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JUSTICES DEAL SETBACK TO METHOD OF FUNDING LEGAL AID TO THE POOR

The Wall Street Journal

June 16, 1998

By Edward Felsenthal, Staff Reporter of The Wall Street Journal

The Supreme Court dealt a blow to a major method of funding legal aid for the poor, but stopped short of wiping it out.

The case challenged a system that many states have used to help pay for legal aid since its federal funding was cut in the 1980s. The states take interest payments that lawyers earn while they hold onto clients' money, such as real- estate closing costs or fees paid in advance. Ordinarily, interest is turned over to the client. But sometimes the money held is so small or kept for such a short time that it doesn't make sense to set up an interest-bearing account. Under the state programs, that money is pooled into larger accounts, and the interest is turned over to legal aid.

The states contend no one gets hurt, because clients wouldn't earn interest on those funds anyway. But the Washington Legal Foundation, a conservative think tank that filed the case, argued that even small amounts of interest are private property and therefore protected by the Constitution. Many conservatives believe legalaid programs tend to pursue cases for liberal causes, such as seeking higher benefits for welfare recipients and filing class-action lawsuits on behalf of illegal aliens.

In a 5-4 decision, the Supreme Court agreed that the interest payments are private property, rejecting the idea they are simply surplus funds created by the government. "The value is created by the [clients'] funds," Chief Justice William Rehnquist said in an opinion for the majority, which included the entire conservative wing of the court. "The state does nothing to create value."

But the court didn't address whether the state plans, known as Interest on Lawyers Trust Account plans, actually violate the Constitution. Past cases make clear that not every government action affecting private property amounts to an illegal "taking." The answer, many courts have said, depends on how much an action interferes with a citizen's investment expectations. Lower courts now will have to address those issues.

Almost every state has an Iolta plan, although some allow lawyers to not participate. Between 1983 and 1993, Iolta plans contributed more than $400 million to state legal-aid programs.

Richard Samp, a lawyer for the Washington Legal Foundation, called the opinion "a resounding endorsement of private property rights."

But Darrell Jordan, a Dallas lawyer who represented the Texas Iolta plan, predicted there will be "several more rounds" before Iolta's fate is sealed. "For us, it's a speed-bump," he said, adding that opponents will "have a tough time" proving the plans are unconstitutional.

Justices David Souter, Stephen Breyer, Ruth Bader Ginsburg and John Paul Stevens dissented from the majority ruling. (Phillips vs. Washington Legal Foundation)

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$100 MILLION IN LEGAL SERVICES FUNDING IS PLACED IN DOUBT BY A SUPREME COURT RULING

The New York Times

June 16, 1998; Page A18

By LINDA GREENHOUSE

A sharply divided Supreme Court today cast constitutional doubt on state programs that generate $100 million a year for legal services for poor people by pooling the interest on some of the money that clients deposit for brief periods with their lawyers.

That interest is actually the property of the clients, the Court ruled in a 5-to-4 decision that raised, but did not answer, the question of whether channeling the money for legal services amounts to an unconstitutional "taking" of private property for a public purpose.

That question will now be answered by the lower Federal courts or by the Supreme Court as the case works it way back up through the legal system. Reaction today was sharply split over whether the Court's handling of the initial property question foreshadowed an eventual ruling that the program is unconstitutional.

The case, a challenge brought to the program in Texas by property rights advocates, represented the leading edge of a debate that has taken place largely out of the public eye but that has galvanized the organized bar in support of programs.

It is also the latest chapter in the long-running, ideologically charged battle over the fate of publicly funded legal services programs, which conservatives in Congress have been trying to kill or curb sharply for the last 20 years. According to a brief filed by the American Bar Association, money generated by the programs is second only to the Federal Government as a source of funding for legal services, accounting for as much as a quarter of the legal services budgets.

The Court split along ideological lines. Chief Justice William H. Rehnquist wrote the majority opinion, which was joined by his four most conservative colleagues: Justices Antonin Scalia, Clarence Thomas, Sandra Day O'Connor, and Anthony M. Kennedy. Justices David H. Souter, John Paul Stevens, Ruth Bader Ginsburg, and Stephen G. Breyer dissented.

In declaring the interest to be clients' property, the Court rejected arguments put forward by the chief justices of all 50 states, the American Bar Association, 35 state attorneys general, and numerous government groups. These groups argued that properly understood, the interest should not be seen as the clients' property because it would be nonexistent, eaten up by transaction costs, except for the pooling arrangement that courts and legislatures in all states have adopted under a program known as

Interest on Lawyers Trust Accounts.

The idea for the program, usually referred to by its initials as Iolta, began in Australia in the 1960's. Its adoption in the United States was delayed until 1980, when Congress first authorized banks to pay interest on checking accounts for certain types of depositors. Before then, lawyers typically deposited short-term client funds, like escrow or settlement deposits, in non-interest bearing accounts.

Once interest-bearing checking accounts became available, the American Bar Association and other lawyers' groups were quick to promote adoption of the Australian idea of directing the pooled interest to legal services. They reasoned that for clients, the interest was largely theoretical in any event, because the costs of opening an account and dealing with tax forms would quickly cancel out the earnings from all but sizeable deposits. When actual net interest to a client was a possibility, that client's deposit would not be pooled, but would go into an individual account for the client's benefit.

The Texas Supreme Court adopted an Iolta program for the state in 1984. All states now have the programs, which flourished at the same time that Congress was cutting the budget of the Legal Services Corporation and placing restrictions on the types of cases that lawyers who work for the federally funded programs can bring.

The case against the Texas program was brought by a conservative public interest law firm, the Washington Legal Foundation. It challenged the program both as an unconstitutional taking of private property and as a form of compelled support for causes not of a client's choosing, in violation of the First Amendment. That aspect of the case was not before the Supreme Court but can be renewed in the lower court proceedings that will follow today's ruling.

Chief Justice Rehnquist, in his majority opinion today in Phillips v. Washington Legal Foundation, No. 96-1578, applied a rule of English common law that "interest follows principal." Because there was no dispute that the principal on deposit was the property of the client, the Chief Justice said, it followed that "any interest that does accrue attaches as a property right incident to the ownership of the underlying principal."

This was the case, the Chief Justice continued, even if at the end of the day there was no net interest for the client to receive. "We have never held that a physical item is not 'property' simply because it lacks a positive economic or market value," he said, adding that: "The government may not seize rents received by the owner of a building simply because it can prove that the costs incurred in collecting the rents exceed the amount collected."

Whether the use of the property was a "taking" within the meaning of the Fifth Amendment or, if so, whether any "just compensation" would be due to the clients, were questions for another day, the Chief Justice said.

In a dissenting opinion, Justice Souter objected that the Court had announced "an essentially abstract proposition" that "may ultimately turn out to have no significance" in resolving the ultimate constitutional question. If the amount of "just compensation" turned out to be zero, he said, "there would be no practical consequence" to having recognized a property right in the first place.

The United States Court of Appeals for the Fifth Circuit, in New Orleans, which found the interest to be property in its 1996 ruling but stopped short of deciding the other questions, will now consider the case again. "We're 90 percent of the way home," Richard Samp, the Washington Legal Foundation's chief counsel, said today in predicting that his group would win the next phase.

The program's supporters were more tempered in their predictions. Jerome J. Shestack, president of the American Bar Association, said in an interview that Iolta programs were "more vulnerable, but still alive" under the ruling today. Mr. Shestack speculated that if there had been a solid five votes on the Court to decide the ultimate issue against the programs, the majority would probably have done so now rather than preserve the issue for another day.

HIGH COURT APPROVES RETAIL PRICE CEILINGS; Decision to Overturn Precedent Allows Manufacturers to Set Limits on What Sellers Charge for Goods. Ruling Could Affect an Array of Industries.

Los Angeles Times

November 5, 1997; Pg. A1

By David G. Savage, Times Staff Writer

In a decision that could lead to lower prices for everything from hamburgers and gasoline to cars and computers, the Supreme Court ruled Tuesday that manufacturers and wholesalers can set retail price ceilings for their products.

In its 9-0 ruling, the court overturned a long-standing doctrine that gave retailers the freedom to charge as much as the market would bear.

Until now, advertisements promoting discounts, whether a 99-cent hamburger or a $1,000 auto price break, had to include the warning "at participating stores only" or "at participating dealerships."

That was required because independent sellers could not be forced to charge the lower price. This "maximum price fixing" had been deemed illegal under antitrust laws in a 1968 high court ruling, Albrecht vs. Herald Company.

Economists and antitrust experts often had derided that decision as mistaken.

Certainly price floors— or "minimum price fixing," which is banned by law— make sense, they said. Price floors hurt consumers because they prevent retailers from offering discounts.

By contrast, banning price ceilings hurts both consumers, who pay more, and manufacturers, who often sell less, economists said.

On Tuesday, the justices admitted that the 1968 precedent was in error and threw it out.

"We conclude that Albrecht should be overruled," Justice Sandra Day O'Connor announced for the court. A "considerable body of scholarship" has shown that not all price fixing is harmful, she said. "Low prices benefit consumers regardless of how they are set and they do not threaten competition."

Tuesday's decision has the potential to reshape the arrangements between manufacturers and retailers in an array of industries, lawyers said. Now, franchise systems, product manufacturers and wholesalers can negotiate new agreements with retailers that include price ceilings.

"It will take a while for this to work its way through the distribution chain in some industries, but I think franchisers are likely to use this decision very quickly," said Steven B. Feirman, a Washington lawyer who represented a coalition of familiar companies including Burger King, Wendy's, Motel 6, General Motors and

Pillsbury.

"Franchisers have been very upset at their inability to deliver uniform low prices. It upsets consumers," he said. "This permits the companies to bring the renegade franchisers into line."

Officials of the American Petroleum Institute, the American Automobile Manufacturers Assn. and the National Manufacturers Assn. were among those applauding the ruling.

"This is good news for manufacturers and consumers. It frees an auto manufacturer to say to a dealer, 'Don't charge any more than X price for a particular model,' " said Roy T. Englert Jr., a lawyer who filed a friend-of-the-court brief for the auto manufacturers. A fixed lower price could help the company sell more cars, he said.

The Federal Trade Commission and the Clinton administration had urged the court to end its ban on fixed-price ceilings. The old rule "strips manufacturers of a mechanism that is pro-competitive," Assistant Atty. Gen. Joel I. Klein, chief of the Justice Department's antitrust division, told the justices during arguments last month.

Not surprisingly, retailers opposed the change. They said Tuesday's ruling will allow big companies to squeeze profit margins for small distributors and independent sellers. Because retailers operate in a competitive economy, they have not been able to gouge consumers by marking up their prices, they maintained.

Janet Speelman, executive director of the Automobile Trade Organizations of California, said that the decision will be disastrous for gasoline dealers.

"Under the guise of protecting consumers, it will allow oil companies to eliminate dealers, one at a time, through economic eviction," said Speelman, whose group represent's the state's gasoline dealers.

She said the decision will allow refiners to squeeze dealer profits by raising wholesale prices while lowering retail prices.

An attorney for the 10,000-member Service Station Dealers of America said he doubts the decision will help consumers.

"Prices at the retail level are already very, very competitive," said attorney Peter Gunst. "I do not believe the decision will have any effect on retail prices."

The case before the court involved a dispute between a Chicago-area service station owner and a gasoline wholesaler. State Oil Co., the wholesaler, tried to impose price limits for its regular and premium gasoline but the service station owner, Barkat Khan, resisted. He filed suit contending that the arrangement violated antitrust laws.

Khan won in the U.S. Court of Appeals in Chicago, even though Chief Judge Richard Posner wrote an opinion mocking the high court's 1968 precedent as "unsound when decided," "moth-eaten" by subsequent scholarship and "increasingly wobbly" in its application. Nonetheless, it is the law until the Supreme Court decides otherwise, said Posner, an antitrust expert.

Ruling in the case (State Oil vs. Khan, 96-871), the Supreme Court took Posner's advice and overruled its precedent.

"Chief Judge Posner aptly described Albrecht's infirmities," O'Connor wrote. Though the court is always cautious about reversing a precedent, she said, the "great weight of scholarly criticism" had convinced the justices that the legal rule prohibiting the setting of maximum retail prices was causing more harm than good.

Tuesday's decision stops short of saying that manufacturers are entirely free to fix maximum prices, the high court noted.

If a retailer can prove in court that a particular price agreement amounts to an "unreasonable restraint on trade" that hurts consumers, the agreement could still be deemed to violate the antitrust laws, O'Connor said. But such cases are very hard to prove and unlikely to occur often, lawyers said.

In practice, manufacturers and wholesalers will have to work with retailers to establish price levels, lawyers said.

"The trick will be finding the right maximum price, whether you are talking about Nike shoes or supermarket items. You don't want to set prices too low. That will drive away your retailers. But you don't want to set them too high either, because that hurts your consumers," said Mark Davidson, a Washington lawyer for the National Manufacturers Assn.

The case illustrates how manufacturers and retailers often have different interests.

The 1968 case arose in the newspaper industry. Typically, publishers want to set low prices to increase circulation. They make money through advertising.

By contrast, independent distributors earn money from the sale of the paper and would prefer higher prices. At airport newsstands, for example, retailers often charge more for papers than the listed price.

The old ruling in the Albrecht case gave the sellers the freedom to set their own prices. Tuesday's ruling will allow newspaper companies to insist on lower prices.

*- Times staff writer Denise Gellene in Los Angeles contributed to this story.

HIGH COURT SAYS PRICE CEILINGS AND SOME 'FIXING' ARE ALLOWED

The New York Times

November 5, 1997; Pg. A1

By Linda Greenhouse

In one of its most important antitrust decisions in years, the Supreme Court ruled unanimously today that a manufacturer or supplier does not necessarily violate Federal antitrust law by placing a ceiling on the retail price a dealer can charge for its products.

The ruling overturned a much-disputed 29-year-old precedent that regarded limits on retail markups as illegal price-fixing, a violation of the Sherman Antitrust Act.

No manufacturers announced any immediate plans to test the ruling, and it is unclear how soon the change might be felt by consumers because the legality of markup limits will now be determined case by case. Some consumer advocates said the Court simply shifted some power away from retailers in a decision that could result in diminished competition. But the Court's action was widely welcomed by manufacturers, who said it could eventually lead to lower consumer prices.

Under the ruling, for example, auto makers, freed to limit markups on popular models, might be able to keep dealers from selling them for more than the amount listed on the sticker. Computer manufacturers might be able to prevent retailers from charging exorbitant prices on hot-selling machines.

"We see this as pro-consumer; this will help to insure that the benefits of a manufacturer's pricing will be passed on to consumers," said Max Gates, a spokesman for the American Automobile Manufacturers Association in Washington.

Writing for the Court, Justice Sandra Day O'Connor said that there was "insufficient economic justification" for prohibiting the practice, which is known as resale price maintenance.

A manufacturer's inability to limit markups, she wrote, can actually harm consumers by leading to higher prices and to monopoly behavior by dealers who serve exclusive territories.

Justice O'Connor also noted that it remained illegal for manufacturers to impose minimum prices on dealers— a version of price-fixing that is still automatically prohibited.

The decision grew out of a lawsuit by a gasoline dealer against his supplier, which had sought to limit prices by requiring the dealer to rebate to the supplier any excess over the allowed markup of 3.25 cents a gallon.

Reflecting the stakes involved, an unusually high number of briefs were filed on both sides of the case, State Oil Company v. Khan, No. 96-871. Organizations including the American Automobile Manufacturers Association, the National Association of Manufacturers and the Business Roundtable, representing the chief executives of 200 large corporations, all urged the Court to overturn the 1968 precedent.

The Justice Department and the Federal Trade Commission also urged the Court to overturn the 1968 ruling, Albrecht v. Herald Company. Joel I. Klein, the Assistant Attorney General for antitrust, told the Court that the ruling had done "considerably more harm than good." Ceilings on prices are "likely to be pro-competitive," Mr. Klein said during the argument, which took place Oct. 7

For the Court to issue a decision of this significance less than a month after the argument indicates the Justices' confidence in repudiating a categorical approach to antitrust law, which had already been deeply eroded in other contexts. For example, in 1977 the Court overturned another important antitrust precedent and ruled that a manufacturer's use of exclusive dealer territories did not automatically violate the Sherman Act.

In contrast to the prior rule, which made all markup limits illegal, today's ruling means such limits will be evaluated by the Federal courts under what is known as the rule of reason, which requires a case-by-case examination of the economic and competitive impact.

In other words, the decision today does not automatically validate all markup limits. The permissible boundaries will be defined gradually as the Federal courts decide cases brought by disgruntled retailers.

The American Petroleum Institute, the trade group representing the oil industry, noted in welcoming the ruling that the decision did not mean markup limits were necessarily lawful. But the group said the ruling "does give the suppliers additional leeway in assuring that their products are marketed in a competitive manner."

On the retailers' side, organizations of automobile and gasoline dealers as well as the attorneys general of 33 states filed briefs urging the Court to hold the line. The Service Station Dealers of America, representing gasoline retailers in 14 states, told the Court that abandoning the absolute rule against setting maximum prices would give suppliers "coercive power over existing franchisees and dealers."

The states' coalition, led by New York and including Connecticut and New Jersey, told the Court that a retreat from its historical "condemnation of all forms of price-fixing" would "launch buyers and sellers in all markets, now governed by clear rules of conduct, upon a sea of doubt."

The Newspaper Association of America filed a brief, joined by The New York Times and other newspapers, that urged the Court to overturn the 1968 precedent. The brief said newspapers often found themselves at odds with their distributors because each was motivated by a different incentive: the distributors wanted a maximum profit per copy, even if the result was fewer sales, while the newspapers typically wanted to maintain or increase circulation, the basis for advertising rates.

The 1968 decision itself grew out of an effort by a newspaper publisher to grant exclusive territories to independent carriers who would not exceed the publisher's desired price.

The tension between newspaper publishers and distributors is mirrored in many other economic sectors where a retailer's desire for higher profits may conflict with a manufacturer's goal of greater volume. Unable to set markup limits, many manufacturers have used other tools to control their retailers' behavior, like consumer rebates and direct advertising, which makes it difficult for a retailer to exceed an advertised price.

The decision today overturned a 1996 ruling by the United States Court of Appeals for the Seventh Circuit, in Chicago. That court ruled reluctantly that a gasoline supplier's effort to set maximum allowable retail prices was an antitrust violation. The appeals court said that while the Supreme Court's 1968 precedent was "unsound when decided" and "inconsistent with later decisions," lower courts had to follow the law until the Justices themselves overruled it.

Some industry experts said the decision today would probably have little effect on products like gasoline. Most dealers set their prices based on local competitive conditions, and if they set prices too high, other stations tend to force them down.

The ruling's impact on auto prices is also unclear. Although it could give auto makers additional leverage in preventing dealers from charging more than the list price, dealers historically have found ways to maximize their profits.

Some dealers are skilled at preventing manufacturers from discovering big price markups. One method, for example, is for a dealer to sell a popular car to a friend at list price and let the friend resell it immediately at a higher price to someone waiting for the car, with the dealer and friend splitting the difference.

Even if auto makers try to make use of the Court's ruling, "the dealers will come up with a way to get around it," said George E. Hoffer, an economics professor at Virginia Commonwealth University who specializes in auto dealership issues.

Some consumer advocates were decidedly pessimistic that the Court's ruling would result in lower prices. Rather, they said, it might just diminish a merchant's ability to determine prices.

Edwin S. Rothschild, the energy policy director for Citizen Action, a Washington-based consumer group, said the Court was "reinventing the Middle Ages; that retailers are not free, that they are serfs."

"This is America," he said. "You're supposed to be able to price goods to attract people or not attract people. That's supposed to determine whether you stay in business or not. Why should we give control to the wholesalers?"

HIGH COURT LIMITS CREDIT UNION'S MEMBERSHIP RANGE

The Washington Post

February 26, 1998; Pg. A06

By Joan Biskupic*, Washington Post Staff Writer

The Supreme Court ruled yesterday that individual credit unions cannot broadly draw members from a variety of occupations. The decision upsets long-standing federal policy and could significantly limit consumer options and the ability of credit unions to compete with banks.

By a 5 to 4 vote, the court said regulators wrongly interpreted a Depression-era law and permitted federally chartered credit unions to enroll millions of workers in different companies and locations. The long-awaited ruling in the case that was argued on the first Monday in October— the first day of the current court term— immediately sparked a battle in Congress over legislation to revise the 1934 statute. At stake, according to the Justice Department, is more than $100 billion held in certain credit unions.

It is unlikely, however, that any credit union customers will be forced out or will see an immediate change in service. The American Bankers Association, which helped bring the case, has withdrawn an earlier demand that credit unions get rid of the 20 million members who signed up under the liberal membership policy. (Overall, 70 million people belong to federal credit unions nationwide.) But the growth of some credit unions will be stunted, and their officials predicted they will scale back marketing and technology efforts undertaken to compete with local banks.

