *Mayo Found. for Med. Educ. & Research v. United States*, 503 F. Supp. 2d 1164, 1171-77 (D. Minn. 2007).

709. *Id.*

710. *Chevron* held that an agency's interpretation of a statute is entitled to substantial deference and sets forth a test for determining whether an agency's interpretation of a statute is reasonable.

711. *Mayo Foundation for Med. Educ. & Research v. United States*, 568 F.3d 675 (8th Cir. 2009).

712. *Id.* at 679-80.

the IRS to interpret these terms as excluding persons who work 40 or more hours per week.[713]

The Supreme Court's ruling in *Mayo* will resolve a flurry of challenges that schools have filed throughout the country challenging the IRS's ability to assess FICA taxes on stipends paid to medical residents. In particular, as noted above, the Second, Sixth, Seventh, and Eleventh Circuits have all held invalid the prior version of the Treasury Regulations, finding that medical students qualified for the exemption from FICA taxes. However, none of these circuits addressed the amended regulations and the IRS's inclusion of a specific carve-out directed at "full-time" students, such as medical school residents. Thus, it is unclear whether these circuits would have deferred to the IRS's interpretation of the language of the student exception as adopted in the amended regulations.

At oral arguments, which took place on November 8, 2010, many justices reiterated, in their questioning, that the IRS's determination is entitled to deference.[714] Another recurring concern was how to "draw the line between a student who is working and a worker who is studying."[715] It remains to be seen how the Court draws that line.

*Update: On January 11, 2011, the Supreme Court issued an 8-0 opinion drafted by Chief Justice Roberts affirming the Eight Circuit, holding that medical residents are employees, not students, even though they continue learning while they are employed.*[716] *As a result, hospitals are not required to pay payroll taxes for medical residents, which should result in substantial cost savings for hospitals employing them.*

# § 3.21 Utilities

## § 3.21.1 The Supreme Court narrows the scope of FERC's oversight of electricity rates—with FERC's endorsement. *NRG Power Marketing v. Maine Public Utility Commission*

In a case arising out of electrical shortages in New England, the Supreme Court has once again narrowed the scope of the Federal Energy Regulatory Commission's (FERC's) oversight of electricity rates in its decision in *NRG Power*

713. *See id.*

714. The transcript of the oral argument is available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-837.pdf.

715. *See* Transcript of Oral Argument at 6, *Mayo Found. v. United States* (09-837), *available at* http://www.supremecourt.gov/oral_arguments/argument_transcript/09-837.pdf (last visited Nov. 11, 2010).

716. *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704 (2011).

*Marketing, LLC v. Maine Public Utilities Commission*.[717] FERC is conferred with authority by the Federal Power Act of 1935[718] (FPA) to regulate the "sale of electric energy at wholesale in interstate commerce."[719] Under the FPA, regulated electric utilities may set rates by tariff, or sellers and buyers may agree to rates by contract.[720] Whatever the method, the FPA requires all wholesale-electricity rates to be "just and reasonable."[721]

In order to ensure wholesale rates satisfy this standard, FERC may examine electricity rates in response to a complaint or upon its own initiative.[722] After a rate hearing, FERC may set aside any rate found to be "unjust, unreasonable, unduly discriminatory or preferential," and replace it with a just and reasonable rate.[723] In conducting this review, however, FERC is required to presume a rate is "just and reasonable" under the FPA if the rate is set by "a freely negotiated wholesale-energy contract."[724] This presumption derives from the Supreme Court's *Mobile-Sierra* doctrine,[725] under which FERC may not modify or abrogate presumed reasonable rates unless FERC "concludes that the contract seriously harms the public interest."[726]

*NRG Power* involved the application of the *Mobile-Sierra* doctrine to rate challenges lodged by third parties that were not parties to the rate contract. The case began in 2006 after FERC approved a settlement agreement that established rate-setting mechanisms for the sale of energy in various New England states that had suffered problems with electric grid reliability. The settlement agreement expressly provided that the *Mobile-Sierra* "public interest" standard would govern any rate challenges.[727]

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717. *NRG Power Mktg., LLC v. Me. PUC*, 130 S. Ct. 693 (2010).

718. 16 U.S.C. § 791a *et seq.* Congress enacted the FPA to regulate nonfederal hydropower projects in order to support development of rivers for energy generation and other beneficial uses, such as water supply, flood control, recreation, and fish and wildlife management. FPA regulations are available at 18 CFR 1-399 (governing the licensing and operation of hydropower facilities).

719. 16 U.S.C. § 824(b)(1).

720. *Id.* at § 824d(c), (d).

721. *Id.* at § 824d(a).

722. *Id.* at §§ 824d(e), 824(e)(a).

723. *Id.* at § 824e(a).

