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Section 4: Business

Institute of Bill of Rights Law, William & Mary Law School

IV. Business

In This Section:

Environmental Protection Agency v. EME Homer City Generation*

12-1182

Ruling Below: *EME Homer City Generation v. Environmental Protection Agency*, 696 F.3d 7, (D.C. Cir. 2013), *cert. granted*, 2013 WL 1283839 (U.S. 2013).

Various States, local governments, industry groups, and labor organizations petitioned for review of the Environmental Protection Agency's (EPA) Transport Rule. The rule sets limits on nitrogen oxides and sulfur dioxide from coal-fired power plants in 28 upwind states in the eastern part of the country. The D.C. Circuit Court held that the EPA exceeded its statutory authority under the "good neighbor" provision of the Clean Air Act in implementing the Transport Rule, and that the EPA could not issue Federal Implementation Plans without giving States an initial opportunity to implement the required reductions through State Implementation Plans (SIP) or SIP revisions.

Questions Presented: (1) Whether the court of appeals lacked jurisdiction to consider the challenges on which it granted relief; (2) whether the states are excused from adopting SIPs prohibiting emissions that "contribute significantly" to air pollution problems in other States until after the EPA has adopted a rule quantifying each State's interstate pollution obligations; and (3) whether the EPA permissibly interpreted the statutory term "contribute significantly" so as to define each upwind State's "significant" interstate air pollution contributions in light of the cost-effective emission reductions it can make to improve air quality in polluted downwind areas, or whether the Act instead unambiguously requires the EPA to consider only each upwind State's physically proportionate responsibility for each downwind air quality problem.

*Consolidated with *American Lung Association v. EME Homer City*

EME HOMER CITY GENERATION, L.P., Petitioner
v.
ENVIRONMENTAL PROTECTION AGENCY, et al., Respondents
San Miguel Electric Cooperative, et al., Intervenors.

United States Court of Appeals, District of Columbia Circuit

Decided on August 21, 2012

[Excerpt; some footnotes and citations omitted.]

KAVANAUGH, Circuit Judge

Some emissions of air pollutants affect air quality in the States where the pollutants are emitted. Some emissions of air pollutants travel across State boundaries and affect air quality in downwind States. To deal with that complex regulatory challenge ... Congress set up a federalism-based system of air pollution control... The Federal Government sets air quality standards for pollutants. The States have the primary responsibility for determining how to meet those standards and regulating sources within their borders.

...[U]pwind States must prevent sources within their borders from emitting federally determined "amounts" of pollution that travel across State lines and "contribute significantly" to a downwind State's "nonattainment" of federal air quality standards. That requirement is sometimes called the "good neighbor" provision.

...[T]o implement the statutory good neighbor requirement, EPA promulgated the rule at issue in this case, the Transport Rule, also known as the Cross–State Air Pollution Rule. The Transport Rule defines emissions reduction responsibilities for 28 upwind States based on those States' contributions to downwind States' air quality problems. The Rule limits emissions from upwind States' coal- and natural gas-fired power plants, among other sources. Those power plants generate the majority of electricity used in the United States, but they also emit pollutants that affect air quality. The Transport Rule targets two of those pollutants, sulfur dioxide (SO_2) and nitrogen oxides (NO_x).

Various States, local governments, industry groups, and labor organizations have petitioned for review of the Transport Rule. Although the facts here are complicated, the legal principles that govern this case are straightforward: Absent a claim of constitutional authority (and there is none here), executive agencies may exercise only the authority conferred by statute, and agencies may not transgress statutory limits on that authority.

Here, EPA's Transport Rule exceeds the agency's statutory authority in two independent respects. *First,* the statutory text grants EPA authority to require upwind States to reduce only their own significant contributions to a downwind State's nonattainment. But under the Transport Rule, upwind States may be required to reduce emissions by more than their own significant contributions to a downwind State's nonattainment. EPA has used the good neighbor provision to impose massive emissions reduction requirements on upwind States without regard to the limits imposed by the statutory text. Whatever its merits as a policy matter, EPA's Transport Rule violates the statute. *Second,* the Clean Air Act affords States the initial opportunity to implement reductions required by EPA under the good neighbor provision. But here, when EPA quantified States' good neighbor obligations, it did not allow the States the initial opportunity to implement the required reductions with respect to sources within their borders. Instead, EPA quantified States' good neighbor obligations and *simultaneously* set forth EPA-designed Federal Implementation Plans, or FIPs, to implement those obligations at the State level. By doing so, EPA departed from its consistent prior approach to implementing the good neighbor provision and violated the Act.

For each of those two independent reasons, EPA's Transport Rule violates federal law. Therefore, the Rule must be vacated.

... Congress could well decide to alter the statute to permit or require EPA's preferred approach to the good neighbor issue. Unless and until Congress does so, we must apply and enforce the statute as it's now written....

I
A

...

The Clean Air Act charges EPA with setting National Ambient Air Quality Standards, or NAAQS, which prescribe the maximum permissible levels of common pollutants in the ambient air. EPA must choose levels which, “allowing an adequate margin of safety, are requisite to protect the public health.”

... EPA designates “nonattainment” areas—that is, areas within each State where the level of the pollutant exceeds the NAAQS.

Once EPA sets a NAAQS and designates nonattainment areas within the States, the lead role shifts to the States. The States implement the NAAQS within their borders through State Implementation Plans, or SIPs. … In their SIPs, States choose which individual sources within the State must reduce emissions, and by how much. …

States must submit SIPs to EPA within three years of each new or revised NAAQS....

...[T]he “good neighbor” provision at issue in this case, is one of the required elements of a SIP. The good neighbor provision requires that SIPs:

(D) contain adequate provisions—

(i) prohibiting, consistent with the provisions of this subchapter, any source or other type of emissions activity within the State from emitting any air pollutant in amounts which will—

(I) contribute significantly to nonattainment in, or interfere with maintenance by, any other State with respect to any such national primary or secondary ambient air quality standard....

The good neighbor provision recognizes that emissions “from ‘upwind’ regions may pollute ‘downwind’ regions.” … By placing the good neighbor requirement in Section 110(a)(2), Congress established the upwind State's SIP as the vehicle for implementing the upwind State's good neighbor obligation.... EPA plays the critical role in gathering information about air quality in the downwind States, calculating each upwind State's good neighbor obligation, and transmitting that information to the upwind State. …

After EPA quantifies a State's good neighbor obligation, if a State does not timely submit an adequate SIP (or an adequate SIP revision) to take account of the good neighbor obligation as defined by EPA, responsibility shifts back to the Federal Government. Within two years of disapproving a State's SIP submission or SIP revision, or determining that a State has failed to submit a SIP, EPA must promulgate a Federal Implementation Plan to implement the NAAQS within that State.

B

...In *Michigan v. EPA,* we considered a challenge to EPA's 1998 NO_x Rule, commonly referred to as the NO_x SIP Call, which quantified the good neighbor obligations of 22 States with respect to the 1997 ozone NAAQS....

[T]he *Michigan* Court found no “clear congressional intent to preclude consideration of cost.” The Court thus held that EPA… could use cost considerations to lower an upwind State's obligations under the good neighbor provision.

In *North Carolina v. EPA,* we considered a challenge to EPA's 2005 Clean Air Interstate Rule, or CAIR. The decision held that the formulas went beyond *Michigan*'s authorization to use cost and that the formulas therefore exceeded EPA's statutory authority. EPA may use cost to “require termination of only a subset of each state's contribution,” the Court explained, but “EPA can't just pick a cost for a region, and deem ‘significant’ any emissions that sources can eliminate more cheaply.”

North Carolina thus articulated an important caveat to *Michigan*'s approval of cost considerations…. Put simply, the statute requires every upwind State to clean up at most *its own* share of the air pollution in a downwind State—not other States' shares.

C

...The Transport Rule is EPA's attempt to develop a rule that is consistent with our opinion in *North Carolina.* … The Transport Rule addresses States' good neighbor obligations with respect to three NAAQS: the 1997 annual $PM_{2.5}$ NAAQS, the 1997 ozone NAAQS, and the 2006 24–hour $PM_{2.5}$ NAAQS.

The Transport Rule contains two basic components. First, the Rule defines each State's emissions reduction obligations under the good neighbor provision. Second, the Rule prescribes Federal Implementation Plans to implement those obligations at the State level....

EPA began by quantifying the “amounts” of pollution that each State must prohibit under the good neighbor provision—that is, “amounts which will... contribute significantly to nonattainment” or “interfere with maintenance” of the three NAAQS in other States.

EPA used a two-stage approach to quantify each State's obligations under the good neighbor provision.

In the first stage, EPA determined whether a State emits “amounts which will ... contribute significantly” to a downwind State's nonattainment of any of the three NAAQS....

For annual $PM_{2.5}$, a total of 18 States exceeded the threshold and were therefore deemed “significant contributors.” For 24–hour $PM_{2.5}$, a total of 22 States[7] exceeded the threshold. Those States were thus included in the Rule's reduction programs for SO_2 and annual NO_x, pollutants that contribute to $PM_{2.5}$ formation. For ozone, a total of 26 States exceeded the threshold. Those States were thus included in the Rule's reduction program for ozone-season NO_x which contributes to ozone formation.

...[A]t stage two, EPA used a cost-based standard: EPA determined how much pollution each upwind State's power plants could eliminate if the upwind State's plants applied all controls available at or below a given cost per ton of pollution reduced.… [H]ow much pollution each upwind State was required to eliminate was not tied to how much the upwind State contributed to downwind States' air pollution problems.

EPA predicted how far emissions would fall if power plants throughout the State were required to install controls available at or below various cost levels....

EPA then added up the emissions from all of the covered States to yield total regionwide emissions figures for each pollutant, at each cost threshold. The higher the cost level selected, the greater the reduction of emissions, but also the greater the costs and burdens imposed on sources within the States.…

EPA determined the amount of SO_2, annual NO_x or ozone-season NO_x that each covered State could eliminate if its power plants installed all cost-effective emissions controls—that is, those controls available at or below the applicable cost-per-ton thresholds. EPA then used those figures to generate 2012, 2013, and 2014 emissions "budgets" for each upwind State, for each pollutant for which that State was covered....

...EPA simultaneously promulgated Federal Implementation Plans, or FIPs.

...The FIPs convert each State's emissions budget into "allowances," which are allocated among power plants in the State. Under the FIPs, it is EPA, and not the States, that decides how to distribute the allowances among the power plants in each State.

The Rule retains a limited, secondary role for SIPs. States have the option of submitting SIPs that modify some elements of the FIPs.... States may also seek to replace the FIPs wholesale, as long as the SIP prohibits the amounts of NO_x and SO_2 emissions that EPA specified. EPA says it would "review such a SIP on a case-by-case basis." But, importantly, the States do not have a post-Rule opportunity to avoid FIPs by submitting a SIP or SIP revision: The FIPs "remain fully in place in each covered state until a state's SIP is submitted and approved by EPA to revise or replace a FIP." ...

D

...In Part II of this opinion, we address whether the Rule exceeds EPA's authority to order upwind States to reduce "amounts which will ... contribute significantly to nonattainment" in downwind States. In Part III, we address whether the statute permits EPA to issue FIPs without giving the States an initial opportunity to implement the required reductions through SIPs or SIP revisions. In Part IV, we consider the remedy.

II

...Under the statute, EPA is limited to ordering upwind States to reduce “amounts which will ... contribute significantly to nonattainment” in downwind States.

A

The Transport Rule defines States' obligations under Section 110(a)(2)(D)(i)(I) of the Clean Air Act, a provision sometimes described as the “good neighbor” provision. The good neighbor provision requires that a State Implementation Plan, or SIP:

(D) contain adequate provisions—

(i) prohibiting, consistent with the provisions of this subchapter, any source or other type of emissions activity within the State from emitting any air pollutant in amounts which will—

(I) contribute significantly to nonattainment in, or interfere with maintenance by, any other State with respect to any such national primary or secondary ambient air quality standard....

The good neighbor provision recognizes that not all air pollution is locally generated.

Although the statute grants EPA significant discretion to implement the good neighbor provision, the statute's text and this Court's decisions in *Michigan* and *North Carolina* establish several red lines that cabin EPA's authority....

First, and most obviously, the text of Section 110(a)(2)(D)(i)(I) tells us that the “amounts which will ... contribute” to a downwind State's nonattainment are at most those amounts that travel beyond an upwind State's borders and end up in a downwind State's nonattainment area. The statute is not a blank check for EPA to address interstate pollution on a regional basis without regard to an individual upwind State's actual contribution to downwind air quality.

Moreover, the statutory text and this Court's decision in *North Carolina v. EPA* demonstrate that EPA may not force a State to eliminate more than its own “*significant* ” contribution to a downwind State's nonattainment area...

Second, under the terms of the statute and as we explained in *North Carolina*, the portion of an upwind State's contribution to a downwind State... depends on the relative contributions of that upwind State, of other upwind State contributors, and of the downwind State itself. Each upwind State may be required to eliminate only its own “amounts which will ... contribute significantly” to a downwind State's “nonattainment.” As explained in *North Carolina,* EPA may not require any upwind State to “share the burden of reducing other upwind states' emissions.” In other words, the statutory text... contains not just an absolute component (meaning that an upwind State's insignificant amounts are not covered) but also a relative component (meaning that each State's relative contribution to the downwind State's nonattainment must be considered).

Moreover, the end goal of the statute is attainment in the downwind State. EPA's authority to force reductions on upwind States ends at the point where the affected downwind State achieves attainment.

...Each upwind State must bear its own fair share. Therefore, the "significance" of each upwind State's contribution cannot be measured in a vacuum, divorced from the impact of the other upwind States. Rather, the collective burden must be allocated among the upwind States in proportion to the size of their contributions to the downwind State's nonattainment....

In addition, our decisions in *Michigan* and *North Carolina* establish that EPA may consider cost, but only to further lower an individual State's obligations....

Third, to conform to the text of the statute, EPA must also ensure that the combined obligations of the various upwind States, as aggregated, do not produce more than necessary "over-control" in the downwind States—that is, that the obligations do not go beyond what is necessary for the downwind States to achieve the NAAQS.

Even when EPA carefully conforms to the above limits on its authority, the possibility of over-control in downwind States still arises because multiple upwind States may affect a single downwind State and, conversely, a single upwind State may affect multiple downwind States.... EPA may require only those reductions that are necessary for downwind States to attain the NAAQS. The good neighbor provision is not a free-standing tool for EPA to seek to achieve air quality levels in downwind States that are *well below* the NAAQS. Therefore, if modeling shows that a given slate of upwind reductions would yield more downwind air quality benefits than necessary for downwind areas to attain the NAAQS, EPA must attempt to ratchet back the upwind States' obligations to the level of reductions necessary and sufficient to produce attainment in the downwind States.

To be sure, as even petitioners acknowledge, there may be some truly unavoidable over-control in some downwind States that occurs as a byproduct of the necessity of reducing upwind States' emissions enough to meet the NAAQS in other downwind States. For those reasons, EPA must have some discretion about how to reasonably avoid such over-control. Moreover, because multiple upwind States may affect a single downwind State, and because a single upwind State may affect multiple downwind States, it may not be possible to accomplish the ratcheting back in an entirely proportional manner among the upwind States. Our cases recognize as much. But the point remains: EPA must avoid using the good neighbor provision in a manner that would result in unnecessary over-control in the downwind States. Otherwise, EPA would be exceeding its statutory authority, which is expressly tied to achieving attainment in the downwind States.

B

We now apply those principles to the EPA Transport Rule. "It is axiomatic that an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress." An agency may not exceed a statute's authorization or violate a statute's limits. If a statute is ambiguous, an agency that administers the statute may choose a reasonable interpretation of that ambiguity—but the agency's interpretation must still stay within the boundaries of the statutory text....

We perceive at least three independent but intertwined legal flaws in EPA's approach to the good neighbor provision....

First, and most fundamentally, the Transport Rule is flawed because the requirement that EPA imposed on upwind States was not based on the "amounts" from upwind States that "contribute significantly to nonattainment" in downwind States, as required by the statute and our decision in *North Carolina*.

Petitioners claim that the initial stage of EPA's analysis—the numerical air quality thresholds, which used a bright-line test for whether a State's downwind emissions "contribute significantly"—created a " 'floor' below which any contribution is, by definition, viewed as insignificant." ...

...The Transport Rule includes or excludes an upwind State based on the amount of that upwind State's significant contribution to a nonattainment area in a downwind State. That much is fine. But under the Rule, a State then may be required to reduce its emissions by an amount greater than the "significant contribution" that brought it into the program in the first place. That much is not fine.

Put more plainly, EPA determined that a State was subject to the good neighbor provision if it contributed at least a certain threshold amount to air pollution in a downwind State. But EPA then imposed restrictions based on region-wide air quality modeling projections; those restrictions could require upwind States to reduce emissions by more than the amount of that contribution.

EPA's approach poses a fundamental legal problem—one that derives from the text of the statute and from our precedents....

By using a numerical threshold at the initial stage—and thereby creating a floor below which "amounts" of downwind pollution were not significant—EPA defined the "mark," to use the term employed in *North Carolina*. EPA could not then ignore that mark and redefine each State's "significant contribution" in such a way that an upwind State's required reductions could be *more* than its own significant contribution to a downwind State....

In short, EPA used the air quality thresholds to establish a floor below which "amounts" of air pollution do not "contribute significantly." The statute requires a State to prohibit at most those "amounts" which will "contribute significantly"—and no more. If amounts below a numerical threshold do not contribute significantly to a downwind State's nonattainment, EPA may not require an upwind State to do more. The Transport Rule does not adhere to that basic requirement of the statutory text and our precedents.

Second, EPA's Transport Rule also runs afoul of the statute's proportionality requirement as described in our decision in *North Carolina*....

Here, EPA's Transport Rule violated the statute because it made no attempt to calculate upwind States' required reductions on a proportional basis that took into account contributions of other upwind States to the downwind States' nonattainment problems.

In the same vein, EPA's Transport Rule failed to take into account the downwind State's own fair share of the amount by which it exceeds the NAAQS....