As quickly as the ruling was announced yesterday, banking and credit union lobbyists pounced on Capitol Hill, where legislation is pending to allow individual credit unions to serve a broad clientele. The fight will be over who can join the nonprofit, tax-exempt cooperatives that tend to offer lower fees and better rates on loans. But some banking officials have vowed also to renew their opposition to credit union exemptions from the federal regulation and taxes imposed on banks.

Rep. Steven C. LaTourette (R-Ohio), lead sponsor of a bill to expand credit unions, noted that the law bars people who work for companies with fewer than 500 employees from forming their own credit unions, and those workers would be unable to join with other small companies to create a cooperative offering deposit and lending services.

"The bulk of the American economic engine is now in [companies] with less than 500 employees. We're not talking about big steel companies anymore," LaTourette said.

House Speaker Newt Gingrich (R-Ga.) endorsed the legislation, saying, "I believe in community-level activism. I believe in local folks helping local folks."

But Edward L. Yingling, lead lobbyist for the American Bankers Association, said, "We hope that the Congress will not be stampeded."

"Credit unions are making millions of dollars and they don't pay any federal taxes. When they start acting just like banks . . they ought to grow up and pay their fair share of taxes," he said.

But he also said the bankers' position is "not to seek any remedy that would require any current customer to lose his or her account."

While Congress created the cooperatives to provide services to low-income people whom banks were ignoring, credit unions over the decades have expanded their clientele and services, and flourished. The 1934 law says credit unions must be limited to groups with a "common bond" of occupation, association or geographical area. In 1982, responding to company downsizing and a recession, the National Credit Union Administration said that as long as each of the smaller groups within a credit union shared a common employment bond, the condition was met.

In yesterday's case from North Carolina, five banks and the American Bankers Association argued that the law means the same bond of occupation has to unite every member. The banks were protesting a cooperative that originally was limited to workers of Western Electric Co. (owned by AT&T Corp.) and had expanded to employees at Duke Power Co., Black & Decker Corp., the American Tobacco Co., a Coca-Cola bottler and others.

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On that threshold question, Justice Clarence Thomas wrote for the court yesterday that the banks' interest in limiting the markets that credit unions can serve falls within the scope of the statute, so they have standing to sue.

The dissenters— Justices Sandra Day O'Connor, John Paul Stevens, David H. Souter and Stephen G. Breyer— disagreed on the standing issue and didn't reach the merits of the case. The statute, O'Connor wrote, is not concerned "with protecting the business interests of competitors."

On the merits, the majority said the "common bond" requirement is not satisfied when employees of unrelated companies are joined in one credit union.

In affirming a decision by the appeals court for the D.C. Circuit, Thomas wrote, "Congress has made clear that the same common bond of occupation must unite each member."

Joining him in the majority in National Credit Union Administration v. First National Bank & Trust were Chief Justice William H. Rehnquist and Justices Antonin Scalia, Anthony M. Kennedy and Ruth Bader Ginsburg.

*- Staff writer Michelle Singletary and staff researcher Ben White contributed to this report.

CREDIT UNION LOSE TO BANKS IN HIGH COURT

The New York Times

February 26, 1998

By Linda Greenhouse

The Supreme Court gave the banking industry an important if perhaps temporary victory today in an intensifying battle to stop the expansion of credit unions. It invalidated a Federal regulation that had allowed millions of people to join the alternatives to banks.

The Court's ruling threw into question the status of as many as 20 million customers of credit unions, the organizations that were born out of the hardships of the Great Depression and have grown into pesky bank rivals in recent years with an array of basic, affordable services ranging from mortgages to checking accounts to A.T.M.'s.

"If this decision is allowed to stand, it would be a massive loss for consumers and choice," said Dan A. Mica, president of the Credit Union National Association. "We think we are a counterbalance to banks, and if we were not there the cost of services would go up for all consumers."

Partly because they expected such a ruling, credit union leaders had been gathering support in Congress for a bill that would permit them to expand their membership, effectively overturning the Court's decision. The battle will now shift to that bill, which has 138 co-sponsors from both parties.

But banks have vowed to fight the bill, and it remains unclear how many credit union customers will ultimately be affected when the battle is resolved.

Representatives of the banking industry disavowed any desire to force credit unions to drop members.

"It is not our intent to create credit union widows and orphans," Monique E. Hanis, director of marketing for the Independent Bankers Association, said. The American Bankers Association, the industry's main trade group, also said it would not seek a solution that forced credit unions to give up members. However, Virginia McGuire, a spokeswoman for the American Bankers Association, said it was possible that credit unions might have to give up some groups of members that joined since July 30, 1996, when a lower-court decision set the stage for the Court's ruling today.

The question of how to remedy the regulation's invalidity is now before the Federal District Court here, which has delayed that phase of the case for more than a year while the Supreme Court reviewed the merits of the issue.

By a vote of 5 to 4, the Court invalidated a 1982 Federal regulation that had permitted thousands of credit unions to expand their membership base far beyond the relatively narrow employee and community groups around which credit unions were originally organized.

The American Bankers Association had challenged the 1982 regulation on the ground that it violated a 1934 Federal law requiring credit unions to limit membership to "groups having a common bond of occupation or association." In an opinion by Justice Clarence Thomas, the Supreme Court agreed.

The regulation issued by the National Credit Union Administration interpreted the phrase "common bond" so broadly, Justice Thomas said, that "it would be permissible to grant a charter to a conglomerate credit union whose members would include the employees of every company in the United States."

The majority opinion, which upheld a 1996 ruling by the United States Court of Appeals for the District of Columbia Circuit, was joined by Chief Justice William H. Rehnquist and by Justices Anthony M. Kennedy, Ruth Bader Ginsburg and Antonin Scalia.

The four dissenters— Justices Sandra Day O'Connor, John Paul Stevens, David H. Souter and Stephen G. Breyer— did not address the merits of the case. Rather, they disputed the bankers' right to have brought the suit in the first place. Banks did not have standing to challenge the regulation, the dissenters said in an opinion by Justice O'Connor, because banks' competitive stake in the outcome did not place them within the "zone of interests" of the statute at issue, which was aimed at regulating credit unions.

Even though the effects of the Court's decision may be temporary, leaders of the credit union industry continued to warn today that membership for millions of people was still at risk. By coincidence, 4,000 credit union members were in Washington today for the first phase of a lobbying effort in expectation of a Supreme Court defeat. "This is a major, massive survival issue for us and we plan to win," Mr. Mica said.

While the legislative outlook is uncertain, the credit unions appear to have won the initial support of some of the more powerful members of Congress.

On the question of the implications of applying the ruling retroactively. "It is inconceivable to me that Congress will allow millions of Americans to be kicked out of the financial institution of their choice," said Representative Jim Leach, an Iowa Republican and the House Banking Committee chairman. He plans to hold hearings on credit union membership next month.

On Tuesday, the House Speaker, Newt Gingrich, announced his support of the bill that would write the invalidated regulation into law. The sponsors are Representatives Steven C. LaTourette, Republican of Ohio, and Paul E. Kanjorski, Democrat of Pennsylvania. While no corresponding measure has been introduced in the Senate, Senator Alfonse M. D' Amato, the New York Republican who is chairman of the Senate Banking Committee, said today that "Congress should and will enact legislation to restore the basic right of Americans to join credit unions."

Given the lobbying power of both sides of the debate, analysts said they expected a real struggle when legislation was presented before the House Banking Committee.

"We intend to nullify the court's decision," Mr. LaTourette said today. "I would be shocked if the House and Senate didn't get something to the President before we adjourn for the year."

Edward F Furash, chairman and chief executive of Furash & Company, a Washington-based financial service industry consultancy, said he expected a "big huge fight" on Capitol Hill.

The case today, the National Credit Union Administration v. the First National Bank & Trust Company, No. 96-843, is rooted in the recession of the early 1980's. Faced with the prospect of bailing out the credit unions of small companies that were failing in substantial numbers, the National Credit Union Administration looked for ways to insulate credit unions from the fortunes of single employers.

For nearly 50 years, the agency had interpreted the Depression-era statute that put credit unions under Federal regulation as placing sharp limits on membership. Section 109 of the Federal Credit Union Act of 1934 provides that "Federal credit union membership shall be limited to groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district." For employee-based credit unions, the agency had interpreted this language to require all members of the credit union to be united by a "common bond."

Under its reinterpretation issued in 1982, however, the credit union administration began permitting membership by wholly unrelated employee groups, as long as each group had its own common bond. A rapid expansion of credit unions resulted. Today, 3,600 of the 7,000 federally chartered credit unions have members from multiple occupational groups, including many of the biggest credit unions, with 32 million members and 79 percent of all deposits.

Enabled by Federal tax regulations to offer relatively low rates on loans and services, the credit unions began vigorous head-to-head competition with local banks for home mortgages, car loans and checking accounts. Not surprisingly, the banks fought back with lawsuits.

The target of the case before the Court was the AT&T Family Credit Union, based in Winston-Salem, N.C., and originally created in 1952 to serve employees of the Western Electric Company. It now has 300 separate employee groups, including employees of a Coca-Cola bottler and the Duke Power Company. A group of North Carolina banks joined the American Bankers Association in filing suit in 1990.

AT&T CORP. V. IOWA UTILITIES BOARD

By Troy R. Rackham

Telecommunications is certainly different in the 1990s, with faxes, computers, fiber optics, cable, etc., than it was in 1934 when Congress passed the first Telecommunications Act aimed at regulating the telecommunications industry. For more than 60 years, the telecommunications industry was governed by this 1934 Act as interpreted by the federal courts.

In 1996, Congress finally enacted a comprehensive bill aimed at altering the face of telecommunications regulations-- the Telecommunications Act of 1996 (the "Act.") The bill was designed, in part, to increase the competition in local and long-distance telephone markets by opening up these monopolistic markets to other providers which had been previously excluded. This increased competition, so the reasoning went, would then force prices down and increase the quality and quantity of services available to the consumer. Of course, local phone networks, who have traditionally had a monopoly over providing local connection services, have not taken kindly to the Telecommunications Act's mandate of opening up local telephone exchange carriers (LEC's) to competition from other possible providers (like the big long-distance providers AT&T, MCI, and Sprint). This is the backdrop against which the case *AT&T Corp. v. Iowa Utilities Board* hits the Court.

At issue in *AT&T Corp.* is whether the Federal Communications Commission lacks the statutory authority to regulate prices that incumbent LEC's may charge in carrying out the Act's mandate to offer interconnection, unbundled access, and resale services to new competitors in local telephone markets, as well as prices for transport and termination of local telecommunications traffic. The authority to regulate these prices has traditionally rested with the individual states. Pursuant to its interpretation of the Act, the FCC issued pricing guidelines in 1996 to ensure that new competitors would get a deeper discount than they were getting in their independent negotiations with the various LEC's.

The LEC's challenged these guidelines in federal court, arguing that the FCC does not have the authority to issue pricing guidelines under the Act or elsewhere. The Eighth Circuit Court of Appeals agreed and held that the Act confers exclusive authority on state utility commissions to determine prices that incumbent LECs may charge for fulfilling their duties under the Act.

The Eighth Circuit also held that the FCC unreasonably interpreted the Act when it issued its "pick and choose" rule. The "pick and choose" rule essentially "allow[s] requesting carriers to 'pick and choose' among individual provisions of other interconnection agreements that have previously been negotiated between an incumbent LEC and other requesting carriers without being required to accept the terms and conditions of their agreeents in their entirety." Iowa Utilities Board v. Federal Communications Commission, § 2B.

Finally, the Eighth Circuit held that FCC's regulations, which prevent the incumbent LEC's from separating their networks and services which they currently combine, contravene the commandment of the Act that these services can be purchased by competing carriers on an unbundled basis.

The Eighth Circuit is the first Court of Appeals to deal with this issue. Thus, the Court seemingly granted certiorari because it wanted to give a definitive answer in a vitally important area of the law. Indeed, the fact that the Eighth Circuit's opinion includes thirty-one pages listing the parties involved in the suit evidences the case's importance. What is more, in addition to the briefs filed by the petitioners (AT&T Corp.) and respondents (State Commission and the National Association of Regulatory Utility Commission), amicus briefs have been filed by organizations such as the United States Telephone Association, BellSouth Corporation, Pacific Bell, Southwestern Bell, The Bank of New York, Citibank N.A., BankAmerica Corporation, First Data Corporation, Ford Motor Company, Honeywell, Inc., Hyatt Corporation, and Microsoft, among others.

Beside the significant pecuniary impact this case will have upon the telecommunications industry, including providers, investors, and consumers, this case may also have important federalism concerns. The central issue presented to the Court is one of preemption. In their brief, the State Commission Respondents framed the issue this way: "Whether the Federal Communications Commission (FCC) may preempt the State public service commissions' discretion to implement key provisions of the Communications Act of 1934, as amended by the Telecommunications Act of 1996.. . ." Regardless of how the Court decides this case, its decision will have a significant impact upon telecommunications law.

SUPREME COURT ACCEPTS PHONE RIVALRY CASE

The Washington Post

January 27, 1998

By Joan Biskupic; Mike Mills, Washington Post Staff Writers

The Supreme Court announced yesterday that it will resolve a dispute over federal regulations intended to bring greater competition, and potentially lower consumer prices, to the nation's $110 billion local telephone markets.

The justices will hear a challenge brought by the Clinton administration and long-distance companies to a lower-court ruling that sharply curtailed the ability of federal regulators to set terms on the prices that competitors must pay to connect to local phone networks.

The Justice Department said the ruling last July by the 8th U.S. Circuit Court of Appeals undercut government efforts to carry out a central goal of the 1996 Telecommunications Act, breaking down monopolies and fostering competition in the local calling industry dominated by the regional Bell companies and GTE Corp.

But the dispute -- actually, eight consolidated cases -- will not be heard by the high court until the fall, and a decision might be at least a year away. That is likely to further delay new competition both in local markets and the long-distance industry.

Although the dispute involves terms for prices and connections in local competition, an overriding question is the Federal Communications Commission's ability to set national policy -- possibly at the expense of individual states -- under the 1996 statute representing the greatest overhaul of telecommunications law this century.

Analysts said the high court's decision could delay not only the pace of local telephone competition but also efforts by the regional Bell companies to enter the long-distance business. The FCC must approve a Bell company's request to offer long-distance, but first agency members must be persuaded that a Bell company sufficiently allows local phone competition.

The 8th Circuit ordered the FCC on Jan. 23 to "cease and desist" from requiring that its pricing guidelines be applied as a condition for approving a Bell company's application to offer long-distance service. The FCC in August had rejected a petition by Ameritech Corp., a Midwest regional phone company, to offer long-distance service in Michigan, in part on grounds that it failed to follow FCC pricing guidelines when setting its connection rates for competitors.

"This is going to slow everybody down," said Stephanie Comfort, a telecommunications analyst with Morgan Stanley Dean Witter. "It will be hard for states to make decisions" on local competition issues with the case pending, she said.

The 1996 law requires existing local telephone companies to sell the use of their equipment and service connections to competitors, so long-distance providers such as MCI Communications Corp. and AT&T Corp. can offer their local service to customers.

The purchasing method primarily at issue involves a competitor's ability to buy access to the entire telephone network at a discount wholesale rate, and then to sell that service under its own brand name. (Because it would be exorbitantly expensive for a company trying to break into the market to build a network from scratch, reselling service is seen as a good, although short term, way to enter the residential calling market.)

But the regional Bells and GTE have been fighting with AT&T, MCI, Sprint Corp. and other potential new local service rivals over network pricing and connection costs. Most discounts negotiated across the country have been in the 15 percent to 25 percent range -- not enough, AT&T and MCI officials have said recently, to make it worthwhile for their companies to pursue a resale approach.

The FCC attempted in 1996 to ensure that new competitors would get a deeper discount by proposing pricing "guidelines" that states should use when arbitrating disputes over interconnection terms between local carriers and upstarts. The guidelines required that the local carriers should only be allowed to charge rivals for the basic cost of providing the service.

The Bells and GTE, which have long argued that the rates should also compensate them for their "historical" investments in the networks, sued the FCC, alleging the commission had overstepped its authority by interfering with local regulators' right to determine prices.

The 8th Circuit in St. Louis agreed, saying Congress did not clearly give the FCC the jurisdiction to enforce national rules related to wholesale prices of local networks. Writing for the court, Judge David R. Hansen said the provision of the law safeguarding states' authority "remains a Louisiana-built fence that is hog tight, horse high, and bull strong, preventing the FCC from intruding on the states' intrastate turf."

The 8th Circuit also threw out several other FCC rules, including one that allowed competitors to purchase separate components of local phone networks at lower prices, while requiring the local phone company to "re-bundle" them into a complete service. The Supreme Court agreed yesterday to also review the issue of rebundling and its pricing standards.

Representing the FCC, Solicitor General Seth P Waxman has argued that Congress gave the commission pricing authority when it required it to implement within six months of the law's enactment requirements relating to prices. The 8th Circuit said that section refers only to a deadline, not particular authority.

"It would be much better for us if we could play using nationwide rules," AT&T President John Zeglis said yesterday after the court announced it would take up the appeal.

But William B. Barfield, BellSouth Corp.'s associate general counsel, said, "Different parts of the country have different realities in terms of the costs to provide service and the federal government should respect the jurisdiction and judgment of the states."

The cases at the Supreme Court are AT&T vs. Iowa Utilities Board; MCI vs. Iowa Utilities Board; FCC vs. Iowa Utilities Board; Association for Local Telecom Services vs. Iowa Utilities Board; Ameritech vs. FCC; GTE Midwest vs. FCC; U.S. West vs. FCC; and Southern New England Telephone vs. FCC.

The consolidated case that the Supreme Court took up yesterday isn't the only legal battle over when competition will come to local markets.

U.S. District Judge Joseph Kendall, in a Dec. 31 ruling, sided with Bell companies SBC Communications Inc. and US West Corp., which contend that the law "punishes" them unconstitutionally by keeping them out of the long-distance market.

The government and long-distance carriers are seeking a motion to postpone that decision, which effectively would allow SBC, US West and Bell Atlantic (which joined the suit on Dec. 30) immediately into the long-distance market.

SUPREME COURT EMBOLDENS FCC, NEW CLECS, BUT INTERCONNECTION RULING UNLIKELY BEFORE 1999

Telecommunications Reports

February 2, 1998

Volume 64; Page 5

The FCC and prospective new local market entrants earned a rare court victory-or at least a partial victory-as the U.S. Supreme Court last week agreed to review a lower court's ruling that overturned key provisions of the FCC's local competition rules adopted in the Common Carrier docket 96-98 "carrier interconnection" proceeding. But unless it expedites consideration, the high court won't hear arguments on the case until the fall and likely won't render a decision until next year. That means the short-term effects of last week's announcement may be limited.

The Supreme Court granted four petitions for certiorari (review) seeking to overturn the U.S. Court of Appeals for the Eighth Circuit's (St. Louis) ruling in Iowa Utilities Board v. FCC (consolidated cases beginning at 96-3321). In that case, the appeals court invalidated various provisions of the FCC's interconnection order, including its rules on the pricing of interconnection, resale, and unbundled network elements.

Those petitions were filed by (1) the U.S. Solicitor General (on behalf of the FCC); (2) a group of interexchange carriers and other potential new local market entrants, led by AT&T Corp., (3) MCI Communications Corp., and (4) a group of competitive local exchange carriers (CLECs).

The high court also granted four related "cross-petitions" from incumbent local exchange carriers (LECs). Justice Sandra Day O'Connor didn't participate in the decisions to grant the petitions.

The primary issues the court will consider are (1) whether the FCC had the authority to issue local exchange competition pricing rules; (2) whether the FCC could require LECs to allow requesting carriers to "pick and choose" individual pieces of interconnection agreements for use in their own pacts; and (3) whether the FCC could require LECs to "rebundle" unbundled network elements for competitors.

In the short term, the telecom landscape remains unchanged. According to the Supreme Court clerk's office, the case will be argued "in the fall" —after the court's next term begins in October. The Eighth Circuit's ruling remains in effect pending final action by the high court. The various petitions [] have been consolidated by the high court and given one hour for oral argument.

The case could be heard earlier, if petitioners requested and the court granted a motion for an expedited briefing schedule. It wasn't clear last week whether any such motions would be filed. One attorney suggested that the court had delayed consideration of the case until the fall, against the advice of the FCC and new local market entrants, because of the logistical complexity of handling four petitions and four cross-petitions.

Without such an expedited briefing plan, a final decision likely won't be issued until next year. That means state regulators will continue to hold exclusive authority over local competition pricing polices-authority that was strengthened further by the Eighth Circuit's recent writ of mandamus barring the FCC from using its pricing policies when reviewing Bell company applications to provide in-region interLATA (local access and transport area) services.