724. *NRG Power*, 130 S. Ct. at 647 (citing *Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527 (2008)) (quotations omitted).

725. The *Mobile-Sierra* doctrine originated in twin 1956 Supreme Court decisions, *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (holding that that FERC must "presume that the rate set out in a freely negotiated wholesale-energy contract meets the 'just and reasonable' requirement imposed by" the FPA, and that the "presumption may be overcome only if FERC concludes that the contract seriously harms the public interest").

726. *Morgan Stanley Capital Group*, 554 U.S. at 613; *see also NRG Power*, 130 S. Ct. at 650-51 ("'The regulatory system created by the [FPA] is premised on contractual agreements voluntarily devised by the regulated companies; it contemplates abrogation of these agreements only in circumstances of unequivocal public necessity.'") (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968)).

727. *NRG Power*, 130 S. Ct. at 647.

Opponents of the settlement that were not actually parties to the agreement petitioned for review of FERC's decision to the U.S. Court of Appeals for the D.C. Circuit, challenging certain rates established by the settlement agreement. The opponents to the settlement objected to FERC's approval of the agreement and argued that the rate challenges by noncontracting third parties should not be controlled by the restrictive *Mobile-Sierra* standard. The D.C. Circuit agreed with the settlement opponents, holding that "when a rate challenge is brought by a non-contracting third party, the *Mobile-Sierra* doctrine simply does not apply,"[728] and disapproving of "the settling parties[']] [attempt] to thrust the 'public interest' standard of review upon non-settling third parties who have vociferously objected to the terms of the settlement agreement."[729] Nevertheless, the D.C. Circuit rejected the settlement opponents' challenge to the settlement, holding that FERC's conclusion that the rates fell within reasonable ranges "was a reasoned decision supported by substantial evidence."[730]

Even though the terms of the settlement were approved, FERC and the settling parties challenged the D.C. Circuit's holding that the *Mobile-Sierra* public interest standard did not apply when a contract rate is challenged by a nonparty to the contract.[731] After granting certiorari, the Supreme Court, in an 8-to-1 decision authored by Justice Ginsburg, held that the *Mobile-Sierra* standard applies to non-contracting parties.

The Supreme Court framed the question before it as follows: "[I]f FERC itself must presume just and reasonable a contract rate resulting from fair, arms-length negotiations, how can it be maintained that non-contracting parties nevertheless may escape that presumption?"[732] The Court stressed that the "animating purpose" underlying the *Mobile-Sierra* doctrine is the "'promotion of the stability of supply arrangements which all agree is essential to the health of the [energy] industry.'"[733] In light of this purpose, a "presumption applicable to contracting parties only, and inoperative as to everyone else—consumers, advocacy groups, state utility commissions, elected officials acting *parens patriae*—could scarcely provide the stability *Mobile-Sierra* aimed to secure."[734] The Court concluded that "the *Mobile-Sierra* presumption does not depend on the identity of the complainant who seeks FERC investigation. The presumption is not limited to challenges to contract rates brought by contracting parties. It applies, as well, to challenges initiated by third parties."[735]

The lone dissenter, Justice Stevens, criticized the Court's extension of the *Mobile-Sierra* doctrine. He argued that the real purpose of *Mobile-Sierra* was to prevent "a seller who is a party to a long-term contract to provide energy to a

728. *Maine Pub. Util. Comm'n v. FERC*, 520 F.3d 464, 478 (D.C. Cir. 2008), *rev'd in part*, 130 S. Ct. 693 (2010).
729. *Id.*
730. *Id.* at 474.
731. *NRG Power*, 130 S. Ct. at 698.
732. *Id.* at 700.
733. *Id.* (quoting *Mobile*, 350 U.S. at 344) (addition in quote).
734. *Id.* at 701.
735. *Id.*

wholesaler [from] unilaterally repudiat[ing] its contract obligations in response to changes in market conditions. . . ."[736]

Notwithstanding Justice Stevens' critique, the *NRG Power* decision and the *Mobile-Sierra* doctrine on which it expands should help shield contract rates from regulatory intervention and diminish the success of third-party challenges. Indeed, in at least one administrative challenge case since *NRG Power* was decided, FERC has applied the *Mobile-Sierra* doctrine to non-contracting challengers and found a contract rate to be reasonable and just.[737] *NRG Power* is also important in that FERC argued *against* reserving for itself broader oversight of rate contracts. Given the Obama Administration's stated desire for more regulatory oversight in the energy industry, this case may be setting up future conflicts between the Administration and FERC—an independent agency that is not beholden to the Department of Energy.

736. *Id.* (Stevens, J., dissenting).
737. *See E.On U.S., LLC v. E.On U.S., LLC*, 132 F.E.R.C. P63,007 (Aug. 18, 2010).