Third, and relatedly, EPA also failed to ensure that the collective obligations of the various upwind States, when aggregated, did not produce unnecessary over-control in the downwind States.... EPA may not require upwind States to do more than necessary for the downwind States to achieve the NAAQS. Here, EPA did not try to take steps to avoid such over-control.

In sum, EPA's authority derives from the statute and is limited by the statutory text. EPA's reading of Section 110(a)(2)(D)(i)(I)—a narrow and limited provision—reaches far beyond what the text will bear.

...It seems inconceivable that Congress buried in Section 110(a)(2)(D)(i)(I)—the good neighbor provision—an open-ended authorization for EPA to effectively force every power plant in the upwind States to install every emissions control technology EPA deems "cost-effective." Such a reading would transform the narrow good neighbor provision into a "broad and unusual authority" that would overtake other core provisions of the Act. We "are confident that Congress could not have intended to delegate a decision of such economic and political significance to an agency in so cryptic a fashion." ...

III

There is a second, entirely independent problem with the Transport Rule.... Instead, in an unprecedented application of the good neighbor provision, EPA also simultaneously issued Federal Implementation Plans, or FIPs, to implement those obligations on sources in the States. EPA did so without giving the States an initial opportunity to implement the obligations themselves through their State Implementation Plans, or SIPs.

...EPA's approach punishes the States for failing to meet a standard that EPA had not yet announced and the States did not yet know.

Under the Act, EPA has authority to set standards, but the statute reserves the first-implementer role for the States. That division of labor applies not just to the NAAQS but also to the good neighbor provision, Section 110(a)(2)(D)(i)(I), as EPA itself has recognized several times in the past....

A

...The [Clean Air] Act sets forth a basic division of labor: The Federal Government establishes air quality standards, but States have primary responsibility for attaining those standards within their borders.

...This Court has described the *Train–Virginia* line of cases as erecting a statutory "federalism bar" under Section 110 of the Act. That statutory federalism bar prohibits EPA from using the SIP process to force States to adopt specific control measures.

In *Train,* the Supreme Court invoked that statutory division of labor in holding that the Clean Air Act gives EPA "no authority to question the wisdom of a State's choices of emission limitations," so long as the State's SIP submission would result in "compliance with the national standards for ambient air." ...

Similarly, in *Virginia,* this Court held that EPA had no authority under Section 110 to condition its approval of northeastern States' SIPs on the States' adoption of California's vehicle emission control measures. ...

In sum, Title I of the Act establishes a "partnership between EPA and the states." The terms of that partnership are clear: EPA sets the standards, but the States "bear primary responsibility for attaining, maintaining, and enforcing these standards."

B

With that basic structure in mind, we consider the question presented here: whether EPA may use its rulemaking authority to quantify States' obligations under Section 110(a)(2)(D)(i)(I) and *simultaneously* issue Federal Implementation Plans, without giving the States a first opportunity to comply.

We begin by briefly describing the set of statutory provisions on which EPA relies here.

EPA is the first mover in regulating ambient air pollution in Title I of the Clean Air Act....

Section 110 governs State Implementation Plans. Section 110(a)(1) requires States to submit SIPs to implement each new or revised NAAQS. Section 110(a)(2) lists many elements.... The good neighbor provision... is one of those required elements.

Section 110(c)(1) creates a federal backstop if the States fail to submit adequate SIPs. When EPA finds that a State "has failed to make a required submission" or "disapproves a State implementation plan submission in whole or in part" because of a SIP "deficiency," EPA must "promulgate a Federal implementation plan" within two years, "unless the State corrects the deficiency".... In essence, the issue here is whether a State's implementation of its good neighbor obligation can be considered part of the State's "required submission" in its SIP (or whether the SIP can be deficient for failing to implement the good neighbor obligation) even before EPA quantifies the State's good neighbor obligation. We think not.... [O]nce EPA defines or quantifies a State's good neighbor obligation, the State must have a reasonable time to implement that requirement with respect to sources within the State.

In short, the triggers for a FIP are EPA's finding that the SIP fails to contain a "required submission" or EPA's disapproving a SIP because of a "deficiency." But logically, a SIP cannot be deemed to lack a required submission or be deemed deficient for failing to implement the good neighbor obligation until after EPA has defined the State's good neighbor obligation. Once it defines the obligation, then States may be forced to revise SIPs under Section 110(k)(5) or to submit new SIPs under Section 110(a)(1). Only if that revised or new SIP is properly deemed to lack a required submission or is properly deemed deficient may EPA resort to a FIP for the State's good neighbor obligation.

C

1

...Title I's core two-step process is that the Federal Government sets end goals and the States choose the means to attain those goals. EPA's theory—that EPA can define the end goals for the good neighbor provision and *simultaneously* issue federal plans to implement them—upends that process and places the Federal Government firmly in the driver's seat at both steps. The FIP-first approach is incompatible with the basic text and structure of the Clean Air Act.

In our view, determining the level of reductions required under Section 110(a)(2)(D)(i)(I) is analogous to setting a NAAQS. And determining the level of reductions under the good neighbor provision triggers a period during which States may submit appropriate SIPs under Section 110(a)(1) or SIP revisions under Section 110(k)(5).

That approach fits comfortably within the statutory text and structure. In both situations—setting a NAAQS and defining States' good neighbor obligations—EPA sets the numerical end goal. And in both cases, once the standards are set, "determining the particular mix of controls among individual sources to attain those standards" remains "a State responsibility."

2

Other contextual and structural factors also support our conclusion...

Section 110's particular function in the statutory scheme is to give the States the first opportunity to implement the national standards EPA sets under Title I. The good neighbor requirement's placement in Section 110(a)—a provision calling for State-level regulation—strongly suggests that Congress intended *States* to implement the obligations set forth in Section 110(a)(2)(D)(i)(I)....

Moreover, Title I contains a separate provision, Section 126, that explicitly contemplates direct EPA regulation of specific sources that generate interstate pollution. Section 126(b) permits a State to petition EPA for a finding that a source in a neighboring State emits pollution in violation of Section 110(a)(2)(D)(i). Section 126(c) gives EPA discretion to impose severe sanctions, including "emission limitations and compliance schedules," on a source for which a finding has been made. The fact that Congress explicitly authorized EPA to use direct federal regulation to address interstate pollution suggests it did not contemplate direct Federal regulation in Section 110(a)(2)(D)(i)(I)....

In sum, the text and context of the statute, and the precedents of the Supreme Court and this Court, establish the States' first-implementer role under Section 110....

3

...In the past, EPA has applied the good neighbor provision in the States-first way we have outlined here.

The 1998 NO_x Rule (which we addressed in *Michigan*) quantified each State's good neighbor obligation but then gave the States 12 months to submit SIPs to implement the required reductions. Indeed, EPA explicitly assured States that the Rule did not intrude on their authority to choose the means to achieve the EPA-defined end goal:

...Thus, in general, it is reasonable to assume that *EPA may be in a better position to determine the appropriate goal,* or budget, for the contributing States, *while leaving [it] to the contributing States' discretion to determine the mix of controls* to make the necessary reductions.

In *Michigan,* this Court held that the 1998 Rule did not transgress the Train–Virginia federalism bar.... We said: "EPA does not tell the states how to achieve SIP compliance. Rather, EPA looks to section 110(a)(2)(D) and *merely provides the levels to be achieved by state-determined compliance mechanisms.*" ...

Like the 1998 NO_x Rule, the 2005 Clean Air Interstate Rule gave States the first crack at implementing the reductions required by EPA.

When EPA issued CAIR FIPs in April 2006, about a year after it promulgated CAIR, it clarified that it intended the FIPs to serve as a "Federal backstop" to the ongoing SIP process, and did not intend to "take any other steps to implement FIP requirements that could impact a State's ability to regulate their sources in a different manner" until "a year after the CAIR SIP submission deadline." ...

EPA's own past practice and statements illustrate the anomaly of its new FIP-first approach.

D

On a separate tack, EPA does not concede that it denied the States their rightful chance to implement their good neighbor obligations. It contends States *did* have an opportunity to submit SIPs....

In effect, EPA claims the statute requires each State to take its own stab in the dark at defining "amounts which will ... contribute significantly" to a downwind State's nonattainment. The State would then have to apply that homemade definition using its own homemade methodology.

Of course, once a State takes its stab, EPA could disapprove it—especially if the State defined its own obligation to be less than what EPA deemed it to be.... Petitioners point out that every Transport Rule State that submitted a good neighbor SIP for the

2006 24–hour $PM_{2.5}$ NAAQS was disapproved.

...EPA itself has recognized that having each State independently guess at its own good neighbor obligations is not a plausible solution to interstate pollution: “It is most efficient—*indeed necessary*—for the Federal government to establish the overall emissions levels for the various States.”

Yet EPA now encourages us to suspend disbelief and conclude that under the statute, a State's only chance to avoid FIPs is to make a successful stab in the dark—a feat that not one Transport Rule State managed to accomplish. EPA clearly does not believe the stab-in-the-dark approach would really permit States to avoid FIPs—its own past statements show that....

When EPA quantifies States' good neighbor obligations, it must give the States a reasonable first opportunity to implement those obligations. That approach reads Section 110(a)(2)(D)(i)(I) in harmony with the rest of Section 110. It preserves Title I's Federal–State division of labor—a division repeatedly reinforced by the Supreme Court and this Court. And it accords with the commonsense notion that Congress did not design the good neighbor provision to set the States up to fail.

IV

The decision whether to vacate a flawed rule “depends on the seriousness of the order's deficiencies (and thus the extent of doubt whether the agency chose correctly) and the disruptive consequences of an interim change that may itself be changed.”

Here, we have no doubt that the agency chose incorrectly. The Transport Rule stands on an unsound foundation—including EPA's flawed construction of the statutory term “amounts which will ... contribute significantly to nonattainment.” ... [T]he Transport Rule's “fundamental flaws foreclose EPA from promulgating the same standards on remand.” EPA's chosen manner of implementing the Rule—issuing FIPs without giving the States a post-Rule opportunity to submit SIPs—also rests on a misreading of the statute.

We therefore vacate the Transport Rule rulemaking action and FIPs, and remand to EPA.

The remaining question is the status of CAIR....

In accordance with our Order granting the motions to stay the Transport Rule, EPA has continued to administer CAIR. Vacating CAIR now would have the same consequences that moved the *North Carolina* Court to stay its hand—and indeed might be more severe now, in light of the reliance interests accumulated over the intervening four years. We therefore conclude, as did the Court in *North Carolina,* that the appropriate course is for EPA to continue to administer CAIR pending its development of a valid replacement....

So ordered.

ROGERS, Circuit Judge, dissenting:

To vacate the Transport Rule, the court disregards limits Congress placed on its jurisdiction, the plain text of the Clean Air Act ("CAA"), and this court's settled precedent interpreting the same statutory provisions at issue today....

Congress has limited the availability of judicial review of challenges to final rules promulgated by the EPA in two ways that are relevant here. Under CAA section 307(b)(1), 42 U.S.C. § 7607(b)(1), petitions for judicial review must be filed within sixty days of promulgation of a final rule, and under CAA section 307(d)(7)(B), 42 U.S.C. § 7607(d)(7)(B), "[o]nly an objection to a rule or procedure which was raised with reasonable specificity during the period for public comment... may be raised during judicial review." The court has, until today, strictly enforced these requirements, which exist for two important reasons: to enforce repose so that the rulemaking process is not crippled by surprise challenges to matters that were rightfully presumed settled, and to guarantee an agency's expert consideration and possible correction of any flaws in its rules *before* the matter reaches a court....

As one basis underlying its vacatur of the Transport Rule, the court permits a collateral attack on prior final rules in which EPA disapproved state implementation plan ("SIP") submissions... or found States failed to submit such a SIP at all.... States may not collaterally attack the propriety of those Final SIP Rules now.... The court therefore lacks jurisdiction under section 307(b)(1) to consider States' belated challenge....

As another ground to vacate the Transport Rule, the court concludes that, under EPA's two-step approach to defining "significant contribution" under the "good neighbor" requirement in section 110(a)(2)(D)(i)(I), a State "may be required to reduce its emissions by an amount greater than the 'significant contribution' that brought it into the program in the first place." ...

The court's remaining reasons for vacatur lack merit. First, the court concludes EPA violated the "good neighbor" provision's "proportionality" requirement.... On the merits, the court's "proportionality" conclusion contradicts the court's opposite conclusion in *North Carolina* that EPA's measurement of a State's "significant contribution" did not have to correlate directly with its air quality impact "relative to other upwind states." Similarly, the court's holding that EPA failed to consider the effect of in-state emissions is likewise premised on the sub-threshold argument. Further, the court's "in-State emissions" and its "over-control" conclusions are contradicted by the Transport Rule administrative record.

I.

Section 307(b)(1) of the CAA, 42 U.S.C. § 7607(b)(1), requires a petition for judicial review of EPA final actions to be filed within sixty days of publication in the Federal Register. "The filing period in the Clean Air Act 'is jurisdictional in nature'; if the petitioners have failed to comply with it, we are powerless to address their claim."

The Supreme Court has explained that "judicial review provisions are jurisdictional in nature and must be construed with strict fidelity to their terms....

Accordingly, in *Medical Waste* this court dismissed a challenge to a final rule for lack of jurisdiction where petitioners failed to seek judicial review when EPA "*first use[d]* " its statutory approach....

...Over a year prior to promulgating the Transport Rule, EPA promulgated Final SIP Rules publishing findings that twenty-nine States and territories had failed to submit SIPs with the required "good neighbor" provisions for the 2006 24–hour $PM_{2.5}$ NAAQS. In these Final SIP Rules, EPA stated:

This finding establishes a 2–year deadline for promulgation by EPA of a FIP...

The Final SIP Rules further state that the findings of failure to submit were of nationwide scope and effect.... No State filed a petition for judicial review.

... Only Georgia, Kansas, and Ohio filed petitions for judicial review of EPA's disapproval action and their petitions are not consolidated with the petitions now under review, as they challenge different final rules.

A.

Now that EPA has, as it warned, promulgated FIPs for States covered by the Transport Rule, State petitioners contend that EPA lacked authority to do so for the 2006 24–hour $PM_{2.5}$ NAAQS because "a FIP can cure a deficiency only in a *required* submission, and States were not required to include SIP provisions to eliminate 'significant contributions' not yet defined by EPA legislative rule." If a State wished to object that under section 110(a) it had no obligation to include "good neighbor" provisions in its SIP until EPA quantified its "significant contribution" in emission reduction budgets, then the CAA required it do so at the time EPA found it had not met its SIP "good neighbor" obligation....

...[T]he court reaches the merits of this issue despite its lack of jurisdiction. In the Final SIP Rules finding States had failed to submit "good neighbor" SIPs, EPA put covered States on unambiguously "sufficient notice" that it interpreted the CAA as placing an independent obligation on each State.... In alerting States to the judicial review deadline, EPA reiterated that States had sixty days to file "*any* petitions for review... Not having sought judicial review of the Final SIP Rules determining that they failed to submit *required* "good neighbor" SIPs, States may not now object that they were *not required* to submit "good neighbor" SIPs until EPA first quantified their reduction obligations....

...[N]either Alabama nor Indiana petitioned for judicial review of EPA's disapproval of their SIP submissions. In the Final SIP Rule disapproving Alabama's SIP submission, EPA quotes one commenter as stating:

EPA has not stated the amount of reduction they believe is needed to satisfy the transport requirements....

EPA responded that "the state obligation stems from the CAA itself.... *States had an opportunity to conduct their own analyses regarding interstate transport.*" ... [N]either

Alabama nor Indiana sought judicial review of EPA's Final SIP Rules disapproving their SIP submissions, and their attempt now to collaterally attack those Final SIP Rules is barred.

Given EPA's clear statements in its Final SIP Rules disapproving States' SIP submissions and finding they failed to submit required “good neighbor” SIPs, there is no basis to conclude that State petitioners might *not* have perceived a substantial risk that EPA *meant* what it *said*.... EPA promulgated Final SIP Rules in which it made its interpretation clear; judicial challenge to those rules is the proper forum to decide the question.

Section 110(c) provides that:

(1) The Administrator *shall* promulgate a Federal implementation plan *at any time* within 2 years after *the Administrator*—

(A) *finds* that a State has failed to make a required submission ... or

(B) *disapproves* a State implementation plan submission in whole or in part;

unless the State corrects the deficiency, and the Administrator approves the plan or plan revision, *before* the Administrator promulgates such Federal implementation plan.

EPA's FIP obligation is therefore not triggered, without more, by a State's mere failure to submit a SIP required by section 110(a), but instead by an *explicit* EPA Final Rule *finding* that the State either failed to submit a required SIP or an adequate SIP. A challenge to EPA's interpretation of section 110(a) must therefore be brought as a petition for judicial review...

The plain text of section 110(c)(1) obligates EPA to promulgate a FIP “at any time” within two years of disapproving a SIP submission or finding a State failed to submit a SIP. Moreover, nothing in section 110(c) requires EPA to reveal to States the *content* (*i.e.,* the emission reduction budgets) it intends to include in its FIP *prior* to *proposing* a FIP. Although the CAA allows States to submit SIPs to “correct[ ] the deficiency,” they must do so “before” EPA's promulgation of a FIP, which may occur “at any time” within two years....

B.

Even if the court had jurisdiction over State petitioners' challenge to their independent obligation to submit “good neighbor” SIPs under CAA section 110(a), its statutory analysis proceeds with no regard for the plain text and structure of the CAA or for the deference owed to permissible agency interpretations of statutes they administer where Congress has left a gap for the agency to fill or the statute is ambiguous.

...[U]nder *Chevron U.S.A. Inc. v. Natural Res. Def. Council*, the first step in statutory interpretation requires a determination of “whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." If, after applying traditional tools of statutory construction, the court determines "the statute is silent or ambiguous with respect to the specific issue," then, under step two, the court will defer to an agency's statutory interpretation if it "is based on a permissible construction of the statute."