CLECs See Bargaining Chip in Court's Action

Potential new local market entrants think the Supreme Court's action at least will strengthen their bargaining position with incumbent LECs in further interconnection negotiations. The decision to hear the case stemmed the tide of consistent court victories by the LECs, and gave new market entrants "something to hold on to" in their negotiations, one interexchange carrier official said. That could be increasingly important as some interconnection agreements near expiration and must be renegotiated.

The Supreme Court's pending review also could delay state regulatory action to set "permanent" local competition pricing rules. Despite having the FCC's pricing rules overturned on jurisdictional grounds, most state regulators have adopted interim rules that largely mirror the FCC's "forward-looking" pricing polices.

But incumbent LECs, which have argued that such pricing policies don't let them recover all their costs, hope that at least some states will back off "forward-looking" pricing policies once they have the time to conduct full cost studies and investigations.

Many of those cost proceedings are under way, and some industry observers believe the Supreme Court's decision could slow state efforts to set their own pricing rules. States may be afraid to stray from the FCC's rules, which many have relied on as an "interim" policy, because those rules may be reinstated as the "law of the land," one observer said.

FCC Chairman William E. Kennard said he was "very pleased" with the Supreme Court's decision to hear the case. "The American people will reap the benefits of competition much sooner if the Supreme Court upholds the interpretation of the Telecommunications Act urged by the FCC," he said.

Mark Rosenblum, AT&T Corp. vice president- law and public policy, said that in adopting general pricing rules for the states to follow, the FCC "was doing exactly what Congress required and expected under the telecom act." Jonathan B. Sallet, MCI Communications Corp.'s chief policy counsel, said, "We believe that upon careful examination of the issues, the Supreme Court will affirm the positions of the FCC."

Heather Burnett Gold, president of the Association for Local Telecommunications Services, said, "The local competition requirements in the 1996 Act are not limited to intrastate communications services. . . Congress intended to establish a national policy that applies to both interstate and intrastate services, with full jurisdiction to adopt and enforce pricing regulations."

The Supreme Court's decision "emphasizes the need" for the FCC to adopt LCI International, Inc.'s "fast track" plan, said Anne K. Bingaman, president of LCI's local telecom division. That plan would allow the Bells into in-region interLATA markets if they split their wholesale and retail operations. "The Supreme Court will decide some critical legal questions regarding the obligations of the [Bell companies] as required by the Telecommunications Act," Ms. Bingaman said. "But the court cannot cure the underlying conflict of interest between [Bell companies'] wholesale and retail operations that led us to this stalemate."

BellSouth Corp. said, "We have every confidence that the Supreme Court will uphold the Eighth Circuit's rulings." It said it was "pleased that in deciding to review the Eighth Circuit's rulings, the Supreme Court also agreed to review the entire issue of rebundling and the pricing standards associated with it."

COURT TO SPEED REVIEW OF RULING IN LOCAL PHONE COMPETITION CASE

The Wall Street Journal

January 13, 1998

Edward Felsenthal, Staff Reporter of The Wall Street Journal

The Supreme Court will speed its review of an appeal of a ruling that sharply limits federal regulatory efforts to set terms on prices and connections to local phone networks.

The ruling by the U.S. appeals court in St. Louis threw out Federal Communications Commission rules governing how local phone companies must open their networks to rivals. In a harshly written decision, the three-judge panel said the FCC trampled on states' rights to carry out key elements of the 1996 Telecommunications Act, which was intended to deregulate the telephone industry and spur competition in both local and long-distance service. The FCC rules are known as "interconnection" rules because they involve the linking of long-distance carriers to local phone networks.

The lower-court decision was a big victory for local carriers, such as the Bell companies and GTE Corp., which expect the decision to keep the FCC from imposing deep discounts on network connections. But it was strongly opposed by long-distance carriers AT&T Corp. and MCI Communications Corp., which appealed to the Supreme Court. The FCC also filed an appeal, complaining in its brief that the ruling "greatly encumbered the process of opening that $100 billion market to competition."

The justices said they would take up the appeals at their Jan. 23 conference. If they decide to hear the case, arguments would be held this spring and a decision could be released by early summer. If the high court hadn't accelerated the process, the case would have had little chance of being reviewed until the fall.

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97-826 AT&T CORP. v. IOWA UTILITIES BOARD

First ruling below (Iowa Utilities Board v. FCC, CA 8, 120 F.3d 753, 66 LW 1078, as amended on rehearing 10/14/97):

The Federal Communications Commission lacks authority to regulate prices that incumbent local telephone exchange carriers may charge in carrying out 1996 Telecommunications Act's mandate to offer interconnection, unbundled access, and resale services to new competitors in local telephone market, as well as prices for transport and termination of local telecommunications traffic. Instead, the Act confers exclusive authority on state utility commissions to determine prices that incumbent LECs may charge for fulfilling their duties under the Act.

The FCC's 'pick and choose' rule, which permits requesting carriers to 'pick and choose' among individual provisions of interconnection agreements previously negotiated between incumbent LECs and other requesting carriers, without being required to accept terms and conditions of agreements in their entirety, violates the Act.

The FCC rules that prohibit incumbent LEC from separating network elements that it may currently combine, and that require incumbent LECs, rather than requesting carriers, to recombine network elements that are purchased by requesting carriers on unbundled basis, violate 47 USC 251(c)(3), which requires incumbent LEC to provide access to elements of its network only on unbundled, rather than combined, basis.

IOWA UTILITIES BOARD, et al Petitioner,
v.
FEDERAL COMMUNICATIONS COMMISSION; United States of America, et al, Respondents.

United States Court of Appeals,
Eighth Circuit.

Decided July 18, 1997
As Amended on Rehearing Oct. 14, 1997.

HANSEN, Circuit Judge.

When Alexander Graham Bell, after spilling sulfuric acid on himself, first transmitted the words, "Mr. Watson, come here; I want you," across a rudimentary phone line in 1876, he could not have possibly imagined that his invention would explode into the current technologically-advanced, multi- billion dollar telecommunications industry. Nor could he have foreseen the amount of legislation, regulation, and litigation that his invention would generate.

I. Background

One hundred twenty years after Bell's discovery, Congress passed the Telecommunications Act of 1996 (the Act), which was designed, in part, to erode the monopolistic nature of the local telephone service industry by obligating the current providers of local phone service (known as "incumbent local exchange carriers" or "incumbent LECs") to facilitate the entry of competing companies into local telephone service markets across the country. Specifically, the Act forces an incumbent LEC (1) to permit a requesting new entrant in the incumbent LEC's local market to interconnect with the incumbent LEC's existing local network and thereby use the incumbent LEC's network to compete with the incumbent LEC in providing telephone services (interconnection); (2) to provide its competing telecommunications carriers with access to individual elements of the incumbent LEC's own network on an unbundled basis (unbundled access); and (3) to sell to its competing telecommunications carriers, at wholesale rates, any telecommunications service that the incumbent LEC provides to its customers at retail rates, in order to allow the competing carriers to resell the services (resale). A company seeking to enter the local telephone service market may request an incumbent LEC to provide it with any one or any combination of these three services. Through these three duties, and the Act in general, Congress sought "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies." Telecommunications Act of 1996.

The Act also establishes a system of negotiations and arbitrations in order to facilitate voluntary agreements between incumbent LECs and competing carriers to implement the Act's substantive requirements.

When a competing carrier asks an incumbent LEC to provide interconnection, unbundled access, or resale, both the incumbent LEC and the competing carrier have a duty to negotiate in good faith the terms and conditions of an agreement that accomplishes the Act's goals. If the parties fail to reach an agreement through voluntary negotiation, either party may petition the respective state utility commission to arbitrate and resolve any open issues. The final agreement, whether accomplished through negotiation or arbitration, must be approved by the state commission.

Several sections of the Act also direct the FCC to participate in the Act's implementation. On August 8, 1996, the FCC issued its First Report and Order. This document contains the Agency's findings and rules pertaining to the local competition provisions of the Act.

Soon after the FCC released its First Report and Order, many petitioners, consisting largely of incumbent LECs and state utility commissions from across the country, filed motions to stay the First Report and Order in whole or in part. Although most of the petitioners requested the court to stay the entire First Report and Order, their specific attacks focused primarily on the FCC's rules regarding the prices that the incumbent LECs could charge their new competitors for interconnection, unbundled access, and resale, as well as on the rules regarding the prices for the transport and termination of local telecommunications traffic. The petitioners argued that the FCC exceeded its jurisdiction in establishing prices for what is essentially local intrastate telecommunications service and that the pricing rules violate the terms of the Act. After the cases were consolidated in this circuit, we decided to stay temporarily, pending our final review, the operation and effect of the pricing provisions and the "pick and choose" rule found in the First Report and Order.

In their main briefs and oral arguments, the petitioners now renew and refine their attacks against the Agency's pricing rules, and they also widen the scope of their challenge to the First Report and Order and assail additional FCC rules, particularly the agency's non-price regulations pertaining to the incumbent LECs' unbundling obligations. Our review of the extensive arguments in this case has confirmed our initial belief that the FCC exceeded its jurisdiction in promulgating the pricing rules regarding local telephone service. We also remain convinced that the FCC's "pick and choose" rule would frustrate the Act's design to make privately negotiated agreements the preferred route to local telephone competition. Our conclusions regarding the additional challenged policies and rules in the FCC's First Report and Order are contained throughout the remainder of this opinion.

II. Analysis

United States Courts of Appeals have been granted exclusive statutory jurisdiction to review the FCC's final orders. We must defer to administrative agency interpretations only if they are consistent with the plain meaning of a statute or are reasonable constructions of ambiguous statutes. Thus, we are empowered to overturn an agency interpretation when the interpretation conflicts with the plain meaning of a statute, when the interpretation is an unreasonable construction of an ambiguous statute, or when an agency acted arbitrarily or capriciously in adopting its interpretation. In this case, we emphasize at the beginning that our review does not encompass any determination regarding the wisdom or prudence of the policies Congress set forth in the Act, those considerations being the Constitutionally-assigned prerogatives of the Legislative Branch of our national government.

A. The FCC's Pricing Rules

All of the petitioners vehemently challenge the FCC's pricing rules. Their primary target is the FCC's mandate that state commissions employ the "total element long-run incremental cost" (TELRIC) method to calculate the costs that an incumbent LEC incurs in making its facilities available to competitors. After applying the TELRIC method and arriving at a cost figure, the state commissions, according to the FCC's rules, must then determine the price that an incumbent LEC may charge its competitors, based on the TELRIC-driven cost figure. The petitioners also challenge the FCC's proxy rates, which, under the provisions of the First Report and Order, are to be used by the state commissions if they do not use the TELRIC method to calculate costs. The incumbent LECs assert that these proxy rates also do not accurately reflect their costs and are artificially low. The petitioners also challenge several other FCC regulations pertaining to the prices that the incumbent LECs are permitted to charge for fulfilling their new duties under the Act.

The petitioners' first line of attack against the FCC's pricing rules is their claim that the FCC has no jurisdiction to promulgate these rules. They argue that the Act plainly directs state commissions, not the FCC, to set the prices that an incumbent LEC may charge an incoming competitor for interconnection, unbundled access, and resale, and also to determine the prices for the transport and termination of calls, when the state commissions conduct arbitrations under the Act. The petitioners also assert that section 2(b) of the Communications Act of 1934, denies the FCC jurisdiction to determine these rates because the rates involve local intrastate communications service. The FCC and its supporting intervenors, however, contend that the Act clearly grants the FCC the power to issue pricing rules regarding local telephone service and that section 2(b) does not prevent the Commission from having jurisdiction to issue the pricing rules at issue here. They do not claim that the FCC's pricing authority is exclusive; instead, they argue that the Act establishes shared or parallel jurisdiction between the states and the FCC under which the FCC is to issue general rules governing the rate-making procedures, while the state commissions are left to establish the actual prices by applying the FCC's mandates. After carefully reading the language of the Act and fully considering and reviewing all of the arguments, we conclude that the FCC exceeded its jurisdiction in promulgating the pricing rules.

1. The Plain Language of Sections 251 and 252

The petitioners point to the language contained in subsections 252(c)(2) and 252(d) to support their claim that the Act directly grants the state commissions the authority to determine the rates involved in implementing the local competition provisions of the Act. Indeed, subsection 252(c)(2) requires a state commission to "establish any rates for interconnection, services, or network elements according to subsection (d) of this section." Meanwhile, subsection 252(d), entitled "Pricing standards," lists the requirements that the state commissions must meet in making their determinations of the appropriate rates for interconnection, unbundled access, resale, and transport and termination of traffic. These statutory provisions undeniably authorize the state commissions to determine the prices an incumbent LEC may charge for fulfilling its duties under the Act.

The FCC and its supporters do not contest the fact that state commissions have the responsibility to set prices under the Act. Instead, they claim that subsection 251(d)(1) gives the FCC parallel authority to issue regulations governing the rate-making methods by which state commissions establish the prices that incumbent LECs may charge their new competitors for connecting with and piggy-backing on the LECs' networks. They claim that subsection 252(c)(1) requires the state commissions to follow these FCC mandates when they determine the actual prices. The FCC also believes that several general rulemaking provisions of the Communications Act of 1934, namely subsections 154(i), 201(b), and 303(r), provide it with additional authority to promulgate its pricing rules.

Despite the FCC's contentions, we are not convinced that these provisions supply the FCC with the authority to issue regulations governing the pricing of the local intrastate telecommunication services that the incumbent LECs are now legally obligated to provide to their new competitors. Subsection 251(d)(1) provides that "[w]ithin 6 months after February 8, 1996, the Commission shall complete all actions necessary to establish regulations to implement the requirements of this section." The FCC believes this provision supplies the Agency with overarching plenary authority to regulate all aspects of section 251 and reasons that because subsection 251(c) requires rates for interconnection, unbundled access, and collocation to be "just, reasonable, and nondiscriminatory," the FCC has the power to regulate these rates and any other rates mentioned in section 251. We are not persuaded by the FCC's interpretation. We believe that subsection 251(d)(1) operates primarily as a time constraint, directing the Commission to complete expeditiously its rulemaking regarding only the areas in section 251 where Congress expressly called for the FCC's involvement. Nowhere in section 251 is the FCC authorized specifically to issue rules governing the rates for interconnection, unbundled access, and resale, and the transport and termination of telecommunications traffic.

The Commission's reliance on general rulemaking provisions that predate the Telecommunications Act of 1996 also fares no better. While subsection 201(b) does grant the FCC jurisdiction over charges regarding communications services, those services are expressly limited to interstate or foreign communications services by subsection 201(a). Consequently, subsection 201(b) does not provide the Commission with the authority to regulate the rates of local intrastate phone service and neither do subsections 154(i) or 303(r). Both of these subsections merely supply the FCC with ancillary authority to issue regulations that may be necessary to fulfill its primary directives contained elsewhere in the statute. Neither subsection confers additional substantive authority on the FCC. Thus, we conclude that none of the statutory provisions relied on by the FCC supply it with jurisdiction over the pricing of local telephone service.

The absence of any direct FCC pricing authority over local telephone service is fatal to the Agency's theory that the Act requires the state commissions to share such local pricing authority with the FCC. While subsection 252(c)(1) does require the state commissions to ensure that their resolutions of arbitrated disputes comply with both section 251 and with the FCC's regulations made pursuant to section 251, as explained above, no provision in section 251 authorizes the FCC to regulate the rates of local phone service. Moreover, the absence of any reference whatsoever to the FCC in the sections of the Act that directly authorize the state commissions to establish prices confirms to us that Congress did not envision the FCC's participation in determining the prices that the incumbent LECs will be able to charge for opening their networks to new entrants. Subsection 252(c)(2) commands state commissions to "establish any rates for interconnection, services, or network elements" and it requires them to follow only the standards in subsection (d). In turn, subsection 252(d) refers exclusively to the determinations by state commissions of the just and reasonable rates, and it provides statutory standards for the state commissions to follow when setting the rates, thus negating any need for additional FCC-mandated rate-making standards or guidelines.

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2. Section 2(b) and the Impossibility Exception

Any ambiguity regarding the FCC's vacuum of authority over local telecommunications pricing under the Act is resolved by the operation of section 2(b) of the Communications Act of 1934. Section 2(b) provides that "nothing in this chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to ... charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service." We believe that the prices that incumbent local exchange carriers may charge their new competitors for interconnection, unbundled access, and resale— the services and facilities that will enable the competitors to provide competing local telecommunications service--as well as the rates for the transport and termination of telecommunication traffic qualify as "charges ... for or in connection with intrastate communications service." In Louisiana Pub. Serv. Comm'n v. FCC, the Supreme Court explained that section 2(b) "fences off" intrastate matters from FCC regulation. The FCC and its supporting intervenors attempt to slip through the fence by arguing that this case qualifies as an exception to the operation of section 2(b).

The Supreme Court emphasized that section 2(b) constitutes an explicit congressional denial of power to the FCC and suggested that Congress could override section 2(b)'s command only by unambiguously granting the FCC authority over intrastate telecommunications matters or by directly modifying section 2(b). The only other gate through the 2(b) fence is the "impossibility" exception, which has evolved out of the Court's opinion in Louisiana. This quite narrow exception provides that the FCC may preempt state regulation of intrastate telecommunications matters only when (1) it is impossible to separate the interstate and intrastate components of the FCC regulation and (2) the state regulation would negate the FCC's lawful authority over interstate communication. The FCC and its supporting intervenors assert that the terms of the Act supply the Commission with a direct grant of intrastate pricing authority sufficient to overcome the operation of section 2(b). Alternatively, they argue that the impossibility exception removes section 2(b) as a barrier to the FCC's pricing rules. We are not convinced by the respondents' arguments here, and we believe that the 1996 Act, when coupled with section 2(b), mandates that the states have the exclusive authority to establish the prices regarding the local competition provisions of the Act.

As explained earlier, the FCC argues that Congress unambiguously granted it intrastate pricing authority through the relationship between subsections 251(d)(1) and 251(c). We have now rejected this interpretation as being inconsistent with the plain meaning of the Act, and we have concluded exactly the opposite— that the Act directly and straightforwardly assigns to the states the authority to set the prices regarding the local competition provisions of the Act in subsections 252(c)(2) and 252(d). Consequently, the FCC's interpretation of the Act does not demonstrate an unambiguous grant of intrastate authority to the FCC required either to jump over or pass through section 2(b)'s fence.

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Faced with the absence of such an unambiguous grant of intrastate pricing authority to the FCC, the Commission and its supporting intervenors resort to arguing that section 2(b) is easily overcome whenever a federal statute's terms unambiguously apply to intrastate telecommunication matters, because they believe the FCC has plenary authority to implement all such federal statutory requirements. They believe that the Louisiana decision supports their proposition that section 2(b) prevents only the FCC's ancillary jurisdiction from extending into intrastate areas, but that it does not limit the federal Commission's primary jurisdiction, which, they argue, presumably extends as far as the reach of a federal communications statute. We do not believe that section 2(b) is limited in this manner, nor do we think the Supreme Court's decision in Louisiana stands for such a far-reaching proposition.

Although the Court's decision in Louisiana focused on whether section 220(b) of the Communications Act of 1934 itself applied to intrastate telecommunication matters, it did so only because section 220 undeniably directed the FCC to administer the depreciation calculations required by the statute. In other words, we believe that the Louisiana decision indicates that in order to qualify for the "unambiguous" exception to section 2(b), a statute must both unambiguously apply to intrastate telecommunication matters and unambiguously direct the FCC to implement its provisions. In Louisiana, section 220(b) clearly passed the second prong but failed to meet the first prong. In the present case, we have the opposite situation: the pricing provisions of sections 251 and 252 clearly apply to intrastate telecommunication service, but they do not unambiguously call for the FCC's participation in setting the rates. To the contrary, the Act specifically calls for the state commissions, not the FCC, to determine the rates for interconnection, unbundled access, resale, and transport and termination of traffic. Consequently, we reject the FCC's contention that its rulemaking authority is coextensive with the reach of every provision of a federal statute involving telecommunications. Section 2(b) is not a limit on Congress's ability to legislate in the area of intrastate telecommunications; it is, however, a limit on the FCC's ability to regulate in the area of intrastate telecommunications. Thus, a federal statute's mere application to intrastate telecommunication matters is insufficient to confer intrastate jurisdiction upon the FCC; the statute must also directly grant the FCC such intrastate authority in order to overcome the operation of section 2(b).

The respondents' last chance to breach the section 2(b) fence lies with the "impossibility" exception to section 2(b). As mentioned above, the impossibility exception allows an FCC regulation to preempt a state regulation when it is impossible to separate the interstate and intrastate components of the asserted FCC regulation and the state regulation would negate the FCC's authority over interstate communication.

We believe that this exception does not apply to the circumstances of this case and thus does not give the FCC the authority to dictate pricing regulations governing the local competition provisions of the Act. First, telecommunication rate-making traditionally has been capable of being separated into its interstate and intrastate components. In fact, other statutory provisions predating the 1996 Act require such separation to occur and command a joint board of federal and state regulators to execute the separations process.

Second, and more importantly, the FCC has not demonstrated that the states' authority to establish the rates in connection with the local competition provisions of the Act would negate any valid authority the Commission has over interstate communications or impede any of its interstate regulatory goals. The impossibility exception is premised on a preemption analysis, and "[t]he critical question in any pre-emption analysis is always whether Congress intended that federal regulation supersede state law." Consequently, our inquiry returns to the language of the Act. As illustrated above, the terms of the Act clearly indicate that Congress did not intend for the FCC to issue any pricing rules, let alone preempt state pricing rules regarding the local competition provisions of the Act. Because the Act clearly grants the states the authority to set the rates for interconnection, unbundled access, resale, and transport and termination of traffic, the FCC has no valid pricing authority over these areas of new localized competition for the states to negate. "An agency may not act at all, let alone preempt state authority, in an area where Congress has explicitly denied it jurisdiction." NARUC, 800 F.2d at 428. The fact that there are specific statutory provisions that expressly indicate that the states have the authority to determine the rates for these local telecommunications services distinguishes this case from all of the cases that invoke the impossibility exception to allow the FCC to preempt state regulations. Because none of the courts invoking the impossibility exception had the assistance of a federal statute that specifically determined who had jurisdiction over the telecommunications area at issue, those courts had to resort to analyzing the interstate/intrastate character of the telecommunications services, as required by sections 151 and 152 of the Communications Act, in order to make such a determination. Here, however, subsections 252(c)(2) and 252(d) clearly assign jurisdiction over the rates for the local competition provisions of the Act to the state commissions, thus avoiding the need to analyze the interstate/intrastate character of these services.

Even a traditional analysis of the interstate/intrastate quality of the local competition provisions of the Act reveals that these functions (i.e., interconnection, unbundled access, resale, and transport and termination of traffic) are fundamentally intrastate in character; thus the FCC's traditional jurisdiction over interstate communications will not be negated by the states' regulation of the rates for these services. The Act primarily focuses on facilitating competition in local telephone service markets by imposing several new duties (interconnection, unbundled access, and resale--the local competition provisions) on incumbent local exchange carriers. Allowing competing telecommunications carriers to have direct access to an incumbent local exchange carrier's established network in order to enable the new carrier to provide competing general local telephone services is an intrastate activity even though the local network thus invaded is sometimes used to originate or complete interstate calls. Contrary to the respondents' contentions, section 2(b) does not prevent the FCC from having jurisdiction only over matters that are purely intrastate. The Supreme Court rejected such a position in its decision in Louisiana.

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Moreover, we reiterate that the text of section 2(b) itself indicates that the FCC does not have jurisdiction over matters "in connection with" intrastate service. Consequently, the fact that the local competition provisions of the Act may have a tangential impact on interstate services is not sufficient to overcome the operation of section 2(b) and does not alter the fundamentally intrastate nature of the Act's local competition provisions. We note that the Act's clear grant of rate-making authority to the state commissions is entirely consistent with the states' historical role in telecommunications regulation, given the intrastate quality of the local competition provisions of the Act. Because the impossibility exception does not apply in this case, section 2(b) remains a Louisiana built fence that is hog tight, horse high, and bull strong, preventing the FCC from intruding on the states' intrastate turf. Having concluded that the FCC lacks jurisdiction to issue the pricing rules, we vacate the FCC's pricing rules on that ground alone and choose not to review these rules on their merits.

B. The FCC's "Pick and Choose" Rule

The petitioners next assert that the FCC's so-called "pick and choose" rule, is an unreasonable interpretation of subsection 252(i). Subsection 252(i) provides:

> A local exchange carrier shall make available any interconnection, service, or network element provided under an agreement approved under this section to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement.

With its "pick and choose" rule, the FCC interpreted this section of the Act to allow requesting carriers to "pick and choose" among individual provisions of other interconnection agreements that have previously been negotiated between an incumbent LEC and other requesting carriers without being required to accept the terms and conditions of the agreements in their entirety. The petitioners argue that such a rule is unduly burdensome on incumbent LECs and that it will thwart negotiations because it allows a later entrant to select the favorable terms of a prior approved agreement without being bound by the corresponding tradeoffs that were made in exchange for the favorable provisions sought by the new entrant. The petitioners assert that subsection 252(i) allows requesting carriers the option to select the terms and conditions of prior agreements only as a whole, not in a piecemeal fashion.

Contrary to the FCC's belief that subsection 252(i) plainly mandates its approach, we think that the language of subsection 252(i) in isolation does not clearly reveal Congress's intent on this issue. Consequently, we "must look to the structure and language of the statute as a whole" to determine if the FCC's interpretation of this ambiguous provision is a reasonable one. Our analysis leads us to conclude that the FCC's rule conflicts with the Act's design to promote negotiated binding agreements.

The structure of the Act reveals the Congress's preference for voluntarily negotiated interconnection agreements between incumbent LECs and their competitors over arbitrated agreements. Voluntary negotiation is the first method listed under section 252, and the Act indicates that the parties may begin negotiations as soon as an entrant submits a request to an incumbent LEC. Meanwhile, the parties' ability to request the arbitration of an agreement is confined to the period from the 135th to the 160th day after the requesting carrier submits its request to the incumbent LEC. These provisions reveal that the Act establishes a preference for incumbent LECs and requesting carriers to reach agreements independently and that the Act establishes state-run arbitrations to act as a backstop or impasse-resolving mechanism for failed negotiations.

The FCC's "pick and choose" rule, however, would thwart the negotiation process and preclude the attainment of binding negotiated agreements. During a negotiation, an incumbent LEC would be very reluctant to make a concession on one term in exchange for a benefit on another term when faced with the prospect that a subsequent competing carrier will be able to receive the concession without having to grant the incumbent the corresponding benefit. In this manner, the FCC's rule would discourage the give-and-take process that is essential to successful negotiations. Moreover, negotiated agreements will, in reality, not be binding, because, according to the FCC, an entrant who is an original party to an agreement may unilaterally incorporate more advantageous provisions contained in subsequent agreements negotiated by other carriers. This result conflicts with the Act's requirement that agreements be "binding," and is an additional impediment to subsequent negotiations, because an incumbent LEC will be even more hesitant to make concessions in subsequent negotiations when it knows that such concessions would be available to all of the competing carriers with which it previously had agreements.

In response to these arguments, the FCC points to the waiver provision of the "pick and choose" rule, and asserts that incumbent LECs will not be so deterred from making concessions because the waiver provision prevents an entrant from adopting the provisions of a previous agreement when an incumbent LEC can persuade a state commission that such adoption would be economically burdensome or technically infeasible. We do not believe, however, that the incumbent LECs can take solace in the waiver provision. With the burden of proof placed on the incumbent LECs, receiving an actual waiver would be an uphill battle that would likely be a rare occurrence. We remain convinced that even in light of the possibility that an exemption could be granted, the incumbent LECs' ability and willingness to negotiate would be severely stifled by the FCC's "pick and choose" rule.

D. FCC Authority Under Section 208

In the discussion section of its First Report and Order, the FCC claims that its general authority to hear complaints under 47 U.S.C. § 208 empowers it to review agreements approved by state commissions under the Act and to enforce the terms of such agreements as well as the actual provisions contained in sections 251 and 252. The Commission's perception of its authority under section 208 is untenable, however, in light of the language and structure of the Act and by the operation of section 2(b).

As an initial matter, the FCC argues that the issue of its complaint authority under section 208 is not ripe for review, because it did not promulgate an actual rule regarding this subject and it would be difficult to determine the actual boundaries of state and federal authority in an abstract setting. Despite the FCC's contentions, we believe that the issue is ripe for review. Congress has granted the courts of appeals jurisdiction to review all final orders of the FCC under 28 U.S.C. § 2342(1) and 47 U.S.C. § 402(a). The fact that the FCC asserts its section 208 authority in the commentary section of its First Report and Order as opposed to stating its position as a rule is immaterial to our determination of ripeness. Instead, we focus on whether the agency's action is final, which requires us to determine if "the agency has completed its decisionmaking process." In paragraphs 127 and 128, the FCC definitively states that its authority to hear complaints under section 208 extends to disputes over the implementation of the requirements of sections 251 and 252. This statement and the contrary conclusions of several of the petitioners present us with conflicting interpretations of the statutory scheme's allocation of jurisdiction. This is a legal question that is ripe for our review.

The language and design of the Act indicate that the FCC's authority under section 208 does not enable the Commission to review state commission determinations or to enforce the terms of interconnection agreements under the Act. Instead, subsection 252(e)(6) directly provides for federal district court review of state commission determinations when parties wish to challenge such determinations. The FCC responds by arguing that federal district court review under subsection 252(e)(6) is not the exclusive remedy for a party aggrieved by state commission decisions under the Act and that such a party has the option of also filing a section 208 complaint with the FCC. Although the terms of subsection 252(e)(6) do not explicitly state that federal district court review is a party's "exclusive" remedy, courts traditionally presume that such special statutory review procedures are intended to be the exclusive means of review. We afford subsection 252(e)(6) our traditional presumption and conclude that it is the exclusive means to attain review of state commission determinations under the Act. Additionally, the complete absence of any reference to section 208 in the Act bolsters our conclusion that Congress did not intend to allow the FCC to review the decisions of state commissions.

We also believe that state commissions retain the primary authority to enforce the substantive terms of the agreements made pursuant to sections 251 and 252. Subsection

252(e)(1) of the Act explicitly requires all agreements under the Act to be submitted for state commission approval. We believe that the state commissions' plenary authority to accept or reject these agreements necessarily carries with it the authority to enforce the provisions of agreements that the state commissions have approved. Moreover, the state commissions' enforcement power extends to ensuring that parties comply with the regulations that the FCC is specifically authorized to issue under the Act, because the Act empowers state commissions to reject arbitrated agreements on the basis that they violate the FCC's regulations. Again, we believe that the power to approve or reject these agreements based on the FCC's requirements includes the power to enforce those requirements. Significantly, nothing in the Act even suggests that the FCC has the authority to enforce the terms of negotiated or arbitrated agreements or the general provisions of sections 251 and 252. The only grant of any review or enforcement authority to the FCC is contained in subsection 252(e)(5), and this provision authorizes the FCC to act only if a state commission fails to fulfill its duties under the Act. The FCC's expansive view of its authority under section 208 is thus contradicted by the language, structure, and design of the Act.

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F. § 251(d)(3) and State Compliance With FCC Rules

In the commentary portion of the First Report and Order, the FCC asserts that "the Commission's regulations under section 251 are binding on the states, even with respect to intrastate matters." With this statement, as well as several others, the FCC purports to preempt any state policy that conflicts with an FCC regulation promulgated pursuant to section 251. The petitioners argue that the FCC's position is untenable in light of subsection 251(d)(3) and the structure of the Act. We agree.

Subsection 251(d)(3), entitled "Preservation of State access regulations," provides the following:

> In prescribing and enforcing regulations to implement the requirements of this section, the Commission shall not preclude the enforcement of any regulation, order, or policy of a State commission that--
> (A) establishes access and interconnection obligations of local exchange carriers;
> (B) is consistent with the requirements of this section; and
> (C) does not substantially prevent implementation of the requirements of this section and the purposes of this part.

Initially, we note that the FCC's authority to prescribe and enforce regulations to implement the requirements of section 251 is confined to the six areas in this section where Congress expressly called for the FCC's participation. Subsection 251(d)(3) further constrains the FCC's authority. Even when the FCC issues rules pursuant to its valid rulemaking authority under section 251, subsection 251(d)(3) prevents the FCC from preempting a state commission order that establishes access and interconnection obligations so long as the state commission order (i) is consistent with the requirements of section 251 and (ii) does not substantially prevent the implementation of the requirements of section 251 and the purposes of Part II, which consists of sections 251 through 261. This provision does not require all state commission orders to be consistent with all of the FCC's regulations promulgated under section 251. The FCC attempts to read such a requirement into this subsection by asserting that a state policy that is inconsistent with an FCC regulation is necessarily also inconsistent with the terms of section 251 and substantially prevents the implementation of section 251. The FCC's conflation of the requirements of section 251 with its own regulations is unwarranted and illogical. It is entirely possible for a state interconnection or access regulation, order, or policy to vary from a specific FCC regulation and yet be consistent with the overarching terms of section 251 and not substantially prevent the implementation of section 251 or Part II. In this circumstance, subsection 251(d)(3) would prevent the FCC from preempting such a state rule, even though it differed from an FCC regulation.

The FCC asserts that other provisions of the Act justify its belief that state interconnection and access rules must be consistent with the Commission's regulations under section 251. The FCC claims that section 253 and subsections 252(c)(1) and 261(c) indicate that state commissions are bound by the FCC's regulations. While subsection 253(d) does empower the Commission to preempt some state policies, those state policies are limited to those that violate the terms of subsections 253(a) or 253(b). Neither subsection 253(a) nor 253(b) requires state policies to conform to any Commission regulations; 253(a) merely requires state policies not to prohibit "the ability of any entity to provide any interstate or intrastate telecommunications service," and 253(b) allows states to impose additional telecommunications requirements as long as they are competitively neutral and consistent with the universal service obligations of section 254. Meanwhile, subsection 252(c)(1) does require state commissions to ensure that arbitrated agreements comply with the Commission's regulations made pursuant to section 251, but by its very terms this provision confines the states only when they are fulfilling their roles as arbitrators of agreements pursuant to the federal Telecommunications Act of 1996. This provision does not apply to state statutes or regulations that are independent from the Telecommunications Act of 1996. Many states enacted legislation designed to open up local telephone markets to competition prior to the 1996 federal Act, and subsection 251(d)(3) was designed to preserve such work of the states.

Finally, the FCC claims that subsection 261(c) provides support for its conclusion that the state regulations must be consistent with the Commission's rules on interconnection and access promulgated under section 251. While subsection 261(c) does require some state rules to be consistent with "the Commission's regulations to implement this part," we believe that this provision applies only to those additional state requirements that are not promulgated pursuant to section 251 or any other section in Part II of the Act. Because subsection 251(d)(3) specifically governs state rules that "establish[ ] access and interconnection obligations of local exchange carriers," which is the heart of the subject matter of section 251, and subsection 261(b) governs state rules that are issued to "fulfill[ ] the requirements of this part," we conclude that the additional state requirements referenced in subsection 261(c) refer to separate state rules that do not directly pertain to the matters found in sections 251 through 261 (Part II) of the Act. Consequently, this provision does not apply to the state rules pertaining to interconnection and access obligations that the Commission believes it has the power to preempt under its section 251 authority, and thus, it does not support the FCC's view that such state rules must conform to the Commission's regulations.

The FCC's blanket statement that state rules must be consistent with the Commission's regulations promulgated pursuant to section 251 is not supportable in light of subsection 251(d)(3). With subsection 251(d)(3), Congress intended to preserve the states' traditional authority to regulate local telephone markets and meant to shield state access and interconnection orders from FCC preemption so long as the state rules are consistent with the requirements of section 251 and do not substantially prevent the implementation of section 251 or the purposes of Part II. We conclude that the FCC's belief that merely an inconsistency between a state rule and a Commission regulation under section 251 is sufficient for the FCC to preempt the state rule, is an unreasonable interpretation of the statute in light of subsection 251(d)(3) and the structure of the Act..

G. The FCC's Unbundling Rules

The FCC issued many rules purporting to implement the incumbent LECs' duties to provide unbundled access to the incumbent LECs' network under subsection 251(c)(3). The petitioners challenge these rules on multiple grounds ranging from assertions that particular rules violate the terms of the Act to claims that these rules altogether effect an unconstitutional taking of the incumbent LECs' property. We address these challenges to the FCC's unbundling rules one by one.

1. The Unbundling Rules in Light of the Terms of the Act

a. OSS, Operator Services, and Vertical Switching Features

Many of the petitioners claim that the FCC's decision to require incumbent LECs to provide competitors with unbundled access to operational support systems (OSS), operator services and directory assistance, and vertical switching features such as caller I.D., call forwarding, and call waiting, unduly expands the incumbent LECs' unbundling obligations beyond the statutory requirements. After reviewing the relevant provisions of the Act, we believe that the FCC reasonably concluded that these features qualify as network elements that are subject to the unbundling requirements of the Act.

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b. Definition of "Technically Feasible"- Rule 51.5

Subsections 251(c)(2) and 251(c)(3) direct interconnection and unbundled access to occur "at any technically feasible point." In its definition of "technically feasible," the FCC states, "A determination of technical feasibility does not include consideration of economic, accounting, billing, space, or site concerns...." One petitioner claims that the FCC's exclusion of economic concerns from such determinations is unreasonable. The petitioner fears that ignoring the economic costs of points of interconnection or unbundled access could result in incumbent LECs having to incur unwarranted expenses in order to meet the demands of competing carriers seeking access to their networks. We, however, believe that the FCC's definition of "technically feasible" is reasonable and entitled to deference. Although economic concerns are not to be considered in determining if a point of interconnection or unbundled access is technically feasible, the costs of such interconnection or unbundled access will be taken into account when determining the just and reasonable rates, terms, and conditions for these services. Under the Act, an incumbent LEC will recoup the costs involved in providing interconnection and unbundled access from the competing carriers making these requests. Consequently, we conclude that the FCC's definition of "technically feasible" will not unduly burden the incumbent LECs, and we uphold the Commission's definition.

c. Technically Feasible and the Presumption for Unbundling

Many petitioners also challenge the FCC's general standards that it proposes be used in determining what network elements must be unbundled. One such standard is the FCC's belief that incumbent LECs presumably must provide unbundled access to "all network elements for which it is technically feasible to provide access on an unbundled basis." A finding that it is technically feasible to unbundle a particular element creates a presumption that the element must be unbundled according to the FCC. Although we just upheld the Commission's definition of the term "technically feasible," we reject the Commission's use of this term to determine what elements must be unbundled. As mentioned above, subsection 251(c)(3) places a duty on incumbent LECs to provide "access to network elements on an unbundled basis at any technically feasible point." By its very terms, this provision only indicates where unbundled access may occur, not which elements must be unbundled. Subsection 251(d)(2) establishes the standards to determine which elements must be unbundled, and this subsection makes no reference to technical feasibility. We think that the FCC's interpretation that an element for which unbundling is technically feasible must presumably be unbundled is contrary to the plain meaning of the Act and cannot stand.

d. The "Necessary" and "Impair" Standards

While subsection 251(d)(2) does not mention technical feasibility as a relevant factor in determining what network elements should be unbundled, it does require the Commission to consider whether access to a network element that is proprietary in nature is "necessary" and whether the failure to provide access to a network element would "impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer." 47 U.S.C.A. § 251(d)(2)(A), (B). The petitioners argue that the FCC's view of these standards is so broad that it essentially reads these requirements out of the statute. We disagree and believe the Commission reasonably interpreted these standards.

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e. Superior Quality-Rules 51.305(a)(4), 51.311(c)

Another source of disagreement between the petitioners and the FCC arises over the Agency's decision to require incumbent LECs to provide interconnection, unbundled network elements, and access to such elements at levels of quality that are superior to those levels at which the incumbent LECs provide these services to themselves, if requested to do so by competing carriers. Here, we believe that the FCC violated the plain terms of the Act when it issued these rules.

Subsection 251(c)(2)(C) requires incumbent LECs to provide interconnection "that is at least equal in quality to that provided by the local exchange carrier to itself...." Plainly, the Act does not require incumbent LECs to provide its competitors with superior quality interconnection. Likewise, subsection 251(c)(3) does not mandate that requesting carriers receive superior quality access to network elements upon demand. The FCC argues that the terms "at least equal in quality" permit the provision of superior quality interconnection; it believes that the nondiscrimination requirements in both subsections 251(c)(2) and 251(c)(3) require incumbent LECs to provide superior quality interconnection and network elements when requested; and it asserts that the provision of superior quality interconnection and network elements will not unduly burden the incumbent LECs, because the requesting carriers will have to pay for these services. We are not convinced by the Commission's justifications for these rules.