The questions regarding States' obligations to submit "good neighbor" SIPs are straightforward: (1) Do States have an independent obligation to submit SIPs with adequate "good neighbor" provisions; (2) if so, what triggers that obligation; (3) if there is an obligation, what is the deadline for the SIP submission; and (4) must EPA prospectively quantify each States' amount of "significant contribution" to downwind nonattainment? The plain text of the statute provides equally straightforward answers: (1) Yes; (2) promulgation of a NAAQS; (3) within three years of promulgation of a NAAQS (unless the EPA Administrator prescribes a shorter deadline); and (4) no, but EPA *may* do so if it chooses.

Section 109 of the CAA requires EPA to promulgate NAAQS, a national health-based standard. Section 110, in turn, provides that

(a)(1) Each State *shall* ... adopt and submit to the Administrator, within 3 years (or such shorter period as the Administrator may prescribe) *after the promulgation of a national primary air quality standard* (or any revision thereof) ... a plan which provides for implementation, maintenance, and enforcement of such [ ] standard ... within such State.

(2) Each implementation plan submitted by a State under this chapter ... *shall*

...

(D) contain adequate provisions—

(i) prohibiting, consistent with the provisions of this subchapter, any source or other type of emissions activity within the State from emitting any air pollutant in amounts which will—

(I) contribute significantly to nonattainment in, or interfere with maintenance by, any other State with respect to any such [NAAQS].

The plain text requires that within three years of EPA's promulgation of a NAAQS, States *shall* submit SIPs, and those SIPs *shall* include *adequate* "good neighbor" provisions.... EPA has the first duty to set the NAAQS, and then States have series of follow-up duties.... Among the duties clearly assigned to States is the inclusion in SIPs of adequate "good neighbor" provisions.

...The court's "role is 'not to 'correct' the text so that it better serves the statute's purposes'; nor under *Chevron* may [the court] 'avoid the Congressional intent clearly expressed in the text simply by asserting that [the court's] preferred approach would be better policy. The Congress has spoken plainly...."

The court's rationale for rewriting the CAA's plain text is its *own* conclusion that "the upwind State's obligation remains *impossible* for the upwind State to determine *until EPA defines it.*” .... Indeed, as this court has recognized, States are charged with operating air quality monitors.... The air quality monitoring data collected by the States is publically available .... State air quality divisions are no strangers to complex air quality and meteorological modeling of interstate transport of emissions.

...[T]heir reason for not doing so appears to stem from insistence (supported by industry sources) that their reduction of emissions not be one iota greater than is necessary for downwind States to attain and maintain NAAQS and that it is easier (and presumably less costly) for EPA to figure this out than it is for the individual States to do so, working cooperatively and using any EPA guidance. This may be so but it does not demonstrate that Congress's scheme, protecting States' choices about how to meet NAAQS requirements, in part by independently determining ways to meet their “good neighbor” obligation as the States argued in *Michigan*, is absurd.

... [I]n two previous “good neighbor” rulemakings EPA afforded States the opportunity to submit SIPs after announcing emission reduction budgets. But an agency is not forever restricted to its previous policy choices or statutory interpretations.... The discretion agencies enjoy in modifying their policy approaches is particularly expansive where the agency declines to exercise its *discretionary* rulemaking authority, as EPA did here.

Here, EPA acknowledged its previous approach, and explained its decision in response to comments requesting States be given time to submit SIPs before EPA imposed the Transport Rule FIPs.... EPA's decision to adhere to the plain text of the statute, and not to exercise its discretionary general rulemaking authority, was thus well-explained by the time pressures imposed *by this court.* Inasmuch as those time pressures were animated as well by concern for the public health and welfare—Congress required that attainment with the NAAQS occur “as expeditiously as practicable.”

Given that the court “will overturn an agency's decision not to initiate a rulemaking only for compelling cause,” and one of those few compelling reasons is when the decision *declining* to promulgate a rule exacerbates “grave health and safety problems for the intended beneficiaries of the statutory scheme,” it hardly makes sense for the court to *require* EPA to promulgate a rule when the effect will be to *delay* health benefits....

In sum, the court's conclusion that it would have been a “homemade” “stab in the dark” for the States to submit adequate “good neighbor” SIPs prior to promulgation of the Transport Rule lacks a basis in fact, and the court's speculation that EPA would have inevitably disapproved such submissions, is just that—speculation.... [T]he court is bound, in view of the host of responsibilities placed on States in the CAA, to enforce the statute as Congress wrote it in plain terms, to give deference to EPA's permissible interpretations where the CAA is silent or ambiguous, and to adhere to the court's interpretation of EPA's authority in *Michigan,* as well as acknowledge, as the expert agency has advised without contradiction, that States have demonstrated competence to satisfy their plain statutory “good neighbor” obligations.

II.

The court also is without jurisdiction to hold that EPA lacked statutory authority to use a different measure of “significant contribution” for setting emission reduction budgets, unrelated to its measure of “significance” for purposes of threshold inclusion of individual States in the Transport Rule.... Because no objection was made during the transport rule administrative proceedings to EPA's statutory authority to adopt its two-step approach, the court thus lacks jurisdiction to decide this issue....

A.

Section 307(d)(7)(B) of the CAA provides that “[o]nly an objection to a rule or procedure which was raised with reasonable specificity *during the period for public comment* ... may be raised during judicial review.” The court also has made clear that “[r]easonable specificity requires something more than a general challenge to EPA's approach.” The court's enforcement of this requirement has been most strict in the context of statutory authority objections....

Consistently, until now, the court has held that failure to object specifically to EPA's lack of *statutory authority* is grounds for dismissal of such objections in this court.

Notably on point, in *Cement Kiln* the court held that comments stating a policy preference to EPA were insufficient to preserve for judicial review objections that the preferred approach was statutorily required.

...Petitioners rely on two comments in an attempt to show a challenge to EPA's statutory authority to the approach it adopted was presented during the Transport Rule administrative proceedings. Neither is sufficient. Tennessee commented that “[a] lower cost threshold should be considered for any State that can reduce their contribution below 1% significance using cost thresholds below the maximum values ($2,000/ton for SO2 and $500/ton for NO_x), if applicable.” But this comment does not suggest that EPA is statutorily barred from following its approach.... [T]he only thing Tennessee commented on with “reasonable specificity” was that EPA consider not using a uniform cost threshold for all States.

Wisconsin's comment also does not demonstrate the statutory authority challenge now advanced by petitioners in this court was preserved....

Wisconsin nowhere suggested that EPA is statutorily required to use the one percent inclusion threshold as a floor for emission reductions; it simply urged that EPA “should” put a “greater emphasis” on air quality impacts at the *individual EGU* level....

Consequently, neither Tennessee's nor Wisconsin's comments argued “with reasonable specificity” that EPA was statutorily required to treat the threshold inclusion level in its two-step approach to defining "significant contribution" as a floor in calculating emission reduction requirements....

All that [petitioner] had to do was draft one sentence that specifically challenged EPA's decision. It did not, and that specific challenge is thus not preserved.

...

None of the comments during the Transport Rule administrative proceedings approaches the level of "reasonable specificity" required for this court to have jurisdiction over petitioners' new statutory authority argument.

B.

Acknowledging this, the court nonetheless concludes that it has jurisdiction to address this new issue because "EPA was on notice that its disregard of the significance floor was a potential legal infirmity in its approach." None of the three reasons the court offers for its conclusion that there need not be objections raised "with reasonable specificity during the period for public comment," is convincing.

First, the court states that EPA was required "to craft a new rule consistent with [*North Carolina*]," and thus should have been alerted to petitioners' new objection, raised for the first time now in this court. But in *North Carolina* the court specifically permitted the exact same approach in CAIR.

...

There is no basis to conclude that EPA acted inconsistently with *North Carolina* by replicating the approach the court left undisturbed....

...EPA was entitled, in the absence of objection in the Transport Rule administrative proceedings, to rely in promulgating the Transport Rule upon the court's decision not to disturb its approach. And the fact that after *North Carolina* no comment in the Transport Rule administrative proceedings objected that EPA was exceeding its statutory authority in adopting its approach underscores the fact that EPA was not acting inconsistently with *North Carolina* in light of a few sentences about fuel factors plucked out of context.

Second, ...the court points to a comment submitted during the CAIR rulemaking that it deems sufficient, when combined with the holding in North Carolina, to "show that EPA 'had notice of this issue and could, or should have, taken it into account.' " The CAIR comment stated "that the threshold contribution level selected by EPA should be considered a floor, so that upwind States should be obliged to reduce their emissions only to the level at which their contribution to downwind nonattainment does not exceed that threshold level." This comment... cannot carry the weight the court assigns to it, particularly in light of the holding in *North Carolina.*

...[T]he cited CAIR comment is insufficient to establish that the issue of EPA's statutory authority was properly preserved for the court to have jurisdiction to address it.

Although the CAIR comment communicates a policy preference, this court has distinguished between comments presenting policy preferences and those presenting statutory authority objections, and technical and policy arguments are insufficient to preserve objections to EPA's statutory authority....

Third, the court concludes that “EPA's statements at the proposal stage indicated EPA was not open to reconsidering CAIR's earlier rejection of petitioners' argument,” and that because EPA had dismissed “the two air quality-only approaches it considered,” the comments of Tennessee, Wisconsin, and Delaware were “ ‘reasonable’ under the circumstances.”... EPA's rejection of two alternative air quality-only approaches has no bearing on whether EPA would have been willing to entertain an objection during the Transport Rule administrative proceedings that the “good neighbor” provision required it to use the threshold level for a State's inclusion in the Transport Rule as a floor for emission reduction obligations.

...The court does not acknowledge this court's precedent setting a strict standard for preservation of statutory authority objections, which demonstrates the inconsistency of the court's exercise of jurisdiction today.

...

None of the court's proffered reasons for ignoring section 307(d)(7)(B)'s jurisdictional limitations has merit on its own, nor in combination. “[Z]ero plus zero [plus zero] equals zero.”

III.

The court's remaining reasons for vacating the Transport Rule are also either beyond its jurisdiction or unpersuasive.

First, the court concludes that EPA violated the CAA by not calculating the required emission reductions “on a proportional basis that took into account contributions of other upwind States to the downwind States' nonattainment problems.” This is so, the court says, because in *Michigan* the court only permitted cost to be considered as a way “to allow some upwind States to do *less* than their full fair share,” not more.... This challenge is limited to the asserted *arbitrariness* of how certain States were categorized for one pollutant's budget for one year. The court lacks jurisdiction to consider *sua sponte* an objection to EPA's statutory authority not raised by petitioners within the sixty day period....

Second, even if petitioners *had* raised a “proportionality” statutory authority objection, this objection and the court's conclusion are premised on the speculative possibility that the Transport Rule might require States to reduce emissions to a level below the one percent of NAAQS inclusion threshold of EPA's two-step approach to defining “signification contribution,” and thus *more* than their statutory fair share—an argument over which the court also lacks jurisdiction.... Without jurisdiction to reach an argument on whether the Transport Rule requires States to reduce *more* than their statutory fair share, *Michigan* requires the conclusion that EPA's choice of cost thresholds in the Transport Rule was permissible.

Next, the court concludes that EPA failed to consider the effect of in-State emissions of downwind States on their own nonattainment and interference with maintenance problems. Even if the court had jurisdiction to address it, the court's conclusion is unsupported by the record. EPA examined the various cost threshold for each State, and in so doing considered how much air quality improvement in downwind states result[ed] from upwind state emission reductions....

EPA thus in fact examined the contribution of downwind States to their own nonattainment problems.

Finally, the court concludes that EPA "did not try to take steps to avoid" collective over-control. This conclusion too is unsupported by the record. The Transport Rule was not projected to achieve attainment of all downwind nonattainment and maintenance problems attributed to upwind States....

IV.

The Transport Rule, as EPA observes, represents "the culmination of decades of Congressional, administrative, and judicial efforts to fashion a workable, comprehensive regulatory approach to interstate air pollution issues that have huge public health implications." The legislative history to amendments of the CAA documents Congress's frustration with the upwind States' historic failure to take effective action on their own to curtail their contributions to problems of pollution in downwind States, leading to amendments to strengthen EPA's hand. The court ignores Congress's limitations on the court's jurisdiction and decades of precedent strictly enforcing those limitations and proceeds to do violence to the plain text of the CAA and EPA's permissible interpretations of the CAA, all while claiming to be "apply[ing] and enforc[ing] the statute as it's now written." The result is the endorsement of a "maximum delay" strategy for regulated entities, rewarding States and industry for cloaking their objections throughout years of administrative rulemaking procedures and blindsiding the agency with both a collateral attack on its interpretation of section 110(a) and an objection raised for the first time in this court, despite the court's previous decisions declining to disturb the approach EPA adopted in the Transport Rule.

To reach the result... the court does several remarkable things. It seizes jurisdiction over the issue of States' independent "good neighbor" obligation by allowing States to pursue a collateral attack on Final SIP Rules from which they either failed timely to file petitions for review or their petitions challenging those rules have not been consolidated with the petitions challenging the Transport Rule that are before this three-judge panel. It asserts jurisdiction over industry's challenge to EPA's two-step approach to defining "significant contribution" by excusing industry from its failure to preserve the issue by first presenting it to EPA and then resting jurisdiction on a comment in another rulemaking that was first cited by industry in *rebuttal* oral argument and cannot bear the weight the court assigns to it because it did not challenge EPA's statutory authority to adopt its two-step approach. All this is contrary to Congress's limitations on the court's jurisdiction and this court's precedent enforcing those limitations. The rest of the court's analysis recalibrates Congress's statutory scheme and vision of cooperative federalism in the CAA. Along the way, the court abandons any consideration that an agency is entitled to repose, absent objection during its administrative proceedings, when a court, here on *two* occasion, expressly leaves undisturbed its two-step approach to enforcing a statute it administers and no objection is raised during the Transport Rule administrative proceedings. Then, in dictum, the court offers suggestions as to how EPA might fix the problems the court has created upon rewriting the CAA and trampling on this court's precedent in *North Carolina* and *Michigan.*

None of this is to suggest that EPA should be excused from the statutory limits on its authority or any material procedural missteps under the CAA or the APA. But neither can the court ignore jurisdictional limits or substantive provisions that Congress wrote in clear terms and EPA's permissible interpretations of the CAA in addressing statutory silence or ambiguity. Rather it underscores why, as a programmatic and public health matter, Congress concluded there are important reasons for jurisdictional limits and administrative exhaustion that this court heretofore has steadfastly acknowledged in recognizing both the limits of its jurisdiction and of its role in enforcing the CAA as Congress wrote it.

Accordingly, I respectfully dissent.

"Supreme Court to Review EPA Rule on Air Pollution Across State Lines EPA"

Wall Street Journal
Brent Kendall & Ryan Tracy
June 24, 2013

The U.S. Supreme Court said Monday it would consider the Environmental Protection Agency's bid to save a clean-air regulation that limited power-plant emissions blowing across state lines.

A federal appeals court in Washington invalidated the EPA's effort last year, handing a significant defeat to the Obama administration's regulatory approach. The regulation required cuts in emissions of nitrogen oxide and sulfur dioxide, both associated with higher rates of heart attacks and respiratory illnesses.

The EPA's Cross-State Air Pollution Rule, issued in 2011, sought to set pollution reductions for 28 upwind states whose emissions of soot- and smog-forming air pollution degrade the air quality of states downwind.

The regulation would have affected about 1,000 power plants in the eastern half of the U.S. To comply, companies with older coal-fired plants would have had to burn less coal, shut the plants down or pay for credits to offset pollution.

The cross-state rule was to replace a Bush-era rule that the appeals court sent back to the EPA in 2008. The U.S. Court of Appeals for the District of Columbia Circuit faulted the Bush rule for allowing states to comply by paying other states to reduce pollution, rather than forcing each state to clean up power plants within its borders. The judges ordered the EPA to rewrite the rule, but also to enforce it in the meantime so as to achieve at least some pollution reduction.

The Obama administration's approach would have taken effect in early 2012, requiring steeper pollution cuts than the Bush rule and forcing some older power plants to close immediately or burn less coal. For now, the Bush rule remains in force and those plants may be able to keep operating until at least 2015, when a stricter EPA rule curbing mercury emissions begins to take effect.

Several states, including Ohio, Michigan and Texas, along with coal-fired power plant owners American Electric Power Co. (AEP), Southern Co. (SO), Xcel Energy Inc. (EXC), and others, challenged the EPA's efforts on several grounds.

Environmentalists and other states, including New York and Massachusetts, backed the EPA, as did companies seeking to turn a profit by replacing coal-fired power plants, a group that includes natural gas-plant owner Calpine Corp. (CPN) and Exelon Corp., owner of the largest U.S. nuclear fleet.

In a divided ruling last summer, the U.S. Court of Appeals for the District of Columbia Circuit said that while the Bush-era rule didn't go far enough to cut pollution, the Obama administration rule went too far and exceeded the EPA's powers under the Clean Air Act.

The court said the EPA wrongly required some states to reduce more than their fair share of air pollution. It said the agency prematurely imposed federal pollution-reduction requirements without first giving states a sufficient chance to reduce pollution on their own terms.

A dissenting judge said the appeals court's ruling trampled on previous court precedent and allowed the challengers to make arguments they had never raised with the EPA.

In the Obama administration's appeal to the Supreme Court, U.S. Solicitor General Donald Verrilli said the lower court ruling would "gravely undermine" the EPA's clean-air enforcement.

Analysts have said the cross-state rule would have accelerated some coal-plant shutdowns, but the plants' days are still numbered because low natural-gas prices are making coal a less attractive fuel source and because the upcoming EPA mercury rule will force plants to cut toxic emissions so much that it will be cheaper to mothball them than to install pollution-control equipment.

The court will consider the case during its next term, which begins in October, with a decision expected by July 2014.

"Obama's EPA Gets Supreme Court Hearing on Coal Pollution"

Bloomberg
Greg Stohr
June 24, 2013

The U.S. Supreme Court agreed to consider reviving an Environmental Protection Agency rule that would curb emissions from coal-fired power plants, in a clash over the Obama administration's biggest air-quality effort.