While the phrase "at least equal in quality" leaves open the possibility that incumbent LECs may agree to provide interconnection that is superior in quality when the parties are negotiating agreements under the Act, this phrase mandates only that the quality be equal— not superior. In other words, it establishes a floor below which the quality of the interconnection may not go. Because the Commission's rule requires superior quality interconnection when requested, the rule is not supported by the Act's language. We also agree with the petitioners' view that subsection 251(c)(3) implicitly requires unbundled access only to an incumbent LEC's existing network--not to a yet unbuilt superior one. Additionally, the nondiscrimination requirements contained in these subsections of the Act do not justify these FCC rules. The fact that interconnection and unbundled access must be provided on rates, terms, and conditions that are nondiscriminatory merely prevents an incumbent LEC from arbitrarily treating some of its competing carriers differently than others; it does not mandate that incumbent LECs cater to every desire of every requesting carrier. Finally, the fact that incumbent LECs may be compensated for the additional cost involved in providing superior quality interconnection and unbundled access does not alter the plain meaning of the statute, which, as we have shown, does not impose such a burden on the incumbent LECs. Therefore, we conclude that sections 51.305(a)(4) and 51.311(c) cannot stand in light of the plain terms of the Act.

f. Combination of Network Elements

We also believe that the FCC's rule requiring incumbent LECs, rather than the requesting carriers, to recombine network elements that are purchased by the requesting carriers on an unbundled basis, cannot be squared with the terms of subsection 251(c)(3). The last sentence of subsection 251(c)(3) reads, "An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service." This sentence unambiguously indicates that requesting carriers will combine the unbundled elements themselves. While the Act requires incumbent LECs to provide elements in a manner that enables the competing carriers to combine them, unlike the Commission, we do not believe that this language can be read to levy a duty on the incumbent LECs to do the actual combining of elements. The FCC and its supporting intervenors argue that because the incumbent LECs maintain control over their networks it is necessary to force them to combine the network elements, and they believe that the incumbent LECs would prefer to do the combining themselves to prevent the competing carriers from interfering with their networks. Despite the Commission's arguments, the plain meaning of the Act indicates that the requesting carriers will combine the unbundled elements themselves; the Act does not require the incumbent LECs to do all of the work. Moreover, the fact that the incumbent LECs object to this rule indicates to us that they would rather allow entrants access to their networks than have to rebundle the unbundled elements for them.

Section 251(c)(3) requires an incumbent LEC to provide access to the elements of its network only on an unbundled (as opposed to a combined) basis. Stated another way, § 251(c)(3) does not permit a new entrant to purchase the incumbent LEC's assembled platform(s) of combined network elements (or any lesser existing combination of two or more elements) in order to offer competitive telecommunications services. To permit such an acquisition of already combined elements at cost based rates for unbundled access would obliterate the careful distinctions Congress has drawn in subsections 251(c)(3) and (4) between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent's telecommunications retail services for resale on the other. Accordingly, the Commission's rule, which prohibits an incumbent LEC from separating network elements that it may currently combine, is contrary to § 251(c)(3) because the rule would permit the new entrant access to the incumbent LEC's network elements on a bundled rather than an unbundled basis.

Consequently, we vacate rule 51.315(b)-(f) as well as the affiliated discussion sections.

g. Obtaining Finished Services Through Unbundled Access

The petitioners next engage in a broad-based attack on the bulk of the FCC's unbundling rules by arguing that the Commission's conclusion that the requesting carriers may obtain the ability to provide finished telecommunications services entirely by acquiring access to the unbundled elements of an incumbent LEC's network violates the terms and structure of the Act. The petitioners contend that while subsection 251(c)(3) allows new entrants access to an incumbent LEC's network elements on an unbundled basis, it does not enable new entrants to provide telecommunications services to the public entirely by acquiring all of the necessary elements on an unbundled basis from an incumbent LEC. The petitioners assert that a competing carrier should own or control some of its own local exchange facilities before it can purchase and use unbundled elements from an incumbent LEC to provide a telecommunications service. The petitioners argue that subsection 251(c)(4) makes resale the exclusive means to offer finished telecommunications services for competing carriers that do not own or control any portion of a telecommunications network. Furthermore, the petitioners point out that under subsection 251(c)(4) a competing carrier may purchase the right to resell a telecommunications service from an incumbent LEC only at wholesale rates. Under subsection 252(d)(1), however, a competing carrier may obtain unbundled access to an incumbent LEC's network elements at a less expensive cost-based rate. The petitioners then argue that by allowing a competing carrier to obtain the ability to provide finished telecommunications services entirely through unbundled access at the less expensive cost-based rate, the FCC enables competing carriers to circumvent the more expensive wholesale rates that the Act requires for telecommunications services, and thereby nullifies the terms of subsection 251(c)(4). Additionally, the petitioners claim that by being able to obtain the ability to provide services at cost under subsection 251(c)(3), competing carriers will be able to capture many of the incumbent LECs' customers to whom the incumbent LECs are expected to charge high prices for certain services to offset the low prices incumbent LECs are required to charge other customers in order to promote universal service. The petitioners claim that the competing carriers will simply offer the same services to these particular customers at lower rates and capture a significant share of the market ("cherry-picking") without achieving any true gain in efficiency or technology. Finally, the petitioners contend that the FCC's view of subsection 251(c)(3) allows carriers to circumvent the Act's restriction on joint marketing of local and long-distance services contained in subsection 271(e)(1). This is because subsection 271(e)(1) prohibits a carrier's joint marketing only of local service obtained under subsection 251(c)(4) (resale) with the carrier's ability to provide long-distance service. It does not apply to local service that a competing carrier achieves under subsection 251(c)(3) (unbundled access). Despite the petitioners' extensive arguments to the contrary, we believe that the FCC's determination that a competing carrier may obtain the ability to provide telecommunications services entirely through an incumbent LEC's unbundled network elements is reasonable, especially in light of our decisions regarding the validity of other specific FCC rules.

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2. The Unbundling Rules and the Purpose of the Act

Several of the petitioners vaguely argue that the FCC's unbundling rules in combination provide competing carriers with such extensive access to the incumbent LECs' networks that they will thwart the Act's principal purpose, which, according to the petitioners, is to promote facilities-based competition and innovation in telecommunications technology. The petitioners claim that under these rules, competing carriers will have no incentive to construct their own facilities because they will be able to earn substantial profits by relying entirely on the incumbent LECs' networks to provide services to their customers. They also assert that neither the competing carriers nor the incumbent LECs will attempt to innovate their technology because the Commission's supposedly broad unbundling rules force a carrier to share such advances in technology with its competitors. We reject these claims and believe that the Commission's rules that we have found to be consistent with the terms of the Act are also consistent with the purpose of the Act.

Initially we note that the petitioners' arguments are generally based on the assumption that the FCC's unbundling rules would operate in conjunction with the Commission's proposed pricing rules. The petitioners have argued that the Commission's pricing rules would result in rates that are unreasonably low, making it inexpensive and thus highly profitable for competing carriers to provide local telecommunications services exclusively through the use of an incumbent

LEC's network. In these circumstances, the petitioners argue, competing carriers would have no incentive to build their own network facilities. We have, however, vacated the FCC's pricing rules and determined that the Act requires state commissions to set the rates that competing carriers must pay for access to incumbent LECs' networks. Since we do not know what the state-determined rates will be, the petitioners' argument that competing carriers will incur only minimal costs in gaining access to incumbent LECs' networks and have no incentive to build their own is merely speculative at best.

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III. Conclusion

We decline the petitioners' request to vacate the FCC's entire First Report and Order and limit our rejection of FCC rules only to those that we have specifically overturned in this opinion. We believe that the provisions of the Commission's First Report and Order are severable and that the Commission intended them to be so.

As an aside, and while we do not pretend to possess the Rosetta stone that reveals the true meaning of every portion of this Act, we hope that our review of the FCC's First Report and Order in light of the Act's provisions offers some guidance to the participants in the telecommunications industry as they continue its evolution into the competitive marketplace Congress intended.

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Before BOWMAN, WOLLMAN, and HANSEN, Circuit Judges.

ORTIZ v. FIBREBOARD

By Darren Welch

What does it take to form a class action suit? The Supreme Court will have to decide how to apply its *Amchem* requirements of adequacy of representation, commonality, and equal shares for all class members to the high-stakes asbestos exposure case at hand.

The United States District Court approved a Rule 23(b)(1), $1.535 billion class-action settlement of the claims of various individuals exposed to asbestos and Fibreboard Corp. and its insurers. The U.S. Court of Appeals for the Fifth Circuit affirmed. The Supreme Court remanded for reconsideration in light its decision in of *Amchen Products, Inc. v. Windsor* (1997).

Amchen requires that settlement-only class actions satisfy the requirements that separate actions of class members would create a risk of estopping other class members claims or impair their ability to protect their interests, all class members share common interests, and that there is no difference in award according to the nature of the injury.

In a brief per curiam opinion, the Fifth Circuit again affirmed the district court's approval of the settlement. The Fifth Circuit distinguished *Ortiz* from *Amchem*, because *Amchem* was decided under a different Federal Rule of Civil Procedure for class settlements and because in *Amchem* there was a difference among the individual awards.

Judge Jerry E. Smith wrote a lengthy dissent in which he claimed the majority flouted the binding Amchem precedent and "over[rode] the substantive and procedural rights of large groups of asbestos claimants." Approval of the settlement means that those individual claimants who had previously secured lawyers to sue Fibreboard are precluded from pursuing those claims individually.

The petitioners object to the settlement and raise several issues on appeal. They claim that the Rules Enabling Act, which gives legitimacy to the Federal Rules of Civil Procedure (under which the class is authorized) "shall not abridge . . . or modify any substantive right." The petitioners claim that the fund artificially limits the claimants to a pro rata share of a limited fund. The petitioners also claim that class members should be able to opt out of the class. Furthermore, they claim that there is no real justicible controversy to adjudicate because Fibreboard picked attorneys to sue itself to create a binding settlement and to limit Fibreboard's future liability.

The Supreme Court granted certiorari and must now decide if the limited fund settlement, in reality a friendly suit contrived by the company to get Federal jurisdiction and limit liability, is valid. The Supreme Court must also decide issues of potential claimant notice and the inability to opt out of the class. Furthermore, *Ortiz v. Fibreboard* is significant because it affects future big-money class action suits, not only in the area of asbestos litigation, but also potentially affecting tobacco litigation and other industries.

HIGH COURT REJECTS CLASS FORMED FOR ASBESTOS DEAL

Business Insurance

June 30, 1997

Mark A. Hofmann

WASHINGTON-The Supreme Court's rejection of a $1.3 billion class-action settlement of asbestos claims will likely chill future efforts to settle mass tort claims with agreements that bind future claimants.

The result of the Supreme Court's 6-2 decision last week in Amchem Products Inc. et al. vs. Windsor et al. will mean more personal injury cases jamming already overcrowded courts, say some observers. That will bring extra pressure on Congress to step in to clarify how such "future-looking" settlements can be structured to meet the needs of claimants as well as defendants.

But, says the attorney who argued against the asbestos settlement before the Supreme Court earlier this year, the decision should not hamper Congress' ability to deal with something like the proposed $368.5 billion settlement of liability claims between 40 states and the tobacco industry.

The Amchem case turned on the question of whether Rule 23 of the Federal Rules of Civil Procedure, which governs civil cases, allowed the certification of a class for purposes of a global settlement of future asbestos-related claims.

As Justice Ruth Bader Ginsburg wrote for the majority, "the class proposed for certification potentially encompasses hundreds of thousands, perhaps millions, of individuals tied together by this commonality: Each was, or some day may be, adversely affected by past exposure to asbestos products manufactured by one or more of 20 companies."

The 20 former asbestos manufacturers had formed the Asbestos Claims Facility, which was the forerunner of the Princeton, N.J.-based Center for Claims Resolution, to handle claims made against them by people exposed to asbestos. The consortium offered to compensate future victims according to the diseases they manifested (BI, Jan. 25, 1993). The agreement also allowed compensation for some claims that did not fall into the four categories of compensable diseases. Everyone who had been exposed to asbestos but who had not filed a claim against any CCR member could either opt out of the class formed for the settlement purpose or remain in the class and agree to use the settlement to resolve any future claim.

A federal district court judge approved the settlement in 1994, but a three-judge panel of the 3rd U.S. Circuit Court of Appeals in Philadelphia overturned it in 1996 (BI, May 20, 1996). The appeals court held that the $1.3 billion settlement violated Rule 23 because disparity among the claimants' illnesses was greater than their commonality. The judges also said classes formed for settlement purposes had to meet the same standard as classes formed for litigation.

The CCR members appealed to the Supreme Court, but a 6-2 majority agreed with the lower court. Writing for the majority, Justice Ginsburg said that what she described as the "sprawling class" did not meet the requirements of Rule 23. The named parties in the class "with diverse medical conditions sought to act on behalf of a single giant class rather than on behalf of discrete subclasses. In significant respects, the interests of those within the single class are not aligned. Most saliently, for the currently injured, the critical goal is general immediate payments. That goal tugs against the interest of exposure-only plaintiffs in ensuring an ample, inflation-protected fund for the future," she wrote.

The justice also wrote that "many persons in the exposure-only category, the Appeals Court stressed, may not even know of their exposure, or realize the extent of the harm they may incur. Even if they fully appreciate the significance of class notice, those without current afflictions may not have the information or foresight needed to decide, intelligently, whether to stay in or opt out."

The majority did note, however, that "the argument is sensibly made that a nationwide administrative claims processing regime would provide the most secure, fair and efficient means of compensating victims of asbestos exposure. Congress, however, has not adopted such a solution." Rule 23 "cannot carry the large load CCR, class counsel and the District Court heaped upon it," the opinion said.

In a partial dissent in which he was joined by Justice John Paul Stevens, Justice Stephen Breyer wrote that, "I believe that the need for settlement in this mass tort case, with hundreds of thousands of lawsuits, is greater than the court's opinion suggests."

After detailing his concerns about the case, Justice Breyer wrote: "The issues in this case are complicated and difficult. The District Court might have been correct. Or not. Subclasses might be appropriate. Or not. I cannot tell. And I do not believe this court should be in the business of trying to make these fact-based determinations."

Justice Sandra Day O'Connor did not participate in the case.

Lawrence Fitzpatrick, president and chief executive officer of the CCR, said the immediate impact on the facility would be slight.

"With one possible exception, I don't expect any change in the membership. The exception is the trust created as a result of the National Gypsum bankruptcy, and that trust is currently weighing its options, and may or may not continue as a center member. I personally feel that they probably will," he said.

"We are in discussions to try to restructure the settlement," he added.

But the impact on similar attempts to create forward-looking settlements will be considerable, said Mr. Fitzpatrick.

"Obviously what the court did in our case was to set up some fairly stringent road maps that settlements must follow in order to obtain judicial approval, and I think it's going to be difficult in some instances to structure settlements that meet all of the court's criteria."

Said Steve Bokat, executive vp of the National Chamber Litigation Center in Washington: "It's unfortunate. I think it may leave room for some settlements in some of these cases, but it clearly will make it harder to settle. I think it's unfortunate for the companies settling, the plaintiffs, and I think it's unfortunate for the courts, because I think these cases are going to continue to clog the courts." The center had filed a brief supporting CCR's position with the Supreme Court.

On the other side of the debate, a self-described public interest law group called the decision a "huge victory for millions of asbestos victims and all Americans.

"It creates important safeguards against class-action abuse, establishes critical limits on the use of class actions to settle personal injury claims, and raises serious doubt as to whether class actions can ever be used to eliminate future victims' rights. This court's ruling truly enhances our system of justice," said the Washington-based Trial Lawyers for Public Justice in a statement issued shortly after the decision.

But Laurence Tribe, the Harvard Law School professor who had argued against the CCR before the Supreme Court, said the decision won't hamper another high-profile proposed mass-tort settlement, that between state attorneys general and the tobacco industry (BI, June 23).

"Nothing in this decision casts a shadow over the authority of Congress to approve something like the tobacco settlement," said Mr. Tribe.

"The asbestos decision underscores how indispensable the role of Congress is, because in the absence of the asbestos ruling, it might have been possible, at least in theory, for the people who negotiated the tobacco settlement to obtain the blessing of one or more courts around the country in order to impose that settlement on the nation without bothering to have the matter debated and perhaps changed in Congress."

Mr. Fitzpatrick and Mr. Bokat agreed that Congress should examine how such mass-tort settlements can be carried out.

"I think there was an understandable backlash in the judiciary to what I call sham class-action settlements," said Mr. Fitzpatrick. He described sham settlements as those class-action suits where individual members of the class receive very little compensation while the attorneys walk away with millions of dollars in fees.

"I think it's time for Congress to step in and do something that eliminates the bogus class-action settlements but still makes it possible to use the class-action settlement mechanism as a tool to solve serious and vexing social problems that cannot really be solved any other way," he said.

Mr. Bokat agreed.

"I think the chamber would support some kind of congressional action" that would protect such future-looking settlements, he said.

"If they want to have a specific rule about asbestos, that should be tailored by Congress," said Victor E. Schwartz, counsel to the Arlington, Va.-based Product Liability Coordinating Committee. "For legislation for asbestos to pass in this Congress, you would probably have to have the trial lawyers, the principal defendants and the unions to agree," he said.

After its Amchem ruling, the court declined to review a proposed mass-tort settlement between Fibreboard Corp. and thousands of people who could file asbestos-related injury claims against the company.

Late Friday, the high court ordered the case-Flanagan vs. Ahearn-back to the 5th U.S. Circuit Court of Appeals for review in light of the Amchem decision, even though the two settlements raised different legal questions. A second asbestos-related case, Ortiz vs. Fibreboard, was also remanded to a lower court for further review.

Amchem Products Inc. et al. vs. Windsor et al., U.S. Supreme Court. No. 96-270. June 25, 1997.

COURT AGAIN LOOKS AT ASBESTOS

U.P.I.

June 22, 1998

Michael Kirkland

The Supreme Court has agreed to take another look at a huge class-action settlement involving asbestos. The case out of federal court in Tyler, Texas, is designed to determine whether the Fibreboard Corp., its insurers and others entered into a sweetheart "global settlement" with lawyers hand-picked by the firm to limit liability in tens of thousands of asbestos-exposure cases, or whether, as Fibreboard says, a lower court was correct in approving the settlement despite Supreme Court precedent. Fibreboard is owned by Owens Corning. The "global settlement" meant those who wanted to sue Fibreboard separately for asbestos would not have that opportunity, even if they thought the settlement was unfair. In 1997, however, the Supreme Court ruled in a separate landmark asbestos case, Amchem vs. Windsor, in favor of plaintiffs who wanted to "opt out" of a global settlement. In Amchem, 20 companies wanted to settle present and future lawsuits over asbestos exposure at the same time, The plaintiffs claimed that the attorneys were picked by the companies to begin a class action lawsuit that would lead to a binding settlement, despite the objections of many plaintiffs whom the attorneys were supposed to represent. The attorneys would have received $70 million in fees, about a third of the settlement. At the time, the federal courts estimated there were more than 150, 000 lawsuits involving claims of exposure to asbestos, a flame-proof material widely used for insulation and other building needs before it was discovered to cause lung injury.

When a federal appeals court approved the Fibreboard settlement, plaintiffs who were unhappy also took their case to the Supreme Court. Without hearing argument, the justices threw out the appeals court ruling and ordered a new hearing in light of the Amchem decision. But the appeals court again approved the Fibreboard settlement, saying it was different from Amchem, by a vote of 2-1, despite the strong dissent of one judge who said the approval flouted Supreme Court precedent and "overrides the substantive and procedural rights of large groups of asbestos claimants." The plaintiffs then once again took their cases to the Supreme Court, saying of the appeals court, "Some people just can't take a hint." The Supreme Court should hear argument in the case sometime next winter or spring. (Nos. 97-1704, Ortiz et al vs. Fibreboard et al; and pending, 97-1695, Flanaghan and Middleton vs. Ahearn et al)

SUP. CT. VACATES ORDER APPROVING FIBREBOARD SETTLEMENT, REMANDS

Andrews Tobacco Industry Litigation Reporter

July 11, 1997

The Supreme Court on June 27 vacated the opinion by the Fifth Circuit U.S. Court of Appeals upholding the $1.5 billion settlement in the Fibreboard Corp. class action and then remanded the suit to the Fifth Circuit for further consideration in light of its ruling in Amchem Products, Inc. v. Windsor. Ortiz et al. v. Fibreboard Corp et al., No. 96-1394 (U.S., certiorari denied June 27, 1997); and Flanagan et al. v. Ahearn et al., No. 96-1379 (U.S., certiorari denied, June 27, 1997).

The Fifth Circuit approved the settlement of the class action on July 25, 1996. The majority's lengthy opinion concluded that the action satisfied the FRCP 23(a) requirements of commonality, typicality and adequacy of representation. It also determined that the class was properly certified as a mandatory class action under FRCP 23(b)(1)(B).

At the same time, the Fifth Circuit also affirmed a class action settlement in Continental Casualty Co. v. Rudd, a related action in which Fibreboard seeks approval of a $2 billion settlement with its principal asbestos insurers, Continental Casualty Co. and Pacific Indemnity Insurance Co.

A dissenting opinion by U.S. Circuit Judge Jerry E. Smith called the settlement the "first no-opt-out, mass-tort, settlement-only, futures-only class action ever attempted or approved," and argued that the majority had improperly "extinguished claims over which they have no jurisdiction and deprived thousand of asbestos victims of basic constitutional rights."

As certified by the district court and affirmed by the Fifth Circuit, the class consists of all those who have been exposed to Fibreboard asbestos products and who had not filed suit or settled a claim against the company before Aug. 27, 1993, the date Fibreboard came to terms with attorneys who had been selected by the district court to represent the class.

The Fifth Circuit will now have to review its ruling in light of the Supreme Court's opinion last week in Amchem Products, Inc. v. Windsor, in which the high court rejected a separate class action brought against the members of the Center for Claims Resolution. In part, it ruled that a class of "future" asbestos claimants cannot be certified because of inherent conflicts of interest among the class members. Some objectors to the Fibreboard settlement represented by Baron & Budd of Dallas had argued in their petition for Supreme Court review that the Fibreboard class action contains the same constitutional, statutory and Rule 23 class certification issues as Amchem Products, Inc. v. Windsor.

The class settlement has also been opposed by maritime claimants represented by the Jaques Admiralty Law Firm of Detroit, which filed a separate petition for review with the Supreme Court. Leonard Jaques says that the Supreme Court's ruling means that "the class action is dead in the water." It also means, according to Jaques, "that there is dim likelihood that there will ever be permitted a class action with respect to disposing of a mass tort problem unless Congress...accepts the responsibility of providing legislation which rules of law and court rules do not provide at this time."

Owens Corning recently announced its intention to acquire Fibreboard Corp., and the company says that the Supreme Court's decision will not affect its decision to proceed with the acquisition.

"Owens Corning fully considered the cases during the due diligence process and factored the possibility of these results into our decision to commence the tender offer," said Christian L. Campbell, general counsel for the company. "Our view regarding this acquisition remains the same; the desirability of the transaction does not depend on the outcome of Fibreboard's global settlement in the courts," he added.

If Fibreboard's global asbestos settlement is ultimately approved by the court, Campbell continued, Fibreboard will be protected from asbestos litigation by the settlement. If the settlement is not approved by the courts, Fibreboard's asbestos liability will be funded by the insurance settlement between Fibreboard and its insurers, he said.

MARITIME CLAIMANTS, ORTIZ OBJECTORS SEEK SUP. CT. REVIEW OF AHEARN

Andrews Asbestos Litigation Reporter

April 17, 1998

Maritime asbestos claimants represented by the Jaques Admiralty Law Firm of Detroit and other asbestos claimants represented by Baron & Budd of Dallas have asked the U.S. Supreme Court to review the Fifth Circuit's January decision reaffirming the settlement of the Fibreboard Corp. class action. Both groups of claimants argue that the circuit court's ruling conflicts with the high court's ruling in Amchem Products, Inc. v. Windsor, which overturned the settlement of an asbestos class action brought against members of the Center for Claims Resolution. Flanagan et al. v. Ahearn et al. (U.S., petition filed April 13, 1998); Ortiz et al. v. Fibreboard Corp. et al. (U.S., petition filed April 16, 1998) see Asbestos LR, Feb. 6, 1998, P. 3.

The Fifth Circuit has, according to the Baron & Budd petition, "issued an invitation to mass tort defendants nationwide to resolve all their future liabilities in one stroke by filing a 'limited fund' settlement-only damages class action in the courts of that circuit - where tort reform by judicial fiat persists despite this Court's resounding condemnation of the practice in Amchem."

The Fibreboard class consists of all those who have been exposed to Fibreboard asbestos products and who hadn't filed suit or settled a claim against the company before Aug. 27, 1993, the date Fibreboard agreed to a $1.535 billion settlement with attorneys selected by the district court to represent the class. The Fifth Circuit first approved the settlement of the class action on July 25, 1996. The majority's lengthy opinion concluded that the action satisfied the FRCP 23(a) requirements of commonality, typicality and adequacy of representation. It also determined that the class was properly certified as a mandatory class action under FRCP 23(b)(1)(B).

At the same time, the Fifth Circuit also affirmed a class action settlement in Continental Casualty Co. v. Rudd, a related action in which Fibreboard seeks approval of a $2 billion settlement with its principal asbestos insurers, Continental Casualty Co. and Pacific Indemnity Insurance Co.

The Supreme Court on June 27, 1997 vacated the Fifth Circuit's opinion and remanded it to the appeals court for further consideration in light of its opinion in Amchem Products Inc. v. Windsor, in which the high court rejected a separate class action brought against the members of the Center for Claims Resolution. In part, it ruled in Amchem that a class of "future" claimants cannot be certified because of inherent conflicts among the class members.

The Fifth Circuit subsequently ordered more briefing by the parties on what action it should take in light of Amchem. The principal parties to the litigation - Fibreboard, its insurers and the future claimants - all urged the court to affirm its prior ruling. Asbestos claimants represented by Baron & Budd and maritime asbestos claimants represented by the Jaques Admiralty Law Firm of Detroit argued that Amchem required the Fifth Circuit to reverse its prior ruling.

A divided, three-judge panel of the Fifth Circuit once again approved the settlements on Jan. 27. A two-judge majority of the Fifth Circuit panel said that it found nothing in Amchem Products that changes its prior decision.

The majority pointed to two "controlling differences" between the case before it and Amchem. First, it said, Amchem proposed certification of a class pursuant to FRCP 23(b)(3), while the instant class was certified under Rule 23(b)(1). Second, the majority said that there is no allocation or difference in awards for individual class members based on the nature or severity of their injuries as there was in Amchem. "In the case here all members of the future claimant class are treated alike," it said.

Finally, the majority said that the members of the instant class are not plagued by conflicting interests like those present in Amchem.

Circuit Judge Jerry E. Smith dissented forcefully. He said that the majority's ruling is "fatally flawed" by its treatment of Fibreboard and its insurers as a limited fund, thereby allowing certification under Rule 23(b)(1)(B). The case isn't suitable for treatment as a limited fund under Rule 23(b)(1)(B), he said, because the asbestos claimants have causes of action against Fibreboard itself for damages not limited by its available insurance coverage, not against a fund.

The judge also accuses the majority of permitting Fibreboard to evade bankruptcy without giving its creditors any indication of what they would be afforded under the Bankruptcy Code. "It is, moreover, a colossal bailout for Fibreboard's shareholders that would not occur in bankruptcy," he added.

Judge Smith also maintained that the class must fail under Amchem because of inadequately representative named plaintiffs and for lack of common issues among the class members.

The Ortiz Objectors' Petition

In their petition for Supreme Court review, the claimants represented by Baron & Budd (the Ortiz objectors) argue that the Fifth Circuit "defied" Amchem's holding that a settlement class action requires heightened attention to the requirements of FRCP 23(a) because the Fifth Circuit said those requirements weren't important in the context of a settlement class action. The Fifth Circuit's rulings on Rule 23(a)'s requirements are "irretrievably tainted" by its application of an erroneous legal standard, the objectors maintain.

The objectors next argue that the Rules Enabling Act prohibits mandatory class treatment of individual claims for damages alleged in the case. The Act says that Rules of Procedure "shall not abridge, enlarge or modify any substantive right." Here, the objectors says, the court is allowing the settling parties to use FRCP 23 to artificially limit the claimants to a pro rata share of an artificially limited settlement fund.

They next insist that due process requires that class members who seek damages for personal injuries must be given an opportunity to opt out of the class. The district court and the Fifth Circuit erred, they say, in relying on the settlement to "recast" the plaintiffs' claims for damages as equitable claims for relief that qualify for mandatory class treatment. They note that the Fifth Circuit majority conceded that the plaintiffs' central legal theory in their complaint is that Fibreboard is liable in tort for damages.

Review is also needed, the objectors continue, to address the issue of whether adequate notice can be given to a class of future claimants, an issue they say the Amchem court recognized but didn't resolve.

Finally, the objectors argue that the class action isn't a justiciable controversy under Article III of the Constitution. They call the suit a "feigned proceeding" intended to resolve future - not existing claims for injuries.

"The filing of the complaint was orchestrated by the settling parties solely as part of their joint effort to foist their negotiated tort reform proposal upon the class. Article III jurisdiction may not rest upon such a 'contrivance between friends for the purpose of founding a jurisdiction which otherwise would not exist,'" the objectors insist.

The objectors brief was submitted by Frederick M. Baron, Brent M. Rosenthal and Steve Baughman with Baron & Budd and by Laurence H. Tribe and Brian Koudoutchos of Cambridge, MA.

The Maritime Claimants' Petition

The maritime claimants contend that the Fibreboard class is doomed by the absence of true common issues. The only issue common to the class is their common interest in avoiding the possibility that Fibreboard will be left without insurance coverage for their claims, the maritime claimants say. "Fears about the outcome of the Coverage Case - litigation to which the class members were strangers - do not fill the bill for 'legal or factual questions that qualify each class member's case as a genuine controversy.' Those questions concern the class member's asbestos-related claim against Fibreboard - not inchoate fears about whether a judgment against Fibreboard could be enforced," the objectors insist.

This absence of common issues "dooms Ahearn for the same reason the Amchem settlement could not stand," they say.

In addition, the maritime claimants also argue that the same intra-class conflicts that consigned the Amchem global settlement to oblivion are fatal to the Ahearn settlement. There is no principled way to distinguish the Fibreboard class from the Amchem, they say. "Indeed", they continue, "the conflict is more egregious in the instant 'limited fund' case. The CCR settlement fund was subject to future replenishment, at least in theory. The Global Settlement is not. The 'tug' between interests pulls with even greater urgency. In the absence of proper subclassing, the Global Settlement must fail for this reason alone," they argue.

In other parts of their brief, the maritime claimants charge that the Fifth Circuit majority has engaged in "impermissible, judicially legislated tort," and that the majority's "ultra-brief per curiam opinion does not discharge its duty to engage in reasoned recitation on remand."

The maritime claimants' brief was submitted by Leonard Jaques with the Jaques Admiralty Law Firm of Detroit.

97-1704 ***ORTIZ* v. *FIBREBOARD CORP.***

Ruling below (Flanagan v. Ahearn, CA 5, 134 F.3d 668, 66 LW 1495):

Class settlement in asbestos litigation is unaffected by Amchem Products Inc. v. Windsor, 65 LW 4635 (US SupCt 1997), which struck down another asbestos class settlement, because, unlike Amchem, in which common issues did not predominate over individual ones and named parties did not fairly represent class, settlement in this case was certified as limited fund under Fed.R. Civ.P 23(b)(1)(B), which does not require predominance showing required under Rule 23(b)(3), which governed in Amchem, and, unlike settlement in Amchem, settlement in this case contemplated no allocation or difference in award according to nature or severity of injury.

Questions presented: (1) May Rule 23(a) requirements of commonality and typicality be met in Rule 23(b)(1)(B) class action, despite Amchem Products v. Windsor, by reference to proposed settlement when claims alleged in complaint share no common or typical questions of law or fact, and may such class be certified under Rule 23(a)(4) despite existence of structural conflicts of interest--including conflict between presently injured and future claimants, same conflict condemned by this court in Amchem? (2) Despite Rules Enabling Act, Rules of Decision Act, teachings of Amchem, and principles of federalism, may federal court certify class action under Rule 23(b)(1)(B), premised upon 'limited fund' contrived by settlement between parties, to circumvent Bankruptcy Code and to alter substantive state law rights of absent class members? (3) Does Due Process Clause: (a) permit federal court to bind absent class members (including residents of state where action is brought) to class action judgment that alters their in personam claims for money damages without giving them chance to opt out of class, and (b) permit federal court sitting in diversity to exercise personal jurisdiction over class members asserting in personam claims for damages without giving them chance to opt out, when those class members lack minimum contacts with forum state? (4) Can class notice sufficient under Due Process Clause and Rule 23(e) ever be given to class that includes unknowing, unidentifiable, potential future asbestos victims who have no perceptible injury at time of class settlement and notice? (5) Does federal court have power under Article III to adjudicate 'case' brought by plaintiffs who do not in good faith plead claims they intend to litigate, but who bring suit as friendly joint venture with defendants solely to provide jurisdictional hook on which federal court agrees to hang tort reform proposal displacing laws of 50 states?

James FLANAGAN, et all. Appellants
v.
Gerald AHEARN, et all., Appellees

No. 95-40635.

United States Court of Appeals,
Fifth Circuit.

Jan. 27, 1998.

PER CURIAM:

In our prior opinion, we affirmed the judgment below, which approved class action settlements of asbestos-related claims involving Fibreboard Corporation. In re Asbestos Litigation, 90 F.3d 963 (5th Cir.1996), vacated, 117 S.Ct. 2503, (1997). The Supreme Court vacated our judgment and remanded the case for reconsideration in light of Amchem Products, Inc. v. Windsor, 117 S.Ct. 2231 (1997). After oral argument and reconsideration, we can find nothing in the Amchem opinion that changes our prior decision. We again affirm.

There are two controlling differences between this case and Amchem. First, this class action proceeded under Rule 23(b)(1); Amchem was a Rule 23(b)(3) case. Second, there was no allocation or difference in award, according to nature or severity of injury, in the present case as there was in Amchem; in the case here all members of the future claimant class are treated alike. Individual damage awards will subsequently be decided according to individual damages.

The district court made extensive findings and found, specifically, that separate actions by members of the class would create a risk of adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests. The language of the district court matches the language of Rule 23(b)(1)(B). No one has contested that finding of the district court, probably because it is incontestable.

The Supreme Court stated in Amchem that a settlement class action, like all federal class actions, cannot proceed unless the requirements of Rule 23(a) are met, irrespective of whether the proposed settlement is deemed fair under Rule 23(e). We detailed in our prior opinion our agreement with the thorough study and conclusions by the district court, satisfying the requirements of class certification under Rule 23(a). All members of the class, and all class representatives, share the common interests: suffering harm from asbestos exposure and seeking equitable distribution of compensation from limited funds. None of the uncommon questions, abounding in Amchem, exist in the present case.

The only conflict between members of the future claimant class could be competition for larger and earlier shares of available money, but that is precisely the reason for Rule 23(b)(1)(B) and the problem it is designed to solve where the money is limited. That conflict or competition is controlled for the benefit of all members of the class. It follows that the lawyer representing the class serves only common interests of the class.

The judgment of the district court is AFFIRMED.

KUMHO TIRE CO. v. CARMICHAEL

By Darren Welch

When products liability plaintiffs bring suit against manufacturers, the standard method to make one's case is by offering expert testimony that the defendant is at fault for design or manufacturing defects in the product. This term, the Supreme Court will decide what standard of reliability a witness must pass before testifying as an expert based on general observation.

On July 6, 1993, plaintiff-appellant Carmichaels' minivan crashed. Defendant-appellees concede the accident was the result of a tire failure. The Carmichaels sued Kumho Tire in federal district court and offered the testimony of Dennis Carlson, an expert on tire failure with 20 years of experience in the field.

A Federal District Court judge in Alabama excluded Carlson's testimony ruling that it did not meet the Daubert criteria for reliability. Writing for the majority in *Daubert v. Merrell Dow Pharmaceuticals* (1993), Justice Blackmun outlined some factors for the admissibility of scientific evidence. These factors include 1) Whether the methodology has a known error rate; 2) Whether the methodology is testable; 3) Whether there are standards for applying the methodology; and 4) Whether the methodology is generally accepted in the scientific community. Furthermore, Federal Rule of Evidence 702 which states "If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education may testify thereto in the form of an opinion or otherwise."

The Carmichael's appealed the exclusion of Carlson's testimony. They argued that the *Daubert* criteria should not apply to expert opinions based on general experience. Both parties agree that Carlson is an expert on tire failure from having analyzed thousands of failed tires. The Carmichaels argue that Carlson's testimony satisfies rule 702 and that *Daubert* does not apply.

The Eleventh Circuit remanded for reconsideration. Writing for the majority, Judge Birch ruled that Carlson's testimony was "non-scientific," but rather based on general observations and thus the *Daubert* criteria does not apply.

The Supreme Court granted certiorari to decide if trial judges can consider the four *Daubert* factors in the Rule 702 analysis of the admissibility of the engineering expert testimony.

Carmichael v. Samyang is important because it will decide what type of expert testimony plaintiffs can offer in big-money product liability cases. Plaintiffs in these cases are often modest-income consumers who cannot afford industry experts, who are often already retained by defendant manufacturers. Sometimes, cash-strapped plaintiffs must secure general observation experts other than those in the industry themselves.

The Supreme Court must now decide between the court system's interest in keeping "junk science" out of the courtroom and the plaintiff's interest in securing witnesses who have expertise based on general observation.

EXPERT WITNESSES UNDER COURT SCRUTINY

Rubber & Plastics News

July 06, 1998

Miles Moore Rubber & Plastics News Staff

WASHINGTON--The Supreme Court has agreed to determine if non-scientific expert witnesses in product liability cases should be held to the same standards as scientific experts.

In a move that could have a major impact on all such lawsuits, the court agreed June 22 to settle this issue by granting Kumho Tire U.S.A. Inc.'s petition for review of a tire product liability case.

In July 1993, eight members of the Carmichael family were riding in their minivan when a Kumho tire on the vehicle blew out. A resulting accident killed one child and injured the other family members.

The Carmichaels sued in U.S. District Court for the Southern District of Alabama, claiming the failed tire was defective. In a summary judgment, the court ruled in Kumho's favor, but an appeals court sided with the Carmichaels.

During the case, the Carmichaels' attorneys called Dennis Carlson, a former engineer with Michelin North America Inc., as an expert witness.

In its appeal to the high court, Kumho said appeals courts have been split sharply on the question of whether the stringent scientific standards for expert witnesses set by an earlier Supreme Court case, Daubert vs. Merrill Dow Pharmaceuticals, also apply to engineering experts.

Kumho's attorneys argued that they do.

"Application of Daubert to expert engineers would drive the quality of such expert evidence in the right direction by ensuring the reliability of their analyses and methods before admitting their testimony," Kumho said in its brief. "If there is an easier admissibility standard for less qualified experts, then lawyers are invited to use less qualified experts in order to avoid analysis of these experts' proposed testimony."

In a four-page response to Kumho's appeal, the Carmichaels' attorneys said Kumho "begs the question of whether or not the testimony is scientific or technical in nature." If it is technical--and the appeals court correctly held it is, according to the Carmichaels--then Daubert cannot apply, they said.

The Carmichaels also accused Kumho of misrepresenting Carlson's testimony. Kumho claimed Carlson had never seen the blown-out tire before issuing his theory that it was defective. Instead, the Carmichaels said, "the evidence in this case reveals that Mr. Carlson reviewed several photographs of the subject tire."

Carlson also reviewed an earlier study by an expert witness who became ill and could not continue with the case and inspected the blown tire prior to giving his deposition, they said.

In his testimony at the first trial, Carlson theorized a design or manufacturing defect caused the blowout, but he did not pinpoint a specific problem. Instead, he said, there was no evidence the tire was abused, and he concluded it was defective.

Kumho petitioned the court for summary judgment and exclusion of Carlson's testimony. The tire maker held that Carlson's theories didn't hold up under the stringent scientific standards for expert witnesses set by Daubert.

The court granted both motions. "Carlson's testimony is simply too unreliable, too speculative and too attenuated to the scientific knowledge on which it is based to be of material assistance to the trier of fact," it ruled.

The Carmichaels appealed to the 11th Circuit Court of Appeals, arguing the application of Daubert's stringent standards to Carlson's testimony is inappropriate and outside the scope of that decision.

In ruling for the Carmichaels, the appeals court said it is apparent Carlson's testimony is non-scientific and, therefore, not covered by Daubert. "Carlson makes no pretense of basing his opinion on any scientific theory of physics or chemistry," the court said. "Instead, Carlson rests his opinion on his experience in analyzing failed tires."

Sidney W. Jackson III, lead attorney for the Carmichaels, said he is "not surprised" the high court granted Kumho's appeal.

Kumho's attorneys and Carlson could not be reached for comment. Other expert witnesses who often testify in tire cases either couldn't be reached or declined to comment.

The Supreme Court has not yet said when oral arguments in the case will be heard.

SUPREME COURT TO REVIEW USE OF SCIENTIFIC EXPERTS

The New Orleans Times-Picayune

June 23, 1998

The U.S. Supreme Court will consider giving companies a powerful new weapon to fend off expert testimony that can be decisive in product-liability cases.

The court agreed to hear an appeal by Korean tire maker Kumho Tire Co. in a case that will give the nine justices a chance to extend a major 1993 decision requiring judges to strictly screen evidence based on scientific studies.

The court will consider arguments that judges must use the same demanding standard in deciding whether experts can offer conclusions based on their general experience or training, rather than a specific scientific study.

With 40,000 product-liability cases filed every year in federal courts, the issue has broad practical consequences. People pressing those cases often rely on expert witnesses, such as engineers, to bolster claims about a product defect.

"It's probably the biggest business case of the term next year," said Alan Untereiner, a Washington product-liability lawyer. "These cases often come down to competing experts testifying."

The case could have a particularly large impact on makers of products such as automobiles and medical devices - frequent targets of expensive product-liability suits.