A federal appeals court threw out the cross-state air pollution rule last year, saying the EPA had gone beyond its powers under federal law. That decision was a victory for coal companies and utilities, which called the measure one of the costliest ever issued under the Clean Air Act.

The administration is seeking to reinstate a rule it says would prevent up to 34,000 premature deaths and produce as much as $280 billion a year in economic benefits. The rule, which has never taken effect, caps emissions of sulfur dioxide and nitrogen oxides in 28 states whose pollution blows into neighboring jurisdictions. All are in the eastern two-thirds of the country.

"The U.S. Supreme Court is likely taking this case in order to reverse the D.C. Circuit panel's decision that is contrary to law and would further delay long-needed clean air standards necessary to protect our public health," Howard Lerner, executive director of the Environmental Law and Policy Center, said today in an e-mailed statement.

14 States

The justices will hear arguments and rule during the nine-month term that starts in October.

Attorneys general from 14 states, led by Texas, are challenging the rule alongside American Electric Power Co. (AEP), Entergy Corp. (ETR), Edison International (EIX), Peabody Energy Corp. (BTU), Southern Co. (SO) and the United Mine Workers of America. They urged the court not to hear the case.

The U.S. Court of Appeals for the D.C. Circuit voted 2-1 to strike down the rule, saying it was too strict and that the EPA didn't give states a chance to put in place their own pollution-reduction plans before imposing a nationwide standard.

EPA's rule would "impose massive emissions reductions without regard to the limits imposed by the statutory text," Judge Brett Kavanaugh wrote for the court.

2005 Measure

The court ordered the agency to continue to enforce a 2005 measure known as the Clean Air Interstate Rule until a viable replacement to the cross-state regulation can be issued -- a process the Obama administration said could take years.

Given that the lower court had thrown out the standard adopted during the Bush administrationas insufficient, and the

Obama-era standard as too stringent, "it was confusing to say the least," Janice Nolen, assistant vice president of the American Lung Association, said in an interview. "We are very pleased that they may clarify this."

The justices also will consider a procedural question -- whether the lower court had power to hear the challenge to the rule. The administration contends the appeals court reached its conclusion only by improperly invalidating other rules that weren't directly before the court.

The lower court decision was a reprieve for coal-dependent power generators facing the combined threats of increasing federal regulation and low natural-gas prices.

The EPA rule targets sulfur dioxide, which can lead to acid rain and soot harmful to humans and ecosystems, and nitrogen oxide, a component of ground-level ozone and a main ingredient of smog.

The cases are *U.S. Environmental Protection Agency v. EME Homer City Generation*, 12-1182, and *American Lung Association v. EME Homer City*, 12-1183.

“D.C. Circuit Upholds EPA Rules on Limiting Greenhouse Gas Emissions”

Legal Newline
Jessica M. Karmasek
July 30, 2013

A federal appeals court ruled last week that a coalition of states and industry groups lacked standing to challenge the federal government’s rules related to greenhouse gas permitting requirements.

In a 2-1 ruling Friday, a panel of the U.S. Court of Appeals for the District of Columbia Circuit ruled against the coalition — including Texas, Wyoming, the Utility Air Regulatory Group and the National Mining Association.

The cases, which were consolidated in the D.C. Circuit’s ruling, challenged the rules promulgated by the federal Environmental Protection Agency in response to a 2007 U.S. Supreme Court holding that greenhouse gases qualify as an “air pollutant” under the federal Clean Air Act.

Last year, the D.C. Circuit upheld the agency’s regulation in the so-called “tailpipe rule” of greenhouse gases emitted by cars and light trucks under Title II of the CAA.

The court in *Coalition for Responsible Regulation Inc. v. EPA* also upheld the agency’s determination that the rule triggered permitting requirements for new major stationary sources of greenhouse gases under Part C of Title I of the CAA.

The D.C. Circuit also dismissed for lack of standing challenges by states and industry groups to “timing and tailoring rules” that ameliorated the burden of Part C permitting for greenhouse gases.

At issue this time around is implementation of the Part C permitting requirements in states without implementation plans for greenhouse gases as of Jan. 2, 2011, when the emission standards in the tailpipe rule took effect.

Texas, Wyoming and the industry groups petitioned the D.C. Circuit for review of five rules, all of which are designed to ensure that a permitting authority existed to issue the required greenhouse gas permits.

They contend the rules are based on an “impermissible interpretation” of the Part C Prevention of Significant Deterioration Program, and violate the CAA’s “orderly process” for revision of state implementation plans, or SIPs.

“The court on more than one occasion has interpreted CAA § 165(a) unambiguously to prohibit construction or modification of a major emitting facility without a Part C permit that meets the statutory requirements with regard to each pollutant subject to regulation under the Act,” Judge Judith Rogers wrote for the D.C. Circuit.

“Because we now hold that under the plain text of CAA § 165(a) and § 167 the permitting requirements are self-executing without regard to previously approved SIPs, industry petitioners fail to show how they have been injured in fact by rules enabling issuance of the necessary permits."

She continued in the 36-page ruling, "State petitioners likewise fail, in the face of Congress's mandate in CAA § 165(a), to show how vacating the rules would redress their purported injuries. Accordingly, because petitioners lack Article III standing to challenge the rules, we dismiss the petitions for lack of jurisdiction."

Judge David Tatel joined Rogers in the opinion. Judge Brett Kavanaugh filed a dissent.

"Supreme Court Should Block EPA's Attempt to Regulate Greenhouse Gases"

The Daily Caller
Karen Harned
June 25, 2013

In the wake of the country's worst economic downturn since the Great Depression, there are some signs that the economy is recovering — housing prices are up almost 11% from last year and consumer confidence is at a five-year high. Unfortunately, the Obama administration is making mistakes that threaten to stifle the recovery. One example is its decision to introduce disastrous new regulations on greenhouse gas (GHG) emissions. President Obama mentioned those proposed regulations in his climate speech on Tuesday.

In December 2009, the Environmental Protection Agency (EPA) unilaterally determined that certain GHGs threaten the public health and welfare and therefore must be regulated under the Clean Air Act. That determination effectively allows the EPA to circumvent Congress and enact new regulations on businesses and individuals that Congress never intended.

These new regulations, if they're allowed to take effect, will brand hundreds of thousands of small farms, restaurants, manufacturers and even commercial offices as "stationary sources" of pollution, meaning that they will be required to complete costly and time-consuming permit applications. This will cost consumers — including hundreds of thousands of small businesses — billions of dollars per year in higher energy bills. As a result, some businesses won't be able to expand, others will have to lay off workers and still others will have to shut their doors.

The administration's decision to impose these costly mandates also sends a terrible message to entrepreneurs and those looking to innovate.

Because the Clean Air Act doesn't actually empower the federal government to regulate GHGs, the EPA's actions have no legal basis. That's why the National Federation of Independent Business, which represents 350,000 small businesses, has joined other organizations in asking the Supreme Court to rule that the EPA has misinterpreted the Clean Air Act in order to justify its policies and effectively rewrite the law. We are hopeful that the Court will see that the president's attempt to use the EPA as a political tool will impact almost every sector of the economy, including universities, schools and hospitals — institutions that are hardly thought of as "polluters."

We all want clean air, water and energy — and a safe environment for our children. Yet we are troubled by the president's decision to bypass Congress and implement an agenda that Congress and the American people have rejected in the past. Climate change policies should be debated, not imposed through agency fiat in a way that will cripple our economy. The Supreme Court should recognize that the federal government has greatly overstepped its bounds, reject this new practice and help America move forward again.

“Supreme Court to Review Decision Critical to Cleaning up America's Air”

Environmental Defense Fund
Graham McCahan
July 1, 2013

On June 24, 2013, the U.S. Supreme Court decided to review the D.C. Circuit Court of Appeals’ decision in a case called *EME Homer City Generation*. To anyone concerned about the quality of the nation’s air, this was very big news. Here’s why.

In *EME Homer City*, which the D.C. Circuit decided last summer, a divided court overturned the Cross-State Air Pollution Rule, one of the Environmental Protection Agency’s most important (and cost-effective) clean air programs. In their filing asking the Supreme Court to hear the case, the Environmental Protection Agency argued that “the court of appeals committed a series of fundamental errors that, if left undisturbed, will gravely undermine the EPA’s enforcement of the Clean Air Act.”

The stakes are high. Every year, the Cross-State Rule, if only it can be applied, will save up to 34,000 lives and $110 to $280 *billion* in net health benefits. Without it, millions of people and entire communities will remain exposed to dangerous levels of pollution.

EPA issued the Cross-State Rule in 2011 under the Clean Air Act’s “good neighbor” provision, which directs states to “prohibit” emissions that are carried downwind and contribute to unhealthy air pollution in neighboring states. If states do not live up to their good neighbor obligations, then the Clean Air Act requires EPA to step in. According to 2011 estimates, air pollution from neighboring states accounted for more than three-quarters of local air pollution in many areas struggling to comply with EPA’s health-based standards. As this data shows, millions of Americans are breathing unhealthy air that originates in neighboring states.

The Cross-State Rule helps address this problem by reducing harmful smokestack pollution from power plants, which can drift for hundreds of miles and adversely affect distant communities. Despite its enormous health benefits and relatively small compliance costs, numerous power companies and several states challenged the Cross-State Rule in the D.C. Circuit. Numerous parties then joined the case in support of EPA and the Cross-State Rule, including: several states and cities that are adversely affected by interstate pollution; three major power companies; and EDF, along with some of its public health and environmental allies.

After the D.C. Circuit struck down the Cross-State Rule, Environmental Defense Fund, along with the American Lung Association, Clean Air Council, Natural Resources Defense Council, and Sierra Club filed a petition seeking Supreme Court review, which the Supreme Court granted along with EPA’s petition.

The Supreme Court, we believe, should reverse the decision of the D.C. Circuit and restore the clean air safeguards of the Cross-State Rule.

This will safeguard the air quality of millions of Americans who depend on EPA to protect them from pollution that comes from beyond the borders of their own states. No wonder, when EPA called for the Supreme Court to review *EME Homer City*, they warned that, should the decision stand, it would "seriously impede the EPA's ability to deal with a grave public health problem."

Northwest, Inc. v. Ginsberg

12-462

Ruling Below: *Ginsberg v. Northwest, Inc.*, 695 F.3d 873 (9th Cir. 2012), *cert granted*, 133 S.Ct. 2387 (2013).

Member of airline's frequent flier program brought action against airline, alleging breach of implied covenant of good faith and fair dealing after it revoked his membership. The United States District Court for the Southern District of California entered order granting airline's motion to dismiss, and member appealed. The Ninth Circuit Court of Appeals held that Airline Deregulation Act (ADA) did not preempt member's claim.

Question Presented: Whether the court of appeals erred in holding, in contrast with the decisions of other circuits, that respondent's implied covenant of good faith and fair dealing was not preempted under the Airline Deregulation Act because such claims are categorically unrelated to a price, route, or service, notwithstanding that respondent's claim arises out of a frequent-flyer program (the precise context of *American Airlines, Inc. v. Wolens*) and manifestly enlarged the terms of the parties' undertakings, which allowed termination in Northwest's sole discretion.

S. Binyomin GINSBERG, Rabbi, an individual and on behalf of all others similarly situated, Plaintiff–Appellant,
v.
NORTHWEST, INC., a Minnesota corporation and a wholly-owned subsidiary of Delta Air Lines, Inc.; Delta Air Lines, Inc., a Delaware corporation, Defendants–Appellees.

United States Court of Appeals, Ninth Circuit

Decided on July 13, 2012

[Excerpt; some footnotes and citations omitted.]

BEEZER, Circuit Judge

Plaintiff brought suit against an airline alleging a common law breach of contract under the implied covenant of good faith and fair dealing. The district court held that Plaintiff's claim was preempted by the Airline Deregulation Act ("ADA"), and dismissed the claim pursuant to Fed.R.Civ.P. 12(b)(6). We conclude that the ADA does not preempt this common law contract claim, and reverse the district court.

When Congress passed the ADA, it dismantled a federal regulatory structure that had existed since 1958. By including a preemption clause, Congress intended to ensure that the States would not undo the deregulation with regulation of their own. Congress's “manifest purpose” was to make the airline industry more efficient by unleashing the market forces of competition—it was not to immunize the airline industry from liability for common law contract claims. Congress did not intend to convert airlines into quasi-government agencies, complete with sovereign immunity.

The purpose, history, and language of the ADA, along with Supreme Court and Ninth Circuit precedent, lead us to conclude that the ADA does not preempt a contract claim based on the doctrine of good faith and fair dealing.

Background

Plaintiff S. Binyomin Ginsberg was an active member of “WorldPerks,” a frequent flier program offered by Defendant Northwest Airlines, Inc. (“Northwest”). Ginsberg began his WorldPerks membership in 1999, and by 2005 he had obtained Platinum Elite Status. Northwest revoked Ginsberg's WorldPerks membership on June 27, 2008. Ginsberg attempted several times to clarify the reasons behind Northwest's decision to revoke his membership. Ginsberg alleges that Northwest revoked his membership arbitrarily because he complained too frequently about the services. Northwest sent Ginsberg an email on November 20, 2008, detailing the basis for Northwest's decision to revoke Ginsberg's membership. In that email the Northwest representative quotes from Paragraph 7 of the General Terms and Conditions of the WorldPerks Program, which provides that Northwest may determine “in its sole judgment” whether a passenger has abused the program, and that abuse “may result in cancellation of the member's account and future disqualification from program participation, forfeiture of all mileage accrued and cancellation of previously issued but unused awards.”

Ginsberg initially filed suit on January 8, 2009, asserting four causes of action: (1) breach of contract; (2) breach of the implied covenant of good faith and fair dealing; (3) negligent misrepresentation; and (4) intentional misrepresentation. Northwest moved to dismiss the complaint pursuant to Fed.R.Civ.P. 12(b)(6), arguing that the ADA preempted the claims. The district court dismissed, with prejudice, Ginsberg's claims for breach of the implied covenant of good faith and fair dealing, negligent misrepresentation, and intentional misrepresentation, concluding that the ADA preempted them “ ‘because they relate to airline prices and services.’ ” The district court also dismissed the general breach of contract claim without prejudice, finding that the claim was not preempted, but that Ginsberg had failed to allege facts sufficient to show a material breach.

Ginsberg only appeals the district court's conclusion that the ADA preempts a claim for breach of the implied covenant of good faith and fair dealing.

Standard of Review

"Dismissals under Fed.R.Civ.P. 12(b)(6) for failure to state a claim are reviewed de novo."

Analysis

Based on our case law, Supreme Court precedent, and the ADA's legislative history and statutory text, we conclude that the ADA does not preempt state-based common law contract claims, such as the implied covenant of good faith and fair dealing. Although Ginsberg's claim may still fail on the merits, the district court erred when it dismissed the claim under the preemption doctrine. Doing so was a misapplication of the law because the ADA was never designed to preempt these types of disputes.

A. Preemption Doctrine

The key to understanding the scope of the ADA's preemption clause is to determine what Congress intended to achieve when it enacted the ADA. "Preemption may be either express or implied, and is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose." This inquiry "begin[s] with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose."

In *Medtronic, Inc. v. Lohr,* the Supreme Court advised that preemption provisions ought to be narrowly construed for two reasons:

First, because the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action.... Second, our analysis of the scope of the statute's pre-emption is guided by our oft-repeated comment ... that the purpose of Congress is the ultimate touchstone in every pre-emption case.

Indeed, preemption analysis "must be guided by respect for the separate spheres of governmental authority preserved in our federalist system." When the question of preemption implicates "a field which the States have traditionally occupied, we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress."

To determine what Congress's "manifest purpose" was, we must first consider the ADA's unique history. Under the Federal Aviation Act of 1958, the Civil Aeronautics Board ("CAB") had regulatory authority over interstate air transportation. But the Board's power in this field was not exclusive, for the statute also contained a "savings clause," clarifying that "[n]othing ... in this chapter shall in any way abridge or alter the remedies now existing at common law or by statute, but the provisions of this chapter are in addition to such remedies." Because the 1958 Act did not expressly preempt state law, this clause allowed states to regulate airlines, leading to economic distortions.

By 1978 Congress had concluded that state-by-state regulation was inefficient and that deregulation, along with market forces, could better promote efficiency, variety, and quality in the airline industry. But seeing that states could just as easily "undo federal deregulation with regulation of their own," Congress included a preemption clause in former section 1305(a)(1), which now reads as follows:

> [A] State, political subdivision of a State, or political authority of at least 2 States may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service of an air carrier that may provide air transportation under this subpart.

At the same time, Congress retained the "savings clause," thereby preserving common law and statutory remedies. Since 1978, the scope of this preemption clause has been hotly debated, but never fully resolved.

B. Supreme Court and Ninth Circuit Precedent

The Supreme Court has encountered the ADA's preemption clause at least three times since 1990. In *Morales,* the Court considered whether the ADA preempted the States "from prohibiting allegedly deceptive airline fare advertisements through enforcement of their general consumer protection statutes." The Court concluded that because advertising has such a direct link to pricing and rates, the ADA preempted restrictions against deceptive advertising. The Court therefore reasoned that the advertising restrictions at issue had the "forbidden significant effect" on rates, routes, or services. Because the regulations were inconsistent with the ADA's deregulatory purpose, they were preempted under former § 1305(a)(1). But in the next breath the Court cabined its holding to those laws that actually have a direct effect on rates, routes, or services.

The Court went to great lengths to make clear that its holding was narrow, and that the ADA only preempts laws that have a direct effect on pricing:

In concluding that the ... advertising guidelines are pre-empted, we do not ... set out on a road that leads to pre-emption of state laws against gambling and prostitution as applied to airlines. Nor need we address whether state regulation of the nonprice aspects of fare advertising (for example, state laws preventing obscene depictions) would similarly "relate to" rates; the connection would obviously be far more tenuous.... [S]ome state actions may affect airline fares in too tenuous, remote, or peripheral a manner to have a preemptive effect.

We echoed this view in *Air Transport Association of America v. City & County of San Francisco*, where we concluded that Congress did not intend for the ADA to preempt state laws forbidding employment discrimination, even if these laws have an economic effect, because employment discrimination laws are not directly related to pricing, routes, or services.

The Court considered the ADA's preemption clause for a second time in *American Airlines, Inc., v. Wolens*. In a fact pattern similar to this case, the plaintiffs in *Wolens* were members of a frequent flyer program and brought suit against an airline. The plaintiffs challenged certain program modifications that devalued credits the members had already earned, and claimed that the devaluation constituted a breach of contract and a violation of Illinois's Consumer Fraud and Deceptive Business Practices Act. The court concluded that § 1305(a)(1) clearly preempted the consumer fraud claim because it was a state-imposed regulation that related to the price, routes, or services of air carriers. But the Court allowed the breach of contract claim to go forward, making clear that the ADA "allows room for court enforcement of contract terms set by the parties themselves." "In so doing, the Court held that Congress did not intend to preempt common law contract claims."

The Court in *Wolens* drew a clear distinction between the consumer fraud claim, which was based on a proscriptive law targeting *primary conduct,* and actions that "simply give effect to bargains offered by the airlines and accepted by airline customers." Because this distinction—between state laws that regulate airlines and state enforcement of contract disputes—is crucial, we quote the Court at length:

> We do not read the ADA's preemption clause, however, to shelter airlines from suits alleging no violation of state-imposed obligations, but seeking recovery solely for the airline's alleged breach of its own, self-imposed undertakings. As persuasively argued by the United States, terms and conditions airlines offer and passengers accept are *privately ordered obligations "and thus do not amount to a State's 'enact[ment] or enforce[ment] [of] any law, rule, regulation, standard, or other provision having the force and effect of law' within the meaning of [§]1305(a)(1).*"

The ADA, as we recognized in *Morales* ... was designed to promote "maximum reliance on competitive market forces." ... Market efficiency requires effective means to enforce private agreements. As stated by the United States: "The stability and efficiency of the market depend fundamentally on the enforcement of agreements freely made, based on the needs perceived by the contracting parties at the time." That reality is key to sensible construction of the ADA.

In sum, the Court concluded that a state does not "enact or enforce any law" when it uses its contract laws to enforce private agreements.

After drawing this distinction, the Court then pointed out institutional limitations that demonstrate the ADA cannot preempt breach of contract claims, including those based on common law principles such as good faith and fair dealing. In particular, the Department of Transportation is not equipped to adjudicate these types of claims. First, the DOT's own regulations "contemplate that ... contracts ordinarily would be enforceable under 'the contract law of the States.' " Second, the DOT is not equipped with either "the authority [or] the apparatus required to superintend a contract dispute resolution regime." Although before 1978 the CAB adjudicated contract disputes, when Congress deregulated the airline industry it dismantled this apparatus and never replaced it. Therefore, if common law contract claims were preempted by the ADA, a plaintiff literally would have no recourse because state courts would have no jurisdiction to adjudicate the claim, and the DOT would have no ability to do so. Effectively, the airlines would be immunized from suit—a result that Congress never intended. This also means that "the lawmakers indicated no intention to establish, simultaneously, a new administrative process for DOT adjudication of private contract disputes." Consequently, the Court flatly refused to "foist on the DOT work Congress has neither instructed nor funded the Department to do." We agree.

The Supreme Court considered § 1305(a)(1) for a third time in *Rowe v. New Hampshire Motor Transport Ass'n*. In *Rowe* a group of transport carrier associations challenged a Maine statute that regulated the shipment of tobacco into the state. The Court concluded that the ADA preempted Maine's statute because the latter "produces the very effect that the federal law sought to avoid; namely, a State's direct substitution of its own governmental commands for 'competitive market forces.' " Invoking *Morales,* the Court emphasized that "state enforcement actions having a connection with, or reference to carrier 'rates, routes, or service,' are pre-empted." Indeed, compared to either *Wolens* or *Morales,* the link in *Rowe* was more directly related to "routes, rates, or services" because it regulated primary activity that fell under the ADA, thereby frustrating Congress's "manifest purpose" to deregulate the industry.

And finally, we addressed a similar question in *West v. Northwest Airlines, Inc.* There, the plaintiff brought suit against Northwest for breach of the covenant of good faith and fair dealing under Montana law. The district court granted summary judgment to Northwest, stating that the claim was preempted by the ADA. On appeal we reversed, concluding that a claim for breach of the covenant of good faith and fair dealing was "too tenuously connected to airline regulation to trigger preemption under the ADA." Although this case was pre-*Wolens,* we conclude it is still good law.

Indeed, in *Charas,* a post-*Wolens* decision, we emphasized that Congress's "clear and manifest purpose" in enacting airline deregulation "was to achieve just that—the economic deregulation of the airline industry." The only purpose of the preemption clause is to prevent state interference with the mandate of deregulation.

Additionally, that Congress did not intend for § 1305(a)(1) to preempt state common law contract claims is evident from another provision: the savings clause, which preserves common law remedies. Because the ADA's preemption clause does not explicitly preempt common law breach of contract claims, we turn to the rest of the statute's language to " 'ascertain and give effect to the plain meaning of the language used,' but must be careful not to read the preemption clause's language in such a way as to render another provision superfluous."

In *Charas* we concluded that, taken together, the savings clause and preemption clause "evidence[ ] congressional intent to prohibit states from regulating the airlines while preserving state tort remedies that already existed at common law, providing that such remedies do not significantly impact federal deregulation." Similar logic would apply to state contract remedies that already existed at common law, such as the implied covenant of good faith and fair dealing.

Moreover, we also may look to "the pervasiveness of the regulations enacted pursuant to the relevant statute to find preemptive intent." As the Supreme Court pointed out in *Wolens,* the DOT is not equipped to handle contract disputes, and its regulations suggest that Congress did not intend to occupy this particular field of law. This stands in contrast, for example, to airline safety, where agency regulations demonstrate "an intent to occupy exclusively the entire field of aviation safety." A claim for breach of the implied covenant of good faith and fair dealing does not interfere with the deregulatory mandate. Although Northwest argues that a common law breach of contract claim, like one based on the doctrine of "good faith and fair dealing," would enlarge the contract's terms—savings clause, notwithstanding—the Supreme Court rejected this argument in *Wolens.* There, the Court explicitly allowed "state-law-based" claims to go forward because that was the purpose of retaining the savings clause. The Supreme Court reasoned that state-law-based contract claims would not frustrate the ADA's manifest purpose: "[b]ecause contract law is not at its core 'diverse, nonuniform, and confusing,' we see no large risk of nonuniform adjudication inherent in 'state-court enforcement of the terms of a uniform agreement prepared by an airline and entered into with its passengers nationwide.'"

As we pointed out in *Air Transport Association of America v. City and County of San Francisco*, "[w]hat the Airlines are truly complaining about are free market forces and their own competitive decisions." In upholding a local law forbidding employment discrimination, the Ninth Circuit reasoned that "[i]n this deregulated environment, airlines can decide whether or not to make large economic investments at the San Francisco airport.... That economic decision may mean the Airlines will have to agree to abide by the [city's anti-discrimination] Ordinance[ ]." Similarly, here, Northwest is free to invest in a frequent flier program; however, that economic decision means that the airline has to abide by its contractual obligations, within this deregulated context, pursuant to the covenant of good faith and fair dealing. Like the ordinance at issue in *Air Transport Association*, state enforcement of the covenant is not "to force the Airlines to adopt or change their prices, routes or services—the prerequisite for ADA preemption."

C. The Implied Covenant of Good Faith and Fair Dealing Does Not "Relate to" Prices, Routes, or Services

Finally, the district court concluded that the ADA preempts Ginsberg's claim for breach of the covenant of good faith and fair dealing because the claim would "relate to" both "prices" and "services." We disagree.

First, the district court uses an overly broad definition of what relates to "prices." In *Wolens* all the justices—including the dissenters—agreed that the ADA does not preempt common law tort claims such as personal injury and wrongful death, even though airline costs and fares would be affected by how restrictive a particular state's law may be. Similarly, here, the link is far too tenuous, and effectively would subsume all breach of contract claims.

Second, the district court's broad understanding of the "relating to" language is also inconsistent with the ADA's legislative history. In 1977, the CAB's proposed preemption language stated that "[n]o State ... shall enact any law ... relating to rates, routes, or services in air transportation." In its explanatory testimony the CAB's representatives never suggested that the "relating to" language created a broad scope for preemption. Rather, the CAB explained that the preemption clause was "added to make clear that no state or political subdivision may defeat the purposes of the bill by regulating interstate air transportation. This provision represents simply a codification of existing law and leaves unimpaired the states' authority over intrastate matters."

The "relating to" language that Congress eventually enacted came from the House version of the bill. But in its Committee Report, the House also made clear that the preemption provision simply "provid[ed] that when a carrier operates under authority granted pursuant to title IV of the Federal Aviation Act, no State may regulate that carrier's routes, rates, or services." This understanding is more narrow than the district court's conclusion. And, in fact, the Senate's version did not even contain the "relating to" language at all. The Senate Report clarified that this section "prohibits States from exercising economic regulatory control over interstate airlines." Finally, the Conference Report adopted the House bill and its explanation, which it described in narrow terms. This history suggest that Congress intended the preemption language only to apply to state laws directly "regulating rates, routes, or services." The district court's broad reading of the statute's language simply finds no support in the legislative history.

Conclusion

Nothing in the ADA's language, history, or subsequent regulatory scaffolding suggests that Congress had a "clear and manifest purpose" to displace State common law contract claims that do not affect deregulation in more than a "peripheral ... manner." We conclude that a claim for breach of the implied covenant of good faith and fair dealing is not preempted by the ADA.

Accordingly, we REVERSE and REMAND to the district court to reconsider the merits of plaintiff's claim.

“Supreme Court to Hear Case of Disgruntled Frequent Flyer”

Reuters
Lawrence Hurley
May 20, 2013

The U.S. Supreme Court agreed on Monday to weigh whether federal law prevented a customer from suing an airline for kicking him out of its frequent flyer program for allegedly complaining too frequently about the service.

Rabbi Binyomin Ginsberg sued Northwest Airlines Corp, which ceased operations in 2010 after merging with Delta Air Lines Inc, for breach of contract after the airline said he had abused the program.

Ginsberg, who is from Minnesota, said he and his wife were thrown out in 2008 for filing too many service complaints.

He said the airline told him it took action in part because he allegedly sought compensation after booking reservations on full flights, knowing he would be bumped to another flight.

Ginsberg said his complaints involved only a small proportion of the flights he took on Northwest and were limited to such issues as long waits for luggage and not being notified about flight cancellations. Northwest said he filed 24 complaints.

A federal judge in California dismissed Ginsberg's lawsuit, which he filed as a possible class action on behalf of others who might have been treated the same way. The judge said Ginsberg's claims were foreclosed because of a federal aviation law, the Airline Deregulation Act. The law says states cannot pass laws that address price, route or service of an air carrier.

The San Francisco-based 9th U.S. Circuit Court of Appeals disagreed with the judge, reviving the lawsuit on the basis that Ginsberg's contractual claim based on Minnesota state law was not related to the price, route or service.

At least four of the nine justices must agree to hear a case before the Supreme Court will accept it. Oral arguments and a ruling are due in the court's next term, which starts in October and ends in June 2014.

The case is Northwest v. Ginsberg, U.S. Supreme Court, No. 12-462.

“Supreme Court To Hear Case Of Frequent Flier Dropped For Complaining Too Much”

International Business Times
Mark Johanson
May 20, 2013

The U.S. Supreme Court agreed Monday to hear the case of Binyomin Ginsberg, the rabbi who was allegedly kicked out of a frequent-flier program for complaining too much about the service. The court case could potentially define what liberties airlines have to set and enforce their own policies under the Airline Deregulation Act.

Ginsberg sued Northwest Airlines for a breach of contract after the carrier, which was absorbed by Delta Air Lines in a 2008 merger, said he had abused his privileges by repeatedly filing complaints for upgrades and other benefits. According to Northwest’s written arguments, the carrier revoked Ginsberg’s membership in the WorldPerks Platinum Elite program in June 2008 after he had complained 24 times in eight months about the carrier’s service.

“You have continually asked for compensation over and above our guidelines,” Northwest said in a letter sent to Ginsberg, according to court papers. “We have awarded you $1,925 in travel credit vouchers, 78,500 WorldPerks bonus miles, a voucher extension for your son, and $491 in cash reimbursements. Due to our past generosity, we must respectfully advise that we will no longer be awarding you compensation each time you contact us.”

Northwest pointed to a paragraph in the fine print of its WorldPerks Program that said abuse “may result in cancellation of the member’s account and future disqualification from program participation, forfeiture of all mileage accrued and cancellation of previously issued but unused awards.”

Ginsberg is dean of Torah Academy in Minneapolis and claims he travels as much as 75 times per year for lectures. He joined Northwest’s WorldPerks program in 1999 and reached Platinum Elite status in 2005, three years before the troubles began. His lawyers said the complaints to Northwest’s customer care that year amounted to just 10 percent of his trips. After he was dropped “without cause” and lost his unused miles, Ginsberg filed a federal class-action lawsuit in 2009 (on behalf of others who might have been treated in the same way) seeking $5 million.

"Rabbi Ginsberg appealed solely with respect to the claim for breach of the implied covenant of good faith and fair dealing," Ginsberg's written argument alleged. Northwest has countered that the Airline Deregulation Act of 1978 prevents any lawsuit governing “price, route or service of an air carrier.” After a U.S. District Court dismissed Ginsberg’s case, the Ninth U.S. Circuit Court of Appeals reinstated it. Now, Northwest wants the Supreme Court to define how much freedom airlines have to set their own policies under the 1978 act. The case -- *Northwest, Inc. v. Ginsberg* (12-462) -- will make its way to the Supreme Court in the fall term, which begins this October.

“Supreme Court to Hear Frequent-Flier Complaint”

CNN
Bill Mears
May 20, 2013

The Supreme Court will hear the case of a frequent flier labeled a frequent complainer by one airline.

Rabbi Binyomin Ginsberg claims his WorldPerks Platinum Elite membership was revoked after being told he had "abused" his privileges, repeatedly filing complaints for upgrades and other benefits.

Northwest Airlines, which was consumed by Delta Air Lines in a 2008 merger, said it had "sole judgment" over the program's general terms and conditions to make such determinations.

At issue is whether Ginsberg has a right under state law to bring his case or whether it is preempted by the 1970s-era law that deregulated the airline industry.

That law prohibits parties from bringing similar state claims against airlines relating to a "price, route, or service" of the carrier.

Ginsberg is dean of Torah Academy in Minneapolis and travels frequently to lecture and teach.

He joined Northwest's WorldPerks frequent flier program in 1999 and reached Platinum Elite status in 2005.

But in June of 2008, Ginsberg claimed a Northwest representative called him and told him his status was being revoked on grounds that he "abused" the program, according to court papers.

Ginsberg said the airline also took away the hundreds of thousands of miles accumulated in his account.

"It didn't make sense. Initially, when they contacted me on the phone I thought it was a prank call," Ginsberg told CNN. "When I pushed for a reason and clarification, they told me it was because I was complaining too much."

A month after that call, Northwest sent the rabbi a letter noting that he had made 24 complaints in the past eight months, including nine incidents of his bag arriving late at the luggage carousel, according to court papers.

"You have continually asked for compensation over and above our guidelines. We have awarded you $1,925 in travel credit vouchers, 78,500 WorldPerks bonus miles, a voucher extension for your son, and $491 in cash reimbursements," the letter said, according to court papers.

"Due to our past generosity, we must respectfully advise that we will no longer be awarding you compensation each time you contact us."

Ginsberg's lawyers countered the rabbi and his wife had been averaging about 75 flights on Northwest each year, and that Ginsberg estimated that only about 10 percent of the trips had resulted in a call to Northwest's customer care.

"I don't think I was a frequent complainer," Ginsberg said. "They should have taken their time and analyzed: Were my complaints legitimate? Should they be doing something to improve their service and quality of product? Instead of worrying, we've got to shut up somebody who is complaining too much."

Later that fall, Northwest sent Ginsberg an e-mail, in which the airline quoted a paragraph from the fine print of the WorldPerks Program.

It stated that Northwest could determine "in its sole judgment" whether a passenger has abused the program, and that abuse "may result in cancellation of the member's account and future disqualification from program participation, forfeiture of all mileage accrued and cancellation of previously issued but unused awards."

Ginsberg sued for $5 million over a breach of contract in January 2009, but a federal judge in San Diego dismissed the class action suit, agreeing with Northwest that the Airline Deregulation Act preempted his claim.

The airline's lawyers also argued that the WorldPerks general terms and conditions did not require Northwest to provide frequent fliers with lengthy explanations or reasons for its decision to terminate or demote a member's status in the program.

But in 2011, a federal appeals court in San Francisco reversed, ordered it to reconsider Ginsberg's class action claims. It said that when Congress passed the deregulation law, it did not intend to "immunize the airline industry from liability for common law contract claims."

There was no immediate comment from Delta to the high court accepting its appeal.

Ginsberg -- who is still a frequent flier, but is no longer loyal to any one airline -- said he is hoping to get his miles back, have his status reinstated, and get fair compensation for what he's gone through.

"To me, it's outright fraud. You can't take somebody's mileage away when they've accumulated it," he said. "We live in a country that was built on freedom and this to me is a tremendous abuse of freedom."

The case is *Northwest, Inc. v. Ginsberg* (12-462).

Chadbourne & Parke LLP v. Troice*

12-79

Ruling Below: *Roland v. Green*, 675 F.3d 503 (5th Cir. 2012), *cert granted*, 133 S.Ct. 977 (2013).