Kumho Tire is fighting a lawsuit by an Alabama family whose minivan crashed in 1993, killing a child and injuring the seven others in the van. The family, Patrick and Luzviminda Carmichael and their children, charged that the blowout of a five-year-old Kumho tire caused the crash.

The court will hear arguments during its 1998-99 term, with a decision expected by July 1999.

The key question for the justices is how to apply their 1993 decision, Daubert v. Merrell Dow Pharmaceuticals Inc., which told federal trial judges to keep "junk science" out of the courtroom. In a fight about birth defects allegedly caused by a prescription drug, the high court said judges must make sure evidence from scientific tests is based on widely accepted scientific methods, not unproven or controversial experiments.

That decision has prompted confusion and debate in lower courts. Some say the Supreme Court meant to impose strict standards that prevent the introduction of any expert testimony not based on rigid scientific tests.

Other courts, such as the panel in the Kumho case, say the Daubert ruling was more limited. Those judges say the decision applies only to evidence that's actually based on formal scientific theories or testing and doesn't prevent experts from relying on their general experience to provide testimony about technical matters.

In the Kumho case, the Carmichaels attempted to present the testimony of Dennis Carlson, a mechanical engineer who, based on his experience in the field, concluded the tire was defective.

A federal trial judge in Alabama, relying on the Daubert ruling, said Carlson's testimony wasn't reliable enough to warrant allowing a jury to consider it. Having rejected the engineer's testimony, the judge then threw out the case, saying the Carmichaels didn't have enough evidence to support their claims.

The Atlanta-based 11th U.S. Circuit Court of Appeals reversed that ruling in a 3-0 decision in December, reviving the lawsuit and permitting Carlson's testimony.

Kumho argues the lower court ruling creates a loophole that would allow unreliable testimony as long as the expert doesn't point to a particular method or technique as the basis for his or her conclusions. The company also argues that, because engineers rely on the application of scientific principles, they aren't fundamentally different from scientists.

THE DAUBERT DECISION: GATEKEEPER OR EXECUTIONER?

Trial

August 1, 1996

Larry E. Cohen

Litigants on both sides of a products claim rely on forensic experts when preparing and presenting evidence. In connection with products as diverse as aircraft, motor vehicles, breast implants, asbestos, farm equipment, and tobacco, experts are called on to help juries understand the specific product's design, defective features, alternative designs, and the causal relationship between the design marketed and the injury.

Typically, a plaintiff has the disadvantage of not being able to hire experts currently employed in the related industry and must instead locate experts who have, either through education or former work experience, delved into the related fields of product safety and design or injury analysis.

Ordinarily, because most plaintiffs have limited financial backing, these experts are unable to conduct expensive, time-consuming scientific research. Instead, their analysis is usually based on the facts of the case, a physical study of the product, its performance in the specific case and as reported in the literature, the available design alternatives used by others in the industry, and a deductive analysis of injury causation.

The defense experts--usually employed within the related industry--rely on industry studies supported by publications often financed and controlled by the industry. The contrast in technical support for each adversary's position is directly related to the parties' respective financial strengths. The Third Circuit Court of Appeals framed the problem astutely several years ago.

If we were to declare as a rule of law that one must actually have practical experience in a given industry in order to qualify as an expert in litigation involving its products, we might very well place an onerous burden on plaintiffs in some cases. Where the industry is small and tightly knit, it may be very difficult for the plaintiff to obtain the services of an expert currently employed therein, and it might be equally difficult to find someone who was formerly employed in the industry. But the key experts of an industry would normally be available to the defendants.

Nevertheless, experts on both sides are generally competent to call on their education, work experience, public literature and research, and product comparisons to present their diverse opinions to the jury. And while the system is often "stacked" in favor of the wealthy defendants, plaintiffs at least have the opportunity to present their grievances to juries of their peers.

In recent years, the defense bar has mounted a legal offensive, euphemistically called "the Daubert defence," to skew the balance of "expert power." In case after case--more often in federal court than in state court--the defense challenges plaintiffs' experts on the bases that they have no personal experience designing the product and that their opinions lack sufficient scientific foundation because they are not supported by the industry-cultivated scientific community. The defense is based on a strained application of the U.S. Supreme Court's decision in Daubert v. Merrell Dow Pharmaceuticals, Inc. As odd as it may seem, the defense bar and some courts have interpreted what was intended by the Court as a loosening of restrictions on expert testimony as a protocol for narrowing the field of experts who are competent to testify. A brief analysis of Daubert and its progeny will demonstrate the fallacy that Daubert has licensed courts to reduce litigation by excluding competent experts.

The Supreme Court abandoned the rigid "general acceptance" test used by most courts to judge the propriety of expert opinions on "novel" or "unorthodox techniques" and decided that this testimony must be evaluated by the liberal construction intended by Federal Rule of Evidence 702.

Daubert recognized that trial courts serve a "gatekeeper" function by judging --before a jury hears the testimony--whether proposed scientific evidence predicated on novel or unorthodox techniques is sufficiently trustworthy to assist the jury in deciding the issues at hand. The Court said a trial court must make a twofold inquiry under Rule 702--whether the testimony will assist the trier of fact and whether it amounts to "scientific knowledge."

In determining what constitutes scientific knowledge, the Court said the focus must be on the principles and methodologies used, not on the conclusions themselves.

The origin of the controversy addressed in Daubert was the so-called junk science debate fueled by legal. commentators and a court system unsure of how to handle the complicated and sometimes controversial scientific study of injury causation using animal testing.

The plaintiffs claimed two mothers' ingestion of Bendectin had caused severe birth defects in their children. The conclusions of plaintiffs' experts linking the drug to birth defects was derived from evidence in the form of in vitro research, animal studies, and re-analysis of published epidemiological studies.

The Supreme Court, faced with the reality of disparate means available to civil litigants because of unequal financial wealth and disproportionate opportunity to scientifically validate opinions, held general acceptance was no longer a pre-requisite to admissibility. Instead, the Court provided a "menu" of factors a trial judge should consider before deciding the issue. These factors included

* whether the expert's proposition is testable, has been tested, and has been subjected to peer review and publication;

* whether the methodology or technique has a known error rate;

* whether there are standards for applying the methodology; and

* whether the methodology is generally accepted in the scientific community.

Unfortunately, some courts misconstrued the Court's intent in introducing the liberalized standard of Rule 702 and wrongly assumed the Court was creating new restrictions on the admissibility of traditional expert opinions.

The Test Under Rule 702

Courts are accorded broad discretion in determining the competency of proposed expert witnesses under the rule. It provides: "If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education may testify thereto in the form of an opinion or otherwise."

Courts have consistently recognized that the rule reflects an attempt to liberalize the rules governing the admission of expert testimony. For example, the Fifth Circuit has reasoned that the use of the conjunction "or" suggests an expert may be qualified on any of the five bases listed.

Similarly, the Eighth Circuit Court of Appeals has observed:

The Advisory Notes to the Rule comment that "[t]he rule is broadly phrased. The fields of knowledge which may be drawn upon are not limited merely to the 'scientific' and 'technical' but extend to all 'specialized' knowledge. Similarly, the expert is viewed, not in a narrow sense, but as a person qualified by 'knowledge, skill, experience, training or education.'"

Under Rule 702, an individual need possess no special academic credentials to serve as an expert, and courts have routinely held that individuals can qualify as experts where they possess sufficient knowledge gained from practical experience, even if they lack academic qualifications in the particular field of expertise. For example, a New York federal district court has held that an expert who has the background to permit him or her to analyze a given set of circumstances can become an expert on a particular product through reading, calculations, and reasoning from known scientific principles.

* * *

Daubert Misapplied

The Daubert decision sought to clarify the standard for evaluating scientific knowledge for purposes of admissibility. The question of admissibility, however, arises only where the proffered evidence deals with "scientific knowledge." The decision does not apply where an expert's opinion is based on education and experience rather than scientific testing.

Despite this, countless defendants have moved to exclude expert testimony in traditional products cases on the basis that expert opinions regarding product defect and causation do not conform to the Daubert criteria. Although some courts have recognized the fallacy of this argument, other courts have mistakenly accepted it as a correct interpretation of the law.

One of the most glaring misapplications of Daubert occurred in Carmichael v. Samyang Tires, Inc. There, the trial court entered summary judgment for the defendant tire manufacturers after concluding that the plaintiff's forensic tire expert--who was admittedly well qualified in his field--had not provided sufficient "scientific foundation" for his opinions, compelling the exclusion of those opinions.

The case involved a rollover accident precipitated by a tire blowout--allegedly caused by tire tread separation. The plaintiff's expert testified in deposition that he had inspected the tire in question and that, consistent with his experience studying other tire separations over the years, he had concluded the blowout was due to a defect in the adhesion among the rubber, steel, and nylon components. He observed that his opinion was based on deductive reasoning--after examining the tire, he had failed to find any evidence of other possible causes.

Despite the logic of this analysis, the trial court used its "gatekeeper" function to disqualify the expert, finding (1) his method of analysis was not susceptible to testing, (2) there were no publications addressing the method, (3) there was no evidence of its potential error rate, and (4) there was no evidence that the method was accepted in the scientific community.

Unfortunately, the trial court in Carmichael and a minority of other courts have improperly construed Daubert as a license to exclude any expert testimony grounded on empirical analysis alone. Taken to its furthest reach, this exclusionary approach can eliminate any opinion that does not meet the many factors listed in Daubert. Fortunately, several appellate courts have ruled otherwise.

* * *

Quite often in science, an opinion will not be subject to actual testing. This is particularly true when the resulting product failure cannot be duplicated. Trial judges must differentiate between the Daubert screening of expert opinion based on "scientific knowledge" or "methodology" and the court's role when an opinion is based on the more typical range of factors, including the expert's education, experience, and factual study.

The logic of Daubert is that experts should be permitted to testify based on well-reasoned science. That science does not have to be supported by physical testing, nor does it require that the opposing experts agree with it. What is necessary is that litigants make a simple showing that the proffered opinions are based on legitimate scientific logic. Applying this approach, courts should inevitably admit into evidence all relevant expert testimony.

97-1709 ***KUMHO TIRE CO.* v. *CARMICHAEL***

Ruling below (Carmichael v. Samyang Tire Inc., CA 11, 131 F.3d 1433, 66 LW 1408):

Expert testimony that implicates scientific principles but that is based on expert's experience and observations need not be subjected to four-part analysis outlined in Daubert v. Merrell Dow Pharmaceuticals Inc., 509 U.S. 579, 61 LW 4805 (1993), for admission of scientific evidence.

Question presented: May trial judge consider four factors set out in Daubert v. Merrell Dow Pharmaceuticals Inc. in Fed.R.Evid. 702 analysis of admissibility of engineering expert's testimony?

Patrick CARMICHAEL, Sr., et all., Plaintiffs-Appellants
v.
SAMYANG TIRE, INC., et all., Defendants-Appellees

United States Court of Appeals,
Eleventh Circuit.

Dec. 23, 1997

BIRCH, Circuit Judge

In this appeal, we determine whether the Supreme Court's Daubert criteria for admission of scientific evidence should apply to testimony from a tire failure expert. In granting summary judgment against plaintiff- appellants, the district court relied on Daubert to exclude testimony from plaintiff-appellants' expert. Plaintiff-appellants, however, argue that the district court should not have applied Daubert because their expert's proffered testimony is not "scientific." We REVERSE.

I. BACKGROUND

On July 6, 1993, plaintiff-appellants, eight members of the Carmichael family (collectively "the Carmichaels"), were involved in a serious automobile mishap when the right rear tire on their minivan failed. This occurrence resulted in significant trauma to each of the Carmichaels; one member of the family ultimately died from her injuries. For the purposes of this appeal, the parties agree that the failure of a tire manufactured and sold by defendant- appellees (collectively "Samyang") directly caused the mishap.

Following the incident, the Carmichaels submitted the carcass of the failed tire to George Edwards, a purported expert on tire failure. After examining the tire, Edwards determined that its failure was not the result of any abuse by the Carmichaels. Therefore, Edwards concluded that a defect in either the tire's design or its manufacture caused the blowout. Before Edwards could be deposed by Samyang, however, he became too ill to testify and transferred the case to his employee, Dennis Carlson [FN1]. After reviewing Edwards's file on the tire and discussing the case with Edwards, Carlson confirmed Edwards's conclusion that a design or manufacturing defect caused the blowout. Carlson, though, did not personally examine the tire until approximately one hour before his deposition by Samyang, long after he had rendered his opinion on the cause of the blowout. In his deposition, Carlson then set forth both his analytical process and his conclusion that the Carmichaels' tire was defective.

FN1. Carlson holds a bachelor's and a master's degree in mechanical engineering from the Georgia Institute of Technology. Carlson worked from 1977 to 1987 as a research engineer for Michelin Americas Research & Development, where he was involved for the majority of his tenure in tire testing. Following that experience, Carlson became a senior project engineer at S.E.A., Inc., where he served from 1987 to 1994 as a tire failure consultant before becoming an employee of George R. Edwards, Inc.

The District Court assumed for the purpose of its Daubert analysis that Carlson is qualified to testify as an expert in tire failure analysis. See Carmichael v. Samyang Tires, Inc., 923 F.Supp. 1514, 1518-19 (S.D.Ala.1996). We, like the district court, assume that Carlson is an expert for the purposes of this appeal.

Before the district court, Samyang moved for the exclusion of Carlson's testimony on the ground that it could not satisfy Daubert 's standards for reliability of scientific evidence. After reviewing Carlson's deposition, the district court agreed and excluded Carlson, writing that "none of the four admissibility criteria outlined by the Daubert court are satisfied in this case." Carmichael, 923 F.Supp. at 1521. Because the Carmichaels' only proffered evidence of a tire defect was Carlson's testimony, the district court then granted summary judgment for Samyang. See id. at 1524. The Carmichaels now appeal the exclusion of their tire expert.

II. DISCUSSION

In Daubert, the Supreme Court established several general criteria for the admission of scientific expert testimony under Federal Rule of Evidence 702. [FN2] See Daubert, 509 U.S. at 593-95, 113 S.Ct. at 2796. Appealing the district court's exclusion of Carlson's testimony, the Carmichaels argue that the district court should not have applied Daubert 's reliability framework because Carlson is not a "scientific" expert. In response, Samyang contends that Carlson's testimony is based on an unreliable scientific analysis. We review the district court's legal decision to apply Daubert de novo, see Compton v. Subaru of Am., Inc., 82 F.3d 1513, 1517 (10th Cir.), cert. denied, 117 S.Ct. 611 (1996), and its decision to exclude particular evidence under Daubert for abuse of discretion, see General Elec. Co. v. Joiner, 118 S.Ct. 512 (1997).

FN2. Rule 702 provides that "If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise."

The Court suggested four primary inquiries for determining the reliability of a scientific theory or technique: (1) whether it has been tested; (2) whether it has been subject to peer review and publication; (3) its known or potential rate of error; and (4) whether it is generally accepted by the relevant scientific community. However, the Court emphasized that

"[t]he inquiry envisioned by Rule 702 is ... a flexible one. Its overarching subject is the scientific validity--and thus the evidentiary relevance and reliability--of the principles that underlie a proposed submission." Daubert, 509 U.S. at 594-95, 113 S.Ct. at 2797.

Despite Samyang's protestations, "Daubert does not create a special analysis for answering questions about the admissibility of all expert testimony. Instead, it provides a method for evaluating the reliability of witnesses who claim scientific expertise." United States v. Sinclair, 74 F.3d 753, 757 (7th Cir.1996). In fact, the Supreme Court in Daubert explicitly limited its holding to cover only the "scientific context." Daubert, 509 U.S. at 590 n. 8, 113 S.Ct. at 2795 n. 8; see also United States v. Cordoba, 104 F.3d 225, 230 (9th Cir.1997) ("Daubert applies only to the admission of scientific testimony."); Compton, 82 F.3d at 1518 (same); Iacobelli Constr., Inc. v. County of Monroe, 32 F.3d 19, 25 (2d Cir.1994) (same). Although the Court's analysis in Daubert may suggest reliability issues for district courts to consider as they determine whether proffered evidence is sufficiently reliable for admission under Rule 702, "the trial court's role as gatekeeper is not intended to serve as a replacement for the adversary system: 'Vigorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof are the traditional and appropriate means of attacking shaky but admissible evidence.' " United States v. 14.38 Acres of Land, 80 F.3d 1074, 1078 (5th Cir.1996) (quoting Daubert, 509 U.S. at 596, 113 S.Ct. at 2798).

What, then, is the difference between scientific and non-scientific expert testimony? In short, a scientific expert is an expert who relies on the application of scientific principles, rather than on skill- or experience-based observation, for the basis of his opinion. See Daubert, 509 U.S. at 590, 113 S.Ct. at 2795. As the Sixth Circuit explained in Berry v. City of Detroit:

The distinction between scientific and non-scientific expert testimony is a critical one. By way of illustration, if one wanted to explain to a jury how a bumblebee is able to fly, an aeronautical engineer might be a helpful witness. Since flight principles have some universality, the expert could apply general principles to the case of the bumblebee. Conceivably, even if he had never seen a bumblebee, he still would be qualified to testify, as long as he was familiar with its component parts.

On the other hand, if one wanted to prove that bumblebees always take off into the wind, a beekeeper with no scientific training at all would be an acceptable witness if a proper foundations were laid for his conclusions. The foundation would not relate to his formal training, but to his firsthand observations. In other words, the beekeeper does not know any more about flight principles than the jurors, but he has seen a lot more bumblebees than they have. 25 F.3d 1342, 1349-50 (6th Cir.1994). Thus, the question in this case is whether Carlson's testimony is based on his application of scientific principles or theories (which we should submit to a Daubert analysis) or on his utilization of personal experience and skill with failed tires (which we would usually expect a district court to allow a jury to evaluate). In other words, is the testimony at issue in this case more like that of a beekeeper applying his experience with bees or that of an aeronautical engineer applying his more generalized knowledge of the scientific principles of flight?

Having clarified the question posed by this case, it seems apparent to us that Carlson's testimony is non-scientific. Although Samyang is no doubt correct that the laws of physics and chemistry are implicated in the failure of the Carmichaels' tire, Carlson makes no pretense of basing his opinion on any scientific theory of physics or chemistry. Instead, Carlson rests his opinion on his experience in analyzing failed tires. After years of looking at the mangled carcasses of blown-out tires, Carlson claims that he can identify telltale markings revealing whether a tire failed because of abuse or defect. Like a beekeeper who claims to have learned through years of observation that his charges always take flight into the wind, Carlson maintains that his experiences in analyzing tires have taught him what "bead grooves" and "sidewall deterioration" indicate as to the cause of a tire's failure. Indeed, Carlson asserts no knowledge of the physics or chemistry that might explain why the Carmichaels' tire failed. Thus, we conclude that Carlson's testimony falls outside the scope of Daubert and that the district court erred as a matter of law by applying Daubert in this case.

Still, the inapplicability of Daubert should not end the day regarding Carlson's reliability. Under Rule 702, it is the district court's duty to determine if Carlson's testimony is sufficiently reliable and relevant to assist a jury. See 14.38 Acres, 80 F.3d at 1078. Moreover, Carlson's testimony is subject to exclusion under Federal Rule of Evidence 403 if its probative value is substantially outweighed by its likely prejudicial effect. Aside from its Daubert related arguments, Samyang has presented this court with a number of potentially troubling criticisms of Carlson's alleged expertise and methodology, including his rendering of an opinion regarding the Carmichaels' tire before he had personally inspected its carcass. We leave judgments about such matters to the discretion of the district court on remand.

III. CONCLUSION

The district court erred as a matter of law in applying the Daubert criteria to the Carmichaels' proffered expert testimony.

Therefore, we REVERSE and REMAND the case to the district court for further proceedings consistent with this opinion.

WRIGHT v. UNIVERSAL MARITIME SERVICE CORPORATION

By Troy R. Rackham

If a collective bargaining agreement requires affected employees to submit all of their claims against the employer to arbitration, does this mean that employees cannot sue employers for violating statutory rights under the Americans with Disabilities Act (ADA)? Many in the legal world thought this question had already been answered. After all, the Supreme Court held in *Alexander v. Gardner-Denver Company* (1974) that an employee covered by a collective bargaining agreement could still sue his employer for discriminating against him on the basis of race in violation of Title VII. The unanimous Court reasoned that the right secured by Title VII, to be free from racial discrimination in employment, is independent of the right to enforce the contractual provision requiring arbitration. Moreover, the Third, Sixth, Seventh, Eighth, Tenth, and Eleventh circuits have all held that an employee can still sue his employer for a claim of discrimination in violation of the ADA.