Investors brought two class actions in Louisiana court against investment company and others, asserting contract and other claims arising from alleged Ponzi scheme. Actions were removed to federal court and transferred by Multi–District Litigation (MDL) Panel to the Northern District of Texas. Latin American investors brought separate class actions against Antiguan bank's insurance brokers and Antiguan bank's attorneys under Texas law, asserting claims for, inter alia, violations of Texas Securities Act, arising from same alleged scheme. The United States District Court for the Northern District of Texas denied Louisiana investors' motion to remand to state court and dismissed their actions, and dismissed Latin American investors' actions. Louisiana and Latin American investors appealed, and appeals were consolidated. The Court of Appeals for the Fifth Circuit reversed and remanded.

Question Presented: (1) Whether the Securities Litigation Uniform Standards Act (SLUSA) precludes a state-law class action alleging a scheme of fraud that involves misrepresentations about transactions in SLUSA-covered securities; (2) whether SLUSA precludes class actions asserting that defendants aided and abetted SLUSA-covered securities fraud when the defendants themselves did not make misrepresentations about the purchase or sale of SLUSA-covered securities; and (3) whether a covered state law class action complaint that unquestionably alleges "a" misrepresentation "in connection with" the purchase or sale of a security covered by the Securities Litigation Uniform Standards Act nonetheless can escape the application of SLUSA by including other allegations that are farther removed from a covered securities transaction.

*Consolidated with *Willis of Colorado Inc. v. Troice* and *Proskauer Rose LLP v. Troice*

James ROLAND; Michael J. Giambrone; Thomas E. Bowden, Individually and on Behalf of Thomas E. Bowden S.E.P. I.R.A.; T.E. Bowden, Sr., Ret. Trust; G. Kendall Forbes, Individually and on Behalf of G. Kendall Forbes I.R.A.; et al., Plaintiffs–Appellants,
v.
Jason GREEN; Charles Jantzi; Tiffany Angelle; James Fontenot; Thomas Newland; Grady Layfield; Hank Mills; John Schwab; Russ Newton; Jim Weller; SEI Investments Company; Certain Underwriters at Lloyds London, in Syndicates 2987, 1866, 1084, 1274, 4000 & 1183; et al., Defendants–Appellees.
Leah Farr; et al., Plaintiffs–Appellants,
v.
Jason Green; Dirk Harris; Timothy E. Parsons; Charles Jantzi; Tiffany Angelle; Grady Layfield; Hank Mills; John Schwab; Russ Newton; Jim Weller; SEI Investments

Company; Certain Underwriters at Lloyds London, in Syndicates 2987, 1866, 1084, 1274, 4000 & 1183; et al., Defendants–Appellees.
Samuel Troice; Horacio Mendez; Annalisa Mendez; Punga Punga Financial, Limited, individually and on behalf of a class of all others similarly situated, Plaintiffs–Appellants,
v.
Proskauer Rose, L.L.P.; Thomas V. Sjoblom; P. Mauricio Alvarado; Chadbourne and Parke, L.L.P., Defendants–Appellees.
Samuel Troice; Martha Diaz; Paula Gilly–Flores; Punga Punga Financial, Limited, Individually and on behalf of a class of all others similarly situated; Promotora Villa Marino, CA; Daniel Gomez Ferreiro; Manuel Canabal, Plaintiffs–Appellants,
v.
Willis of Colorado Incorporated; Willis Group Holdings Limited; Amy S. Baranoucky; Robert S. Winter; Bowen, Miclette & Britt, Incorporated; Willis Limited, Defendants–Appellees.

United States Court of Appeals, Fifth Circuit

Decided on March 19, 2012

[Excerpt; some footnotes and citations omitted.]

PRADO, Circuit Judge

This consolidated appeal arises out of an alleged multi-billion dollar Ponzi scheme perpetrated by R. Allen Stanford through his various corporate entities. These three cases deal with the scope of the preclusion provision of the Securities Litigation Uniform Standards Act ("SLUSA"). That provision states: "No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." All three cases seek to use state class-action devices to attempt to recover damages for losses resulting from the Stanford Ponzi scheme. Because we find that the purchase or sale of securities (or representations about the purchase or sale of securities) is only tangentially related to the fraudulent schemes alleged by the Appellants, we hold that SLUSA does not preclude the Appellants from using state class actions to pursue their recovery and REVERSE.

I

A

In 1995, because of "perceived abuses of the class-action vehicle in litigation involving nationally traded securities," Congress passed the Private Securities Litigation Reform Act ("PSLRA"). "Its provisions limit recoverable damages and attorney's fees, provide a 'safe harbor' for forward-looking statements, impose new restrictions on the selection of (and compensation awarded to) lead plaintiffs, mandate imposition of sanctions for frivolous litigation, and authorize a stay of discovery pending resolution of any motion to dismiss." These reforms were enacted to combat the "rampant" "nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests," and manipulation of clients by class counsel in securities litigation. Perhaps the most consequential reform, however, was that the PSLRA "impose[d] heightened pleading requirements in actions brought pursuant to § 10(b) [of the Securities and Exchange Act of 1934] and Rule 10b–5."

The reforms had their intended effect, "[b]ut the effort also had an unintended consequence: It prompted at least some members of the plaintiffs' bar to avoid the federal forum altogether." "[R]ather than confronting the restrictive conditions set forth by the PSLRA, plaintiffs began filing class-action securities lawsuits under state law, often in state court." "To stem this shift from Federal to State courts and prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA], Congress enacted SLUSA."

"The stated purpose of SLUSA is 'to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives' of the PSLRA ... [by advancing] 'the congressional preference for national standards for securities class action lawsuits involving nationally traded securities.' Specifically, the "core provision," provides that "[n]o covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." To effectuate this, SLUSA mandates: "Any covered class action brought in any State court involving a covered security ... shall be removable to the Federal district court for the district in which the action is pending" and subject to dismissal.

B

In February 2009, the Securities and Exchange Commission ("SEC") brought suit against the Stanford Group Company, along with various other Stanford corporate entities, including the Antigua-based Stanford International Bank ("SIB"), for allegedly perpetrating a massive Ponzi scheme.

According to the SEC, the companies' core objective was to sell certificates of deposit ("CDs") issued by SIB. Stanford achieved and maintained a high volume of CD sales by promising above-market returns and falsely assuring investors that the CDs were backed by safe, liquid investments. For almost 15 years, SIB represented that it consistently earned high returns on its investment of CD sales proceeds .... In fact, however, SIB had to use new CD sales proceeds to make interest and redemption payments on pre-existing CDs, because it did not have sufficient assets, reserves and investments to cover its liabilities.

... At the SEC's request, the district court issued a temporary order restraining the payment or expenditure of funds belonging to the Stanford parties. The district court also appointed [a] Receiver for the Stanford interests and granted him the power to conserve, hold, manage, and preserve the value of the receivership estate.

Lastly, the district court in the SEC action entered a case management order requiring all lawsuits against SIB's service providers or third parties to be filed as ancillary proceedings to the SEC action.

1

Two groups of Louisiana investors, represented by the same counsel, filed separate lawsuits in the 19th Judicial District Court, East Baton Rouge Parish on August 19, 2009—*Roland v. Green* and *Farr v. Green.* In those actions, each set of plaintiffs sued the SEI Investments Company ("SEI"), the Stanford Trust Company (the "Trust"), the Trust's employees, and the Trust's investment advisors (collectively, the "SEI Defendants") for their alleged role in the Stanford Ponzi scheme. The plaintiffs alleged violations of Louisiana law including breach of contract, negligent representation, breach of fiduciary duty, unfair trade practices, and violations of the Louisiana Securities Act.

The plaintiffs in the *Roland* and *Farr* actions (the "*Roland* Plaintiffs") allege that SIB sold CDs to the Trust (located in Baton Rouge, Louisiana), which in turn served as the custodian for all individual retirement account ("IRA") purchases of CDs. According to the plaintiffs, the Trust contracted with SEI to have SEI be the administrator of the Trust, thereby making SEI responsible for reporting the value of the CDs. Plaintiffs finally allege misrepresentations by SEI induced them into using their IRA funds to invest in the CDs. Specifically, the plaintiffs allege that the SEI Defendants represented to them that the CDs were a good investment because (1) they could be "readily liquidated"; (2) SEI had evaluated SIB as being "competent and proficient"; (3) SIB "employed a sizeable team of skilled and experienced analysts to monitor and manage [its] portfolio"; (4) "independent" auditors "verified" the value of SIB's assets; (5) the SEI Defendants had "knowledge" about the companies that SIB invested in and that those companies were adequately capitalized; (6) the Antiguan government regularly "examined" SIB; (7) the CDs were a "safe investment vehicle suitable for long term investment with little or no risk"; (8) SIB had "retained legal counsel" that ensured that the investments were structured so as to comply with state and federal law; (9) the CDs would produce "consistent, double-digit returns"; and (10) SIB's assets were "invested in a well-diversified portfolio of highly marketable securities issued by stable national governments, strong multinational companies, and major international banks."

The SEI Defendants sought removal to the United States District Court for the Middle District of Louisiana on the basis that SLUSA precluded the state court from entertaining the suits. The Multi–District Litigation ("MDL") Panel subsequently transferred the case to the Northern District of Texas (Judge Godbey) where the separate *Roland* and *Farr* suits were consolidated. The *Roland* Plaintiffs then filed a motion to remand their cases back to the Louisiana state court.

2

The *Roland* action has been consolidated on appeal with two other actions. In these cases, a group of Latin American investors (the "*Troice* Plaintiffs") brought two separate class actions against, respectively, SIB's insurance brokers (the "Willis Defendants") and SIB's lawyers (the "Proskauer Defendants"). The *Troice* Plaintiffs brought claims under Texas law—specifically, violations of the Texas Securities Act, aiding and abetting these violations, and civil conspiracy. Similar to the *Roland* Plaintiffs, the *Troice* Plaintiffs allege that the Willis Defendants represented to them that the CDs were a good investment because (1) SIB was based in the United States and "regulated by the U.S. Government"; (2) SIB was "insured by Lloyd's"; (3) SIB was "regulated by the Antiguan banking regulatory commission"; (4) SIB was "subjected to regular stringent risk management evaluations" conducted by "an outside audit firm"; (5) the CDs were safe and secure; (6) SIB's portfolio produced "consistent, double-digit returns"; (7) the CDs' "high return rates ... greatly exceed those offered by commercial banks in the United States"; and (8) SIB's assets were "invested in a well-diversified portfolio of highly marketable securities issued by stable national governments, strong multinational companies, and major international banks." The *Troice* Plaintiffs only alleged aiding and abetting violations of the Texas Securities Act and civil conspiracy against the Proskauer Defendants. That is to say that the *Troice* Plaintiffs did not allege that the Proskauer Defendants made any (mis)representations to them.

The *Troice* Plaintiffs sued the Willis Defendants and Proskauer Defendants in separate suits in the United States District Court for the Northern District of Texas, invoking that court's jurisdiction under the Class Action Fairness Act. Both suits were assigned to Judge Godbey pursuant to the MDL order. The Willis and Proskauer Defendants moved to dismiss the suits pursuant to SLUSA.

C

Judge Godbey, due to the "multitude of Stanford-related cases" pending before him with similar issues, decided to "select one case initially in which to address the applicability of [SLUSA]." The case the district court chose was *Roland v. Green.* On August 31, 2010, the district court issued its opinion on the applicability of SLUSA preclusion to the Stanford litigation.

In that opinion, after briefly discussing the history and purpose of SLUSA, the district court turned to the central question of "whether the plaintiff alleges the use of misrepresentations, omission, or deceptive devices 'in connection with the purchase or sale of a covered security.' " First, the district court concluded that the SIB CDs themselves were not "covered securities" within the meaning of SLUSA because SIB never registered the CDs, nor were they traded on a national exchange….

Noting that the Supreme Court has urged a " 'broad interpretation[ ]' of the 'in connection with' [requirement] ... in order to further the PSLRA's goals," the district court stated that "the strength of the nexus between an allegedly fraudulent scheme and the securities transactions serves as the primary thread tying the caselaw together." Given the "melange" of other circuit courts' formulations of the test to determine what connection between a fraud and transactions in covered securities is required for SLUSA preclusion to apply and the "apparent absence of controlling Fifth Circuit authority," the district court decided to employ the Eleventh Circuit's approach from *Instituto De Prevision Militar v. Merrill Lynch* ("*IPM*").

Applying the Eleventh Circuit's test, the district court found that the *Roland* Plaintiffs had alleged two distinct factual bases connecting the fraud to transactions in covered securities. First, the district court found that "[t]he [*Roland*] Plaintiffs' purchases of SIB CDs were 'induced' by the misrepresentation that SIB invested in a portfolio including SLUSA-covered securities." It noted that the CDs' promotional material touted that the bank's portfolio of assets was invested in "highly marketable securities issued by stable governments, strong multinational companies and major international banks." The district court also found that the purported investment of the bank's portfolio in SLUSA-covered securities gave its CDs certain qualities that induced Plaintiffs' purchases. The instruments were labeled CDs "to create the impression ... that the SIB CDs had the same degree of risk as certificates of deposit issued by commercial banks regulated by the FDIC and Federal Reserve." However, they were advertised to function "[l]ike well-performing equities" by offering "liquidity combined with the potential for high investment returns." This was supposedly made possible by "the consistent, double-digit returns on the bank's investment portfolio," which stemmed, in part, from the presence of SLUSA-covered securities. The *Roland* Plaintiffs allege in their petition that had they "been aware of the truth" that SIB's "portfolio consisted primarily of illiquid investments or no investments at all," they "would not have purchased the SIB CDs." The district court therefore found that the *Roland* Plaintiffs sufficiently alleged that their "CD purchases were induced by a belief that the SIB CDs were backed in part by investments in SLUSA-covered securities."

Additionally, the district court found the *Roland* Plaintiffs' "allegations ... reasonably imply that the Stanford scheme coincided with and depended upon the [*Roland*] Plaintiffs' sale of SLUSA-covered securities to finance SIB CD purchases." It noted that the *Roland* Plaintiffs claim that the fraud was a scheme targeting recent retirees who were urged to roll the funds in their retirement account into an IRA administered by SEI, of which the Trust was the custodian and which was fully invested in the CDs. The district court noted that "retirement funds come in a variety of forms that might not all involve SLUSA-covered securities," but that "stocks, bonds, mutual funds, and other SLUSA-covered securities commonly comprise IRA investment portfolios." From this, the court stated "that at least one of the [*Roland*] Plaintiffs acquired SIB CDs with the proceeds of selling SLUSA-covered securities in their IRA portfolios," and therefore, this "modest finding" independently supported the district court's ruling that the *Roland* Plaintiffs' claims were precluded by SLUSA. Accordingly, the district court denied the *Roland* Plaintiffs' motion for remand and dismissed the action pursuant to 15 U.S.C. § 78bb(f)(1)(A).

In a separate order, the district court considered the *Willis* Defendants' and the *Proskauer* Defendants' motions to dismiss. Stating "[b]ecause [the *Troice*] Plaintiffs bring class claims 'based upon the statutory or common law of' Texas and 'alleging ... a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security,' " the discussion in the district court's order in *Roland v. Green* compels the finding that SLUSA precludes the *Troice* Plaintiffs' action, and therefore it must be dismissed.

The *Roland* and *Troice* Plaintiffs timely appealed their dismissals, which this court consolidated for the purposes of oral argument and disposition.

II

The *Roland* case is before us from a denial of a motion to remand, and the *Troice* cases are before us on motions to dismiss. On each procedural posture, our review is the same—de novo.

III

A

Though the question of the scope of the "in connection with" language under SLUSA is one of first impression in this circuit, we do not write on a blank slate. The Supreme Court directly addressed the issue of what constitutes "in connection with the purchase or sale of a covered security" in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit.* In that case, a former broker joined with customers of Merrill Lynch in a class action against the firm for breaches of fiduciary duty and contract, alleging that Merrill Lynch had issued biased research and investment recommendations. These misrepresentations, according to Dabit's complaint, harmed the class members in two ways. First, as to the customers, the misrepresentations allegedly "caused them to hold onto overvalued securities." Second, as to the brokers, the misrepresentations allegedly caused them to "los[e] commission fees when their clients, now aware that they had made poor investments, took their business elsewhere." The district court dismissed all of the claims based on SLUSA. The Second Circuit affirmed as to the claims of buyers and sellers, but said SLUSA did not preclude the claims of "holders," those who had not purchased or sold a security but suffered merely by retaining or "holding" their existing shares in reliance on Merrill Lynch's allegedly fraudulent research. The central question in *Dabit,* therefore, was whether the holders' claims were precluded given SLUSA's requirement that a fraud alleged be "in connection with the purchase or sale of a covered security."

After discussing the purposes of Section 10(b) and the history of Rule 10b–5 litigation, the Court noted that the reason it had barred holders from asserting a private right of action under Rule 10b–5 in *Blue Chip Stamps v. Manor Drug Stores* was "policy considerations," including the special danger that " 'vexatious[ ] ... litigation' " posed in the realm of securities. The same policy considerations that led to that limitation on Rule 10b–5's private right of action, motivated Congress in its passage of the PSRLA and SLUSA. In using the "in connection with" language that had been the focus of so much litigation in the Rule 10b–5 context, the Court found that "Congress can hardly have been unaware of the broad construction adopted by both this Court and the SEC." It also found that by using the exact same language—"in connection with the purchase or sale of [covered] securities"—Congress intended to incorporate the judicial interpretations given to that phrase into SLUSA as well.

Since Congress intended "in connection with" to mean the same thing in SLUSA as it does in Section 10(b), "it is enough that the fraud alleged 'coincide' with a securities transaction—whether by the plaintiff or by someone else. The requisite showing, in other words, is 'deception "in connection with the purchase or sale of any security," not deception of an identifiable purchaser or seller.' " From these principles, the Court held that SLUSA precludes state-law holder class actions like Dabit's.