The Fourth Circuit Court of Appeals, however, held in *Wright v. Universal Maritime Service Corporation* that an employee cannot sue his employer over an alleged violation of the ADA because he is under a collective bargaining agreement which requires him to submit all of his claims against his employer to arbitration. The Fourth Circuit relied on its earlier decision, *Austin v. Owens- Brockway Glass Container*, in which the Fourth Circuit concluded that the Supreme Court itself had significantly limited its *Alexander* in *Gilmer v. Interstate/Johnson Lane Corporation*. The Supreme Court, in *Gilmer*, held that arbitration of statutory claims is binding upon both parties in the non-union sector. Specifically, the Supreme Court held that an age discrimination claim brought by an employee of a Wall Street securities corporation must be submitted to arbitration because of the agreement signed by the employee.

The Supreme Court granted certiorari in the case in order to resolve the circuit split. The landscape of labor law could change significantly if the Supreme Court affirms the Fourth Circuit's opinion, as many of the amicus briefs already filed argue. Amicus briefs have been filed by the National Academy of Arbitrators, the National Employment Lawyers Association, NOW Legal Defense and Education Fund, Association of Trial Lawyers, Disability Rights Education & Defense Fund, the National Partnership for Women and Families, the United States, the EEOC, the ACLU, the AARP, and the American Federation of Labor all in support of the petitioner.

SUPREME COURT WILL CONSIDER ARBITRATION'S ROLE AT WORK

The New York Times

March 3, 1998

Section A; Page 14; Column 1

By Linda Greenhouse

The Supreme Court agreed today to decide whether a clause in a labor contract requiring workplace disputes to be resolved by arbitration bars individual workers from suing their employer for discrimination.

The case is an appeal by a longshoreman who tried to bring a lawsuit under the Americans With Disabilities Act after a group of shipping companies refused to hire him when he returned after recovering from a serious on-the-job injury.

The Federal appeals court in Richmond ruled last year that because the collective bargaining agreement between the International Longshoreman's Association and employers in the Port of Charleston, S.C. provided for grievance and arbitration of all "matters under dispute between the parties," the worker had in effect given up his right to sue.

The relationship between increasingly popular arbitration clauses and the battery of Federal anti-discrimination laws has been a source of great dispute in the lower Federal courts. "This issue arises literally daily, in some union-represented bargaining unit somewhere in the nation," the longshoreman's lawyers said in their petition urging the Justices to resolve the issue.

Though the law at issue in this case is the disability act, the Justices' decision will also apply to other Federal laws that bar discrimination in the workplace based on race, sex and age.

In contrast to the ruling in this case by the United States Court of Appeals for the Fourth Circuit, most of the Federal appeals courts have ruled that workers covered by contracts with arbitration clauses retain their right to bring discrimination suits.

Those decisions have largely been based on a 1974 Supreme Court ruling, Alexander v. Gardner-Denver Company, which held that an employee covered by an arbitration agreement could nonetheless sue his employer for racial discrimination under Title VII of the Civil Rights Act of 1964.

In that case, in a unanimous decision written by Justice Lewis F Powell Jr., the Court said the contractual right to submit a dispute to arbitration and the legal right not to be discriminated against were not interchangeable. "Both rights have legally independent origins and are equally available to the aggrieved employee," Justice Powell said.

The 1974 decision also noted that informal arbitration procedures offered employees fewer legal protections than the rules that apply in Federal court, and that arbitrators may not be knowledgeable about Federal discrimination law. "The specialized competence of arbitrators pertains primarily to the law of the shop, not the law of the land," Justice Powell said.

However, the Fourth Circuit, in the case now before the Supreme Court, concluded that the Justices had sharply limited the 1974 ruling in a decision from 1991, Gilmer v. Interstate/Johnson Lane Corporation. In that case, the Court ruled that a stockbroker who had agreed to the New York Stock Exchange's rule requiring arbitration of employment disputes between brokers and member firms could not sue his employer for age discrimination.

So the question for the Court in the new case, Wright v. Universal Maritime Service Corporation, No. 97-889, is which of the two precedents should govern the longshoreman's discrimination suit. Although the Court was not completely clear in the 1991 case, that 7-to-2 decision indicated that the Justices were elaborating on, rather than overruling, their earlier decision.

Justice Byron R. White's majority opinion, noting the "tension between collective representation and individual statutory rights," drew a distinction between the stockbroker, who had entered into an individual arbitration agreement and could fairly be held to it, and union members, who were part of such an agreement only by virtue of collective bargaining and should not have to give up their "independent statutory rights accorded by Congress."

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ARBITRATING DISCRIMINATION CASES UNDER UNION CONTRACTS

The National Law Journal

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Are employees who are governed by collective bargaining agreements entitled to greater rights than their non-union counterparts? This question is presented in *Wright v. Universal Maritime Service*, a case which arose in Charleston, SC.

Ceasar Wright, a longshoreman, was severely injured when he fell from the top of a cargo container and landed on one heel. He filed a claim for benefits under the Longshore and Harbor Workers Compensation Act, which he ultimately settled for a lump-sum payment of $250,000. Nearly three years after his injury, Wright tried to return to work. The association of stevedoring contractors informed Wright's union that Wright was not "qualified" to work under the terms of the labor agreement. Instead of processing a grievance, however, the union advised Wright to obtain counsel, and charges of disability discrimination were filed.

The Equal Employment Opportunity Commission dismissed the charges, whereupon Wright commenced litigation in U.S. District Court. In three successive decisions -- a recommendation by a Magistrate Judge, an adoption and amplification of that recommendation by a District Judge, and a denial of reconsideration -- Wright's claims were dismissed due to his failure to proceed through the collectively-bargained grievance-and-arbitration procedure. Wright appealed to the Fourth Circuit, which issued an unpublished opinion affirming the decisions below. Wright then petitioned for certiorari, which was granted on March 3.

The Court will be called on to resolve a dispute among the circuits regarding the permissibility of binding arbitration of "statutory" claims such as employment discrimination disputes under collective bargaining agreements. Such arbitration is already available as an alternative to litigation in the nonunion sector, as the Court's 1991 decision in *Gilmer v. Interstate/Johnson Lane* clearly established.

Gilmer dealt with an age discrimination claim. In Congressional action bracketing that decision, both the Americans with Disabilities Act and the Civil Rights Act of 1992 contained sections expressly encouraging the use of alternative dispute resolution procedures including arbitration. On that basis, the Fourth Circuit, in *Austin v. Owens-Brockway Glass Container*, determined that Alexander is no longer controlling, and that a collective bargaining agreement containing an arbitration procedure which covers claims arising under federal law "ousts a court of jurisdiction" over employment discrimination complaints of employees subject to such an agreement. The Fourth Circuit reasoned that Ms. Austin's disability claim was arbitrable under the labor contract and that deferral to that process was mandated by the language of the ADA.

The decisions in *Wright* adhered to the logic of *Austin*. Since *Austin* was decided, however, the Third, Sixth, Seventh, Eighth, Tenth and Eleventh Circuits have concluded that *Alexander* is still alive, and that statutory discrimination claims cannot be resolved in arbitration under a collective bargaining agreement. The fundamental issue presented in Wright is, therefore, whether labor-management arbitration can satisfy the policies underlying federal employment discrimination legislation, or whether the possibility of a union's unfair or negligent representation suffices to force all such disputes into the courts. If the second alternative prevails, the rationale for union representation is called into severe question.

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MANDATORY ARBITRATION: A PILL MANY ARE FORCED TO SWALLOW

USA Today

July 9, 1998

By Stephanie Armour

Many employers are taking away employees' rights to sue in the courts over workplace issues. Instead, workplace disputes are being shifted into a non-judicial and often secretive realm where rulings need not always follow the law.

In order to get or keep a job, tens of thousands of workers are being told they must submit to mandatory arbitration. That means discrimination, harassment or others claims are heard in a private office by paid arbitrators.

Under federal law, arbitrators need no credentials or training. Written opinions need not be issued. Appeals are rare. Refusal to submit future claims to arbitration often results in firing.

Critics say companies have found the gilded loophole for escaping costly jury awards and punitive damages. The system, they say, is fast eroding hard-won civil rights protections.

"What they're really trying to do is get out of the legal system as best they can," says Paul Carrington, a law professor at Duke University in Durham, N.C. "Employees are bargaining away their rights."

A host of companies, including Circuit City, Travelers Group and Hooters of America, make workers abide by mandatory arbitration. The Olive Garden and Red Lobster will finish rolling out their requirements this summer.

The clauses also are cropping up in many consumer agreements drafted by banks, brokers, health plans and other firms. Bank of America, Kaiser Permanente, computer-seller Gateway and others require arbitration in some contracts.

The arbitration business

Arbitration is giving rise to a booming industry all its own. Professional arbitrators hire themselves out to various firms, charging from about $150 an hour to thousands.

Private companies supplying for-hire arbitrators (dubbed "neutrals") have prospered. JAMS/Endispute, the nation's largest private arbitration and mediation firm, brought in about $50 million in 1996.

"I've seen how helpful and beneficial it can be," says Richard Chernick, a Los Angeles-based arbitrator. "It's fair and extraordinarily flexible. It provides a meaningful alternative."

But some find the industry growth alarming. Critics say:

Women claiming harassment may be forced to divulge sexual histories because federal evidence rules often don't apply in arbitration. "They can put in gynecological information, all kinds of horrible things, that you couldn't do in a courtroom," says Lauren Asher at the National Partnership for Women and Families.

Arbitrators are sometimes hired repeatedly by a company, raising concerns they will side with businesses to avoid losing exclusive contracts. "If an arbitrator rules against a company, will they ever work for that company again?" says Stewart Karlin, an employment lawyer in Fort Lauderdale, Fla.

The closed-door process silences public discussion because arbitrators are not legally required to issue written decisions. Wrongs can be hidden, critics say, if there is no public record.

Critics: Process flawed

Arbitrators may lack the legal power to force employers to change discriminatory practices. And despite efforts to add more women and minorities, critics argue that too many arbitrators are white males lacking the diversity of a jury panel.

Some say the process is so flawed workers shouldn't be forced to abide.

"The whole thing really stinks," says Bob Letwin, who says he was fired from Bentley's, a luggage retailer, for not signing an arbitration clause. "There's no written opinion, it's all hush hush. The arbitrator doesn't even have to know the law. It's a shame this is going on."

Letwin, of Fort Lauderdale, brought his case to the National Labor Relations Board; he says he was reinstated in 1996 and is now retired. Bentley's did not return calls seeking comment.

Fighting an arbitration requirement is tough, opponents say, because judges have a vested interest in supporting the system. Many judges are looking for ways to clear overflowing dockets.

And working as an arbitrator is an alluring retirement career for those on the bench, who also must rule on the legality of arbitration clauses.

"It's a scandal happening in the light of day," says Cliff Palefsky, a San Francisco-based employment lawyer. "Arbitration has created a supplemental judicial retirement system, and it's wrong."

At JAMS/Endispute, there are about 350 arbitrators and mediators earning $250 or more an hour. "A lot of them are former judges," says Susan Bunney, spokeswoman for the Irvine, Calif.-based company, adding that many employees prefer the confidentiality.

The industry has grown as employers look for relief. Discrimination cases filed in federal court rose from 8,000 in 1991 to more than 24,000 today, according to the Bureau of National Affairs.

"It's faster, it's cheaper," says Dottie Wade at Travelers. "We think it's better for us and for the employees."

The arbitration process

For the most part, here's how it works: A company sets up a process to handle internal complaints. Employees may learn of the requirement through a memo, job application or language written into an employee handbook.

The process often involves bringing complaints to a manager, peer-review panel or mediator. If those alternatives fail, workers must go to arbitration.

Employers and workers often agree on who will serve as arbitrator, but in some cases it's the boss' pick. Costs may be split or picked up by the employer. In some cases, loser pays all.

Employees must submit to the process to get or keep jobs.

When Donald Lagatree refused to sign a clause at two separate law firms, the legal secretary was fired by both.

Lawsuits he filed challenging the mandates were rejected by Los Angeles Superior courts.

"It seemed so unfair," says Lagatree, 43, of Long Beach, Calif. "I didn't think I should sign away my constitutional rights. It was more than a matter of money to me."

Critics worry companies may hide damaging information since depositions and discovery are often curtailed; arbitrators don't always have the same legal power as a judge to require documents be turned over.

Appeals are tough, legal experts say. Most can only be made on grounds such as fraud, bias or the intentional skirting of a law known to the arbitrator.

The compulsory practice has taken off since *Gilmer vs. Interstate/Johnson Lane*, a 1991 case in which the Supreme Court ruled a securities representative with an age-discrimination complaint had to submit to arbitration.

Congress amended the Civil Rights Act in 1991 to guarantee a jury trial to plaintiffs with complaints such as sex, national origin, religious or racial discrimination.

But arbitration clauses require workers to give up that right by going to paid dispute settlers.

More companies are adopting the practice. The American Arbitration Association (AAA), an industry giant, handled cases for a few dozen companies in 1991. Now it serves about 350 firms employing 4 million workers covered by both mandatory and voluntary arbitration clauses.

"It really is a major trend," says Toni Griffin at the AAA. "In most cases, employees are looking for an apology or a change in policy."

In the wake of criticism, the National Association of Securities Dealers moved to end mandatory arbitration of brokers' employment cases. The Securities and Exchange Commission approved the change in June, but such reversals still buck the trend.

Hoping to guarantee fairness, large firms that farm out arbitrators have adopted self-imposed guidelines.

Arbitrators are trained. They won't work for companies they don't think play fair, such as those who ban depositions or keep workers from bringing in their own representation. Both sides must agree to the arbitrators used. Some require arbitrators to issue written opinions and decide cases based on the law.

But critics say the guides only sugar-coat systemic problems, since nothing is legally enforceable. Employers who don't want to abide by the guidelines can simply ignore them, they say, shopping around for other arbitrators. Workers, some say, deserve a choice.

"I'm not really comfortable saying I'm a substitute for the court. It still gnaws at me," says Arnold Zack, a Boston-based arbitrator and past president of the National Academy of Arbitrators. "A free system will give much greater protection."

But supporters say employers who turn the process into a private star chamber will be exposed through legal challenges. They say the process, which leads to smaller financial awards than those in jury trials, is less contentious and time consuming.

"The rationale is it's faster, less expensive, fairer and more consistent," says Mike McNeil, at the Atlanta-based Hooters restaurant chain.

And supporters argue that many critics are lawyers with their own cloaked agenda.

"Lawyers lose in an arbitration setting," says Alfred Feliu, a New York arbitrator. "By definition, they're not going to make as much money."

But some employees say suing should be their right.

Etel Lindblom tried to bring a lawsuit against her former employer, Tenet Healthcare, claiming age discrimination.

The Fort Lauderdale nurse says she was shocked to learn she'd signed away her right to sue. A U.S. District Court ruled she had to abide by a clause mandating arbitration. Tenet did not return calls seeking comment.

"I didn't know what arbitration was. They just gave me an employee handbook and you sign that you received it," says Lindblom, 54. "It favors the employer. I think it's dirty politics."

PROS AND CONS

SUPPORTERS SAY	CRITICS SAY
Financial awards tend to be more reasonable because arbitration avoids the emotional reaction of juries.	Arbitration silences public discussion of findings because the process is confidential and written opinions need not be issued.
Arbitrators are typically trained and experienced in employment law and abide by a code of ethics and standards.	Companies can limit the damages claimants receive and deny them payment of lawyers fees.
Arbitrators typically are mutually agreed upon by both sides.	Arbitrators, unlike judges, often lack the ability to order a company to take corrective action to change discriminatory practices.
Arbitration costs are less expensive than a jury trial because lawyers aren't always needed, and the process is much shorter than a judicial proceeding.	Arbitration is more costly than lawsuits, which cost about $150 to file. Claimants may be required to split the arbitration costs or pay all fees if they lose. Arbitrators may charge $150-$3,000 an hour.
Companies that provide arbitrators are actively recruiting a diverse staff.	Most arbitrators are white males and lack the diversity of a jury panel.

97-889 WRIGHT v. UNIVERSAL MARITIME SERVICE CORP.

(Ruling Below: 121 F.3d 702 (4th Cir. 1998), 157 L.R.R.M. 2640, 11 N.D.L.R. 2)

An Employee's failure to submit Americans with Disabilities Act claim to arbitration under collective bargaining agreement arbitration clause that covers 'all matters affecting wages, hours, and other terms and conditions of employment' precludes federal court jurisdiction over claim.

Question presented: Was court below correct in holding— contrary to *Alexander v. Gardner- Denver Co.*, and other cases, and contrary to seven other circuits— that general arbitration clause in collective bargaining contract bars employee covered by contract from filing his own lawsuit under federal anti-discrimination statute?

Ceasar WRIGHT, Plaintiff-Appellant,
v.
UNIVERSAL MARITIME SERVICE CORPORATION, et al, Defendants-Appellees.

United States Court of Appeals, Fourth Circuit.

Decided: July 29, 1997

PER CURIAM:

Ceasar Wright sued the South Carolina Stevedores Association ("SCSA") and six of its individual members alleging violations of the Americans with Disabilities Act. The district court, relying on Austin v. Owens-Brockway Glass Container, dismissed the case because Wright had failed to submit his claim to arbitration as required by the collective bargaining agreement ("CBA") between the SCSA and Wright's union. On appeal, Wright argues that Austin is inapplicable because the CBA here does not specifically address ADA claims. This contention is meritless. An arbitration agreement need not list every possible dispute between the parties in order to be binding. To hold otherwise would directly contradict Supreme Court precedent and the strong federal policy favoring arbitration. Accordingly, we affirm the judgment of the district court.

I.

Ceasar Wright worked as a longshoreman in Charleston, South Carolina from 1970 to 1992. On February 18, 1992, he was injured at work. Consequently, Wright filed suit for benefits under the Longshore and Harbor Workers' Compensation Act, and his employer, Stevens Shipping Company, settled the claim for $250,000. During the course of this suit, Wright represented that he had been totally and permanently disabled.

On January 2, 1995, Wright appeared at the hiring hall of the Local 1422 of the International Longshoreman's Association ("the union"), claiming that he was ready and able to return to work. Wright presented a note from his physician, Dr. Howard Brilliant, which stated that he could return to full duty.

From January 2 through January 11, 1995, the union referred Wright to four different stevedoring contractors. Initially, none of these employers objected to Wright's work. However, when the companies discovered that Wright had earlier received a settlement for total and permanent disability, they, both individually and acting through their multi-employer collective bargaining representative the SCSA, advised the union that Wright would no longer be accepted for employment referral. The SCSA maintained that under the CBA, Wright was not qualified to work due to his total and permanent disability.

The union responded with a letter disputing the SCSA's interpretation of the CBA. However, neither Wright nor the union ever filed a formal grievance under the CBA's arbitration procedure, and the union advised Wright to pursue a statutory claim under the Americans with Disabilities Act. Wright then filed this suit against the SCSA and six of its individual members.

The case was referred to a magistrate judge who, citing Austin v. Owens- Brockway Glass Container, recommended the case be dismissed because Wright had failed to submit his claim to arbitration as required by the CBA. The district court adopted this position over Wright's objections. Wright now appeals.

II.

In Austin, this court established that collective bargaining agreements to arbitrate employment disputes are binding upon individual employees even when the dispute involves a federal cause of action. Where such an agreement exists, a failure to process a claim under the agreement precludes a court from exercising jurisdiction over the merits of the claim. Id. Wright did not submit his claim to arbitration. Thus, under Austin, the only issue in this case is whether there was an agreement to arbitrate ADA claims in the CBA between Wright's union and the SCSA.

The arbitration clause at issue is particularly broad. The clause states that the "Union agrees that this Agreement is intended to cover all matters affecting wages, hours, and other terms and conditions of employment." However, Wright contends that since the agreement does not specifically address ADA claims it cannot be binding here.

We are unpersuaded. An employer need not provide a laundry list of potential disputes in order for them to be covered by an arbitration clause. For example, in Gilmer v. Interstate/Johnson Lane Corp., the Supreme Court held that a plaintiff was required to submit his ADEA claim to arbitration where the arbitration agreement covered "any dispute, claim or controversy." The language of the CBA at issue in this case is equally broad, covering "all matters" regarding "terms and conditions of employment." This language easily encompasses Wright's ADA claim. A narrower interpretation of the agreement would fly directly in the face of both the ADA's statutory preference for arbitration, and the strong federal policy favoring alternative dispute resolution.

Under Austin, Wright must submit his claim to arbitration. Wright, however, contends that we should remand this case so that the district court may retain jurisdiction to monitor the arbitration process. We decline this invitation. Austin does not require a district court to retain jurisdiction once a case is dismissed for failure to exercise arbitral remedies. Indeed, the district court precisely followed Austin 's instruction that a claim that has not been properly submitted to arbitration should be dismissed without prejudice and without any opinion on "the merits of the claim, or whether or not the same is subject to arbitration." Those issues are for the arbitrators, and the district court's disposition of this case was entirely proper.

III.

For the foregoing reasons we affirm the judgment of the district court.

AFFIRMED.