B

Since *Dabit,* six of our sister circuit courts have tried to give dimension to the "coincide" requirement announced in *SEC v. Zandford* and brought into the SLUSA scheme in *Dabit. Romano v. Kazacos*; *Segal v. Fifth Third Bank, N.A.*; *Madden v. Cowen & Co.*; *Instituto De Prevision Militar v. Merrill Lynch*; *Siepel v. Bank of Am., N.A.*; *Gavin v. AT&T Corp.* To be sure, we are only bound by decisions of the Supreme Court, which has stated that "in connection with" must be interpreted broadly. But the test it has offered—whether or not "the fraud alleged '*coincide*[*s*]' with a securities transaction,"—is not particularly descriptive. Moreover, when the Court first set forth the "coincide" requirement, it cautioned that "the statute must not be construed so broadly as to convert every common-law fraud that *happens to involve* [*covered*] *securities* into a violation of § 10(b)." In light of this tension, consideration of how our sister circuits have construed and applied this "coincide" requirement is helpful in deciding how best to approach our present case.

In our consideration, we find most persuasive the decisions from the Second, Ninth, and Eleventh Circuits. The cases from the other circuits do not attempt to define the "coincide" requirement, but merely discuss what connection above and beyond "coincide" is sufficient. For example, in *Segal,* the Sixth Circuit noted that fraud allegations that "depend on" transactions in covered securities meet the "coincide" requirement, but it does not state that for a fraud to "coincide" *requires* that the fraud "depend on" transactions in covered securities. It narrowly holds that where fraud depends on transactions in covered securities, the fraud will also coincide with transactions in covered securities.

The Second, Ninth, and Eleventh Circuits have, however, attempted to give dimension to what is sufficiently connected/coincidental to a transaction in covered securities to trigger SLUSA preclusion. The Eleventh Circuit in *Instituto De Prevision Militar v. Merrill Lynch*(“*IPM*”) dealt with claims brought by a Guatemalan government agency that administered a pension fund for Guatemalan military veterans, which invested in Pension Fund of America (“PFA”), and other Latin American PFA investors against Merrill Lynch. According to their complaint, Merrill Lynch “actively promot [ed] PFA and vouch[ed] for the character of PFA's principals.” After determining that the class met SLUSA's definition of a “covered class action,” the Eleventh Circuit turned to the “coincide” requirement. It held that requirement met if either “fraud ... induced [plaintiffs] to invest with [the defendant(s)]” or “a fraudulent scheme ... coincided and depended upon the purchase or sale of [covered] securities.” The court found that “IPM is complaining about fraud that induced it to invest with PFA, which means that its claims are ‘in connection with the purchase or sale’ of a security under SLUSA.”

The Ninth Circuit articulated its test for the “coincide” requirement slightly differently in its *Madden v. Cowen & Co.* opinion. That case involved shareholders of two medical care providers that were looking to merge with a larger company. In attempting to merge these two medical care providers, the shareholders retained an investment bank, Cowen, “to look for prospective buyers, give advice regarding the structure of any potential sale, and render a fairness opinion regarding any proposed transaction.” Two suitors stepped up—one closely-held corporation and another publicly-traded company. Cowen recommended to the shareholders that they accept the bid from the publicly-traded company. After the merger was complete, the stock price of the publicly-traded company tumbled. The shareholders then brought suit against Cowen for “negligent misrepresentation and professional negligence under California law.” Based on *Dabit*'s statement that “in connection with” must be interpreted the same way under SLUSA as it is under Section 10(b), the Ninth Circuit looked to its prior precedent and held fraud is “ ‘in connection with’ the purchase or sale of securities if there is ‘a relationship in which the fraud and the stock sale coincide or are more than tangentially related.’ ” Applying the “more than tangentially related” test, the court found that “the misrepresentations and omissions alleged in the complaint are more than tangentially related to [the shareholders'] purchase of the [publicly-traded company's] securities.”

The most recent circuit to consider the scope of the “coincide” requirement post-*Dabit* was the Second Circuit in *Romano v. Kazacos.* *Romano* dealt with two consolidated cases—one brought by Xerox retirees and one by Kodak retirees—alleging that Morgan Stanley “misrepresented that if appellants were to retire early, their investment savings would be sufficient to support them through retirement.” Based on these alleged misrepresentations, the retirees “deposited their retirement savings into Morgan Stanley IRA accounts, where covered securities were purchased on their behalf.” In discussing the “coincide” requirement, the Second Circuit stated that

"SLUSA's 'in connection with' standard is met where plaintiff's claims turn on injuries caused by acting on misleading investment advice—that is, where plaintiff's claims necessarily allege, necessarily involve, or rest on the purchase or sale of securities .... [Additionally,] the more exacting induced standard satisfies § 10(b)'s 'in connection with' requirement."

Each of the circuits that has tried to contextualize the "coincide" requirement has come up with a slightly different articulation of the requisite connection between the fraud alleged and the purchase or sale of securities (or representations about the purchase or sale of securities. Beyond these various interpretations, we also think it useful before our standard to consider cases more factually analogous to ours than *Dabit* and much of its progeny. That is, cases where the fraud alleged was centered around the purchase or sale of an uncovered security, like the CDs at issue in this appeal.

C

The preclusion analysis under SLUSA is slightly more complex in cases where the fraudulent scheme alleged involves a multi-layered transaction, like the one at issue in our case. In these cases, the plaintiffs often are fraudulently induced into investing in some kind of uncovered security, like a CD or a share in a "feeder fund," which has some relationship either through the financial product's management company or through the financial product itself to transactions (real or purported) in covered securities, such as stocks. Some of the more analogous cases arise out of the slew of recent suits stemming from the Bernie Madoff Ponzi scheme, especially the so-called "feeder fund" cases. From our reading of these uncovered securities cases, we glean three approaches: (1) focus the analysis on whether the financial product purchased was a covered security (the "product approach"); (2) focus on the "separation" between the investment in the financial product and the subsequent transactions (real or purported) in covered securities (the "separation approach"); and (3) focus on the "purpose(s)" of the investment (the "purposes approach").

1

Courts that take the product approach focus their analysis on the type of financial product upon which the alleged fraudulent scheme centers. In doing so, the crux of the analysis is not whether or not the "coincide" requirement of SLUSA is met, but rather whether the financial product qualifies as a "covered security" under 15 U.S.C. § 78bb(f)(5)(E). In *Ring v. AXA Financial, Inc.*, the Second Circuit held that claims of fraud relating to the sale of an interest in a term life insurance policy, a Children's Term Rider ("CTR") (a "classic insurance product" and an uncovered security) were not SLUSA-precluded merely because the insurance company held covered securities in its portfolio, which in turn backed the plaintiffs' interest in the CTR. It likewise found the fact that the CTR was attached to a variable life insurance policy, which is a covered security under SLUSA, was insufficient to preclude all claims relating to the CTR because "the CTR and the policy to which it is appended must be considered separately." Similarly, in *Brehm v. Capital Growth Financial*, the district court held that "private placement securities or debentures" were not covered securities. Moreover, it found that allegations that the defendants were also going to invest in "securities and other intangible instruments that are traded in the public markets or issued privately" were insufficient to bring the case within SLUSA's preclusive ambit.

The most-cited case using this approach is *Pension Committee of the University of Montreal Pension Plan v. Banc of America Securities, LLC*. That case was an "action to recover losses stemming from the liquidation of two British Virgin Islands based hedge funds ... in which [the plaintiffs] held shares." The *Montreal Pension* court held, "Because plaintiffs purchased shares in hedge funds, rather than covered securities, SLUSA does not preempt plaintiffs' state-law claims." It went on to discuss *Dabit* and distinguished it by stating,

> The interpretation of SLUSA urged by the [Defendants] stretches the statute beyond its plain meaning. There are no grounds on which to justify applying *Dabit* to statements made by the [Defendants] concerning *uncovered hedge funds*—even when a portion of the assets in those funds include covered securities. This outcome is required because the alleged fraud relates to those hedge funds rather than to the covered securities in the portfolios.

Lastly, using some language more characteristic of the purpose and separation approaches, the court also distinguished its case from the Madoff feeder fund cases where SLUSA preclusion was found. It noted that the feeder funds in those cases were "nothing but ghost entities—easily pierced," and that those funds essentially "did not exist and had no assets. Thus," it found, the plaintiffs in those cases "could claim that they deposited their money [in the funds] for the purpose of purchasing covered securities." None of those conditions were present in the funds purchased by the plaintiffs; therefore, it concluded, "covered securities are not 'at the heart' of this case."

2

The separation approach considers the degree of separation between the fraud inducing the plaintiffs to buy the uncovered securities and the downstream transactions in covered securities. This focus is somewhat like *Montreal Pension*'s concern about what is at the "heart" of the case. The most cited case using the separation approach is *Anwar v. Fairfield Greenwich Ltd.* (*Anwar II*). *Anwar II* dealt with a feeder fund to invest in Madoff's funds. The district court in *Anwar II*, however, found distinct differences in how the funds at issue in that case operated and the usual way Madoff feeder funds operated. Finding that the funds at issue were "not ... cursory, pass-through entit[ies]," the *Anwar II* court held that "[t]hough the [c]ourt must broadly construe SLUSA's 'in connection with' phrasing, stretching SLUSA to cover this chain of investment—from [p]laintiffs' initial investment in the [f]unds, the [f]unds' reinvestment with Madoff, Madoff's supposed purchases of covered securities, to Madoff's sale of those securities and purchases of Treasury bills—snaps even the most flexible rubber band." Therefore, the court found that the "coincide" requirement was not met because "[t]he allegations in [that] case present[ed] multiple layers of separation between whatever phantom securities Madoff purported to be purchasing and the financial interests [p]laintiffs actually purchased."

3

The third and most widely adopted approach is the purpose approach, which primarily concerns itself with what the purpose of the investment was. The clearest articulation of this approach asks whether the uncovered securities (feeder funds) "were created for the purpose of investing in [covered] securities."

In ascertaining the purpose of the investment, these courts have considered what the fraud "at the heart of the case" was. They have also looked to the centrality of transactions in covered securities to the fraud. Finally, some courts have considered the "nature of the parties' relationship, and whether it necessarily involved the purchase or sale of securities."

D

Given the Supreme Court's express reliance on "policy considerations" in its determination of the scope of the "in connection with" language in Section 10(b), we find it useful to consider such arguments in our formulation of the standard. Specifically, we find persuasive Congress's explicit concern about the distinction between national, covered securities and other, uncovered securities.

As we have stated previously, "SLUSA advances 'the congressional preference for national standards for securities class action lawsuits involving *nationally* traded securities.' " The rationale for this preference is clear: Because

> companies can not control where their securities are traded after an initial public offering ..., companies with publicly-traded securities can not choose to avoid jurisdictions which present unreasonable litigation costs. Thus, a single state can impose the risks and costs of its peculiar litigation system on all national issuers. The solution to this problem is to make Federal court the exclusive venue for most securities fraud class action litigation involving nationally traded securities.

Such concerns are unique to the world of national securities. That SLUSA would be applied only to transactions involving national securities appears to be Congress's intent: "[T]he securities governed by this bill—and it is important to emphasize this point—are by definition trading on national exchanges. As we all know, securities traded on national exchanges are bought and sold by investors in every State, and those investors rely on information distributed on a national basis.

Exempting non-national securities from SLUSA's preclusive scope does not render them unregulated. When enacting SLUSA, Congress recognized the importance of maintaining the vital role of state law in regulating non-national securities. Congress found "that in order to avoid ... thwarting ... the purpose of the [PSLRA], national standards for nationally traded securities must be enacted, while preserving the appropriate enforcement powers of state regulators, and the right of individuals to bring suit." Notably, state common law breach of fiduciary duty actions provide an important remedy not available under federal law. In addition to fiduciary duty actions, over-extension of SLUSA also threatens state creditor-debtor regimes, which we have held are likely available to the Appellants. The differences between the federal and state remedies have led our colleagues on the Eleventh Circuit to note that "[s]ince not every instance of financial unfairness or breach of fiduciary duty will constitute a fraudulent activity under § 10(b) or Rule 10b–5, federal courts should be wary of foreclosing common law breach of fiduciary duty actions which supplement existing federal or state statutes." This wariness is echoed by the members of Congress appearing as *amici* on behalf of the Appellants: "The interpretation of SLUSA and the 'in connection with' requirement adopted by the District Court ... could potentially subsume any consumer claims involving the exchange of money or alleging fraud against a bank, without regard to the product that was being peddled." As they point out, every bank and almost every company owns some covered securities in its portfolio, and every debt instrument issued by these banks and companies is backed by this portfolio in the same way the CDs here were ultimately backed by the assets in SIB's portfolio. Precluding any group claim against any such debt issue merely because the issuer advertises that it owns these assets in its portfolio would be a major change in the scope of SLUSA.

IV

It is against this backdrop that we must go about formulating our standard for judging the connection of claims like the Appellants' to the purchase or sale of covered securities. As noted previously, there is tension in the law between following the Supreme Court's command that "in connection with" must be interpreted broadly, *Zandford* and its concurrent instruction that the same language "must not be construed so broadly as to convert every common-law fraud that happens to involve [covered] securities into a violation of § 10(b)."

The Eleventh Circuit's test from *IPM*, employed by the district court, is a good starting point because it identifies the two different perspectives from which to approach the question of connectivity. *IPM* held that the "coincide" requirement is met if either "fraud ...*induced* [plaintiffs] to invest with [the defendant(s)]" or "a fraudulent scheme ... coincided and *depended upon* the purchase or sale of [covered] securities." The "induced" prong examines the allegations from the plaintiffs' perspective by asking essentially whether the plaintiffs thought they were investing in covered securities or investing because of (representations about) transactions in covered securities. The "depended upon" prong views the allegations from the opposite perspective, the defendants', essentially asking whether the defendants' fraudulent scheme would have been successful without the (representations about) transactions in covered securities. These two perspectives—plaintiffs' and defendants'—

are also seen in the various uncovered securities cases in the district courts.

Viewing the allegations from the plaintiffs' perspective, however, asks the wrong question. By tying the "coincide" requirement to "inducement," it unnecessarily imports causation into a test whose language ("coincide") specifically disclaims it. The defendant-oriented perspective, like *IPM*'s "depends upon" prong, is more faithful to the Court's statement that "[t]he requisite showing ... is deception in connection with the purchase or sale of any security, *not deception of an identifiable purchaser or seller*." *Dabit*'s formulation focuses the analysis on the relationship between the defendants' fraud and the covered securities transaction without regard to the fraud's effect on the plaintiffs. Additionally, *IPM*'s "depended upon" prong appears very similar to the Second Circuit's test from *Romano,* which found SLUSA preclusion is appropriate where "plaintiff's claims 'necessarily allege,' 'necessarily involve,' or 'rest on' the purchase or sale of securities."

Though the defendant-oriented perspective is the proper point of view from which to consider the allegations, the problem we see with the test from that perspective as articulated by the Second and Eleventh Circuits is that it is too stringent a standard. Specifically, a reading of the opinions of the Sixth and Eighth Circuits on SLUSA preclusion suggests that those courts would find the "depended upon" standard to be too high a bar. The Sixth Circuit in *Segal* seemed to suggest that while a claim that "depended on" a securities transaction was sufficient, there were other connections that would also meet the "coincide" requirement. In *Siepel*, the Eighth Circuit found that the "coincide" requirement is less stringent than a standard requiring the fraud "relate to" transactions in covered securities.

In light of this, we find Ninth Circuit's test from *Madden,* which is that "a misrepresentation is 'in connection with' the purchase or sale of securities if there is a relationship in which the fraud and the stock sale coincide or are *more than tangentially related,*" to be the best articulation of the "coincide" requirement. This articulation nicely deals with the Court-expressed tension in *Zandford* that the requirement "must not be construed so broadly as to [encompass] every common-law fraud that happens to involve [covered] securities." It also heeds the Seventh Circuit's advice that " 'the "connection" requirement must be taken seriously.' " Lastly, it incorporates the significant policy and legislative intent considerations, all of which militate against an overbroad formulation. Therefore, we adopt the Ninth Circuit's test. Accordingly, if Appellants' allegations regarding the fraud are more than tangentially related to (real or purported) transactions in covered securities, then they are properly removable and also precluded.

V

Having established the standard by which the Appellants' allegations will be judged, we turn now to the *Roland* and *Troice* complaints. "The plaintiff is 'the master of her complaint,' and, as such, a determination that a cause of action presents a federal question depends upon the allegations of the plaintiff's well-pleaded complaint." The artful pleading doctrine is an independent corollary to the well-pleaded complaint rule: "[u]nder this principle, even though the plaintiff has artfully avoided any suggestion of a federal issue, removal is not defeated by the plaintiff's pleading skills in hiding [a] federal question." We have stated previously that the artful pleading doctrine "applies *only* where state law is subject to complete preemption." However, as the Second Circuit has noted, there is another situation where the artful pleading doctrine applies: "when Congress has ... expressly provided for the removal of particular actions asserting state law claims in state court."

Application of the first prong is a bit tricky because SLUSA is a statute of preclusion, rather than preemption. But its effect is the same: where plaintiffs proceed as a class of fifty or more, state law securities claims are no longer available to them and federal law, which compels the dismissal of those claims, controls. Application of the second prong is straightforward. Since SLUSA expressly provides for the removal of covered class actions, it falls under the "removal" exception to the well-pleaded complaint rule. Consequently, we are free to look beyond the face of the amended complaints to determine whether they allege securities fraud in connection with the purchase or sale of covered securities.

Because of the need to examine the actualities of the alleged schemes, we find the product approach taken by some district courts, which focuses its analysis on the type of financial product upon which the alleged fraudulent scheme centers, to be too rigid. Our conclusion, in accord with the district court, that the CDs were uncovered securities therefore does not end our inquiry. We must instead closely examine the schemes and purposes of the frauds alleged by the Appellants.

A

With respect to the claims against the *SEI* Defendants and the *Willis* Defendants, we find the Appellants' allegations to be substantially similar such that they can be analyzed together.

1

The district court found that Appellants' claims were precluded because Appellants invested in the CDs, at least in part, because they were backed by "covered securities." To be sure, the CDs' promotional material touted that SIB's portfolio of assets was invested in "highly marketable securities issued by stable governments, strong multinational companies and major international banks." This is, however, but one of a host of (mis)representations made to the Appellants in an attempt to lure them into buying the worthless CDs. Viewing the allegations, as we must, from how the advisors at SEI and Willis allegedly structured their fraudulent scheme, we find the references to SIB's portfolio being backed by "covered securities" to be merely tangentially related to the "heart," "crux," or "gravamen" of the defendants' fraud.

When we look over the complaints against the SEI Defendants and the Willis Defendants, we find that the heart, crux, and gravamen of their allegedly fraudulent scheme was representing to the Appellants that the CDs were a "safe and secure" investment that was preferable to other investments for many reasons. For example, as alleged by the *Roland* Plaintiffs, the CDs were principally promoted as being preferable to other investments because of their liquidity, consistently high rates of return, and the fact that SEI and other regulators were keeping a watchful eye on SIB. Similarly, the so-called "safety and soundness letters" sent by the Willis Defendants focused on the "professionalism" of SIB and the "stringent" reviews. That the CDs were marketed with some vague references to SIB's portfolio containing instruments that might be SLUSA-covered securities seems tangential to the schemes advanced by the *SEI* and *Willis* Defendants.

Our conclusion that the allegations do not amount to being "in connection with" transactions in covered securities is bolstered by the distinction between the present cases and the Madoff feeder fund cases. Comparing the allegations in the uncovered securities cases we surveyed, we find the most similarity with the allegations in the *Montreal Pension* case. The CDs, like the uncovered hedge funds in *Montreal Pension,* were not mere "ghost entities" or "cursory pass-through vehicles" to invest in covered securities. The CDs were debt assets that promised a fixed rate of return not tied to the success of any of SIB's purported investments in the "highly marketable securities issued by stable national governments, strong multinational companies, and major international banks." Unlike in the Madoff feeder fund cases, "plaintiffs could [not] claim that they deposited their money in the bank for the purpose of purchasing covered securities." Finally, as was the case in *Anwar II,* there are "multiple layers of separation" between the CDs and any security purchased by SIB.

Therefore, we find that the fraudulent schemes of the *SEI* Defendants and the *Willis* Defendants, as alleged by the Appellants, are not more than tangentially related to the purchase or sale of covered securities and are therefore not sufficiently connected to such purchases or sales to trigger SLUSA preclusion.

2

The district court also justified its decision based on the fact that "at least one of the [*Roland*] Plaintiffs acquired SIB CDs with the proceeds of selling SLUSA-covered securities in their IRA portfolios" and that those transactions brought the action within the ambit of SLUSA preclusion. While we do not quarrel with the district court's finding that some plaintiffs sold covered securities to buy the CDs, we think that the way the district court approached this alleged connection was incorrect. The appropriate inquiry under SLUSA is whether the fraudulent scheme, as alleged by the Appellants, was connected with a transaction in a covered security. While the fact that covered securities were in fact traded as a part of the fraud is evidence of the defendants' intent, it is not dispositive.

Appellants argue that "[t]he source of funds used to buy uncovered securities is irrelevant." In response, the defendants posit that this cannot be the case in light of the Supreme Court's decisions in *Superintendent of Insurance v. Bankers Life & Casualty Co.* and*Zandford.* In *Bankers Life,* the Court dealt with a company president who allegedly conspired to acquire the company's stock using the company's assets and caused the company to liquidate its bond portfolio and to invest the proceeds in a worthless certificate of deposit. The Court held that the scheme was "in connection with" the purchase or sale of securities such that suits by defrauded investors of the company could be maintained under Section 10(b). In *Zandford,* the Court found that where a broker took over a customer's portfolio to purportedly manage and invest the assets but in fact, liquidated covered securities in order to steal the customer's funds, the fraud was "in connection with" transactions in securities because "[t]he securities sales and respondent's fraudulent practices were not independent events" and "each sale was made to further respondent's fraudulent scheme."

Based on our reading of the allegations in the Appellants' complaints, the connection between the fraud and sales of covered securities is not met here. Unlike *Bankers Life* and *Zandford,* where the entirety of the fraud depended upon the tortfeasor convincing the victims of those fraudulent schemes to sell their covered securities in order for the fraud to be accomplished, the allegations here are not so tied with the sale of covered securities. To be sure, it was necessary for fraud for the defendants to have the Appellants invest their assets into the CDs, but based on the allegations, there is no similar focus to *Bankers Life* and *Zandford* on the sale of covered securities. Therefore, we find that the fact that some of the plaintiffs sold some "covered securities" in order to put their money in the CDs was not more than tangentially related to the fraudulent scheme and accordingly, provides no basis for SLUSA preclusion.

B

We view the claims against the *Proskauer* Defendants as different from those alleged against the other defendants. Unlike the claims against the *SEI* Defendants and the *Willis* Defendants, the *Troice* Plaintiffs' claims against the Proskauer Defendants are solely for aiding and abetting the Stanford Ponzi scheme. That is to say, the allegations against the SEI and Willis Defendants were, *inter alia,* that they made misrepresentations to the Appellants about the liquidity, soundness, and safety of investing in the CDs whereas the *Troice* Plaintiffs do not allege that the *Proskauer* Defendants made *any* misrepresentations to them. The core allegation is that without the aid of the *Proskauer* Defendants the Stanford Ponzi could not have been accomplished. However, when we examine the substance of the claims against the Proskauer Defendants, it is clear that there are misrepresentations involved.

Specifically, the *Proskauer* Defendants allegedly misrepresented to the SEC the Commission's ability to exercise its oversight over Stanford and SIB. By telling the SEC that it could not investigate the operations of Stanford and SIB, the *Proskauer* Defendants obstructed any chance of an SEC investigation uncovering the fraud, thereby allowing it to continue and harm the *Troice* Plaintiffs to occur. These alleged misrepresentations were one level removed from the misrepresentations made by *SIB* or the *SEI* and *Willis* Defendants. The connection that the *Proskauer* Defendants would have us find is that the misrepresentations to the SEC about its regulatory authority allowed SIB to recruit the *Willis* Defendants to sell CDs, who in turn misrepresented to the *Troice* Plaintiffs a host of things in order to convince them that the CDs were good investments, including vague references to SIB's portfolio containing instruments that might be SLUSA-covered securities. Like with the *SEI* and *Willis* Defendants, the misrepresentations made by the *Proskauer* Defendants are not more than tangentially related to the purchase or sale of covered securities and therefore, SLUSA preclusion does not apply.

VI

For the foregoing reasons, the judgments are REVERSED. The *Troice* cases are remanded to the district court, and the *Roland* case is remanded to the state court.

REVERSED.

“U.S. Supreme Court To Review Fifth Circuit’s SLUSA Decision in Stanford Ponzi Scheme Case”

JD Supra Law News
Shawn Hough & Frank Oliva
January 28, 2013

The Supreme Court recently granted *certiorari* to examine the “in connection with” requirement of the Securities Litigation Uniform Standards Act (“SLUSA”) in *Chadbourne & Parke LLP v. Troice*, No. 12-79. SLUSA generally precludes state law securities class actions when there is a misrepresentation or omission “in connection with the purchase or sale of a covered security”:

No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal Court by any private party alleging a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security.

In light of a seeming disagreement among the Circuits, this case could have a significant impact on which cases are precluded under SLUSA.

The case stems from a Ponzi scheme perpetrated by R. Allen Stanford, which unraveled in 2009. Stanford purported to sell certificates of deposit (“CDs”) that generated above-market returns. Purchasers of Stanford’s fraudulent CDs were led to believe that the CD’s were backed by SLUSA-covered securities. The United States District Court for the Northern District of Texas held that the lawsuit was precluded by SLUSA. The district court reasoned that the Supreme Court urged a broad interpretation of the “in connection with” requirement in order to further SLUSA’s goals, and that plaintiffs’ allegations sufficiently connected the fraud to transactions in covered securities, thus triggering the protections of SLUSA against class actions based on state law.

On appeal, the Fifth Circuit disagreed and held that SLUSA did not preclude various Stanford suits from moving forward because plaintiffs’ allegations were only “tangentially related” to securities trades covered by SLUSA. The Fifth Circuit adopted the Ninth Circuit’s approach to determine whether allegations of fraud are sufficiently connected to covered securities to trigger SLUSA preclusion. Under the Ninth Circuit standard, state law fraud allegations trigger the protections of SLUSA if they are more than tangentially related to real or purported transactions in covered securities. The Fifth Circuit reasoned that the claim that the proceeds from the sale of CDs were invested in a portfolio including SLUSA-covered securities was but one of a host of misrepresentations made to plaintiffs in the attempt to lure them into buying the worthless CDs. The real focus of the fraud, according to the court, was that the CDs were said to be a safe and secure investment. In addition, the Fifth Circuit found that the sale of covered securities by plaintiffs to finance the purchase of CDs only created a tangential relationship between the fraud and covered securities because Stanford did not convince the victims to sell the securities.

While each case is arguably fact-specific, the *Chadbourne* case could potentially shed light on a legal standard that has proved slippery for the courts.

"Ponzi Scheme Victims and SLUSA: The Supreme Court to Decide What Claims Can Proceed"

LexisNexis
Kathy Bazoian Phelps
February 6, 2013

Defrauded investors in a Ponzi scheme have a few choices when the scheme goes bust. They can wait for a distribution from the insolvency proceeding, or they can take matters into their own hands and form a class to sue third parties for their damages. However, the Securities Litigation Uniform Standards Act ("SLUSA") can impose a formidable barrier for those types of class action suits.

SLUSA states, "No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security."

The Supreme Court has agreed to hear an appeal in three related cases in the Allen Stanford Ponzi scheme case on the significant question of when SLUSA precludes investors' state law claims for relief against third parties.

The decision that the Supreme Court will review is the Fifth Circuit's decision in *Roland v. Green*, 675 F.3d 503 (5th Cir. 2012). The district court had before it three state class actions to recover damages. In these suits, investors asserted a range of claims under Texas and Louisiana law against a number of third party defendants, including two law firms, Proskauer Rose and Chadbourne & Parke, as well as an insurance brokerage, Willis of Colorado, Inc. These are the parties that eventually petitioned the Supreme Court to hear the case.

In their complaints, the plaintiffs claimed that they were misled into buying Stanford's International Bank's certificates of deposit by several misrepresentations, including that SIB's assets were "invested in a well-diversified portfolio of highly marketable securities issued by stable national governments, strong multinational companies, and major international banks." The plaintiffs alleged that law firms aided and abetted Stanford's fraud.

The defendants moved to dismiss under SLUSA, asserting that the plaintiffs were claiming misrepresentations of material facts in connection with the purchase of a "covered security." The district court agreed and dismissed.

What Does "In Connection With" a "Covered Security" Mean?

The district court found that the SIB CDs themselves were not "covered securities" within the meaning of SLUSA because SIB never registered the CDs, nor were they traded on a national exchange. Nevertheless, it held that the alleged misrepresentations were "in connection with" the purchase of a "covered security," finding that:

- The plaintiffs' "purchases of SIB CDs were 'induced' by the misrepresentation that SIB invested in a portfolio including SLUSA-covered securities"; and
- The plaintiffs' allegations "reasonably imply that the Stanford scheme coincided with and depended upon the Plaintiffs' sale of SLUSA-covered securities to finance SIB CD purchases."

On appeal, the Fifth Circuit reversed and reinstated the plaintiffs' state law-based class action suits. *Roland*, 675 F.3d at 520. It reviewed the substantial conflicts in the standards that the other courts of appeals had adopted on the issue of when a misrepresentation is "in connection with the purchase or sale of a covered security." The Fifth Circuit agreed with the standard that the Ninth Circuit had adopted in *Madden v. Cowen & Co.*, 576 F.3d 957 (9th Cir. 2009): "Accordingly, if Appellants' allegations regarding the fraud are more than tangentially related to (real or purported) transactions in covered securities, then they are properly removable and also precluded." *Roland*, at 520.

Applying that standard, the Fifth Circuit concluded that the plaintiffs' "references to SIB's portfolio being backed by 'covered securities' to be merely tangentially related to the 'heart,' 'crux,' or 'gravamen' of the defendants' fraud." Rather, the court found that the "heart, crux, and gravamen of their allegedly fraudulent scheme was representing to the Appellants that the CDs were a 'safe and secure' investment that was preferable to other investments for many reasons." *Id*. Therefore, the Fifth Circuit rejected the district court's rationale that the plaintiffs' purchases of SIB's CDs were induced by the misrepresentation that SIB invested in a portfolio that included SLUSA-covered securities.

The district court had also concluded that the claimed fraud was "in connection with" the sale of a security because to fund their investments in SIB's fraudulent CDs, some plaintiffs had sold their existing, unrelated securities. The Fifth Circuit also rejected that rationale, finding that Stanford's scheme was focused not on persuading the plaintiffs to sell their securities, but on selling the fraudulent CDs.

The Split in the Circuits

The standard adopted by the Fifth and Ninth Circuits - the "more than tangentially related" test - is a narrow test, which results in the dismissal of smaller group of these class action suits against third parties in Ponzi scheme and other fraud cases.

On the other hand, the tests adopted by the Second, Sixth, and Eleventh Circuits are broader and require the dismissal of a larger group of these cases. Although these courts articulate their tests slightly differently, each certainly would require the dismissal of the three cases in *Roland v. Green*.

In *Romano v. Kazacos*, 609 F.3d 512, 522 (2d Cir. 2010), the Second Circuit held that the SLUSA requirement is met "where plaintiff's claims 'necessarily allege,' 'necessarily involve,' or 'rest on' the purchase or sale of securities." (This was the test on which the district court relied in dismissing *Roland v. Green*.)

In *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305, 310 (6th Cir. 2009), the Sixth Circuit held that SLUSA's "in connection with" requirement is satisfied when the fraud "coincide[s] with" or "depend[s] upon" securities transactions. The Sixth Circuit further held that SLUSA "does not ask whether the complaint makes 'material' or 'dependent' allegations of misrepresentations in connection with buying or selling securities." It only "asks whether the complaint includes these types of allegations, pure and simple."

In *Instituto De Prevision Militar v. Merrill Lynch*, 546 F.3d 1340, 1349 (11th Cir. 2008), the Eleventh Circuit held that a misrepresentation is made "in connection with" a covered securities transaction so long as either an alleged misrepresentation about a covered securities transaction "induced [plaintiff] to invest with [defendant]," or the misrepresentation "coincided and depended upon the purchase or sale of securities."

Supreme Court Precedent

The Supreme Court's decision will likely turn on its interpretation of its own precedent in *SEC v. Zandford*, 535 U.S. 813, 824 (2002), and *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006).

In *Zandford* the issue was when a misrepresentation is "in connection with" a securities sale, as required to state a claim under § 10(b). The Court held that it is sufficient if the misrepresentation "coincides" with the sale or purchase of a covered security. However, the Court cautioned that "the statute must not be construed so broadly as to convert every common-law fraud that happens to involve [covered] securities into a violation of § 10(b)."

In *Dabit*, the Court addressed the SLUSA issue - when is a plaintiff's claim of a misrepresentation "in connection with the purchase or sale" of a covered security? In that case, the plaintiffs alleged in their state law fraud suit that the defendants' misrepresentations induced them to hold their securities. They had neither purchased nor sold a security as a consequence of the alleged misrepresentations. The Supreme Court nevertheless held that SLUSA bars their claims. It held that the SLUSA phrase "in connection with the purchase or sale of a covered security" must be given the same "broad construction" as the nearly identical "in connection with" language in § 10(b) itself, which requires only that the "fraud alleged 'coincide' with a securities transaction-whether by the plaintiff or by someone else."

Significance of the Outcome of *Roland v. Green*

The outcome of *Roland v. Green* in the Supreme Court will directly impact the availability of investors' remedies in many Ponzi scheme cases, where the perpetrator's promise to invest in securities turns out to be wholly illusory. For example, as we know, Bernard Madoff also falsely promised securities investments. Madoff investors have the additional issue that many of Madoff's victims invested not with him directly, but with feeder funds who in turn invested with Madoff.

"Fifth Circuit Finds SLUSA Does Not Preclude Stanford Investors' State Claims"

Securities Law Professor Blog
March 20, 2012

The Fifth Circuit recently held that SLUSA did not preclude state law class actions seeking to recover damages for losses resulting from the Stanford ponzi scheme, because the purchase or sale of securities (or representations about the purchase or sale of securities) was "only tangentially related" to the ponzi scheme. *Roland v. Green* (5th Cir. Mar. 19, 2012).

In that case Louisiana investors sued the SEI Investments Company (SEI), the Stanford Trust Company, the Trust's employees and the Trust's investment advisers alleging violations of Louisiana law. According to the plaintiffs, the Antigua-based Stanford International Bank (SIB) sold CDs to the Trust, which served as the custodian for individual IRA purchases of the CDs. The Trust, in turn, contracted with SEI to administer the Trust, making SEI responsible for reporting the value of the CDs. Plaintiffs allege that misrepresentations by SEI induced them to use their IRA funds to purchase the CDs, including that the CDs were a safe investment because SIB was "competent and efficient," that independent auditors "verified" the value of SIB's assets, and that SIB's assets were invested in a "well-diversified portfolio of highly marketable securities." The defendants sought removal to district court on the basis of SLUSA preclusion. (*Roland* was consolidated with two similar class actions.)

The district court, in holding that SLUSA precluded the class actions, acknowledged that the SIB CDs were not themselves "covered securities" under the statute, but determined that this did not end the inquiry. It found that the requisite connection existed because (1) the plaintiffs' purchases of the CDs were allegedly induced by the representation that SIB invested in a portfolio of "covered securities" and (2) at least one plaintiff's purchases of the CDs were allegedly funded by sales of covered securities.

Though the question of the scope of the "in connection with" requirement under SLUSA was one of first impression in the Fifth Circuit, the appeals court noted that six circuits have addressed the issue. The Fifth Circuit initially found the decisions from the Second, Ninth and Eleventh Circuits most useful, because they attempted to give dimension to what is sufficiently connected/coincidental to a transaction in covered securities to trigger SLUSA preclusion. However, because each of these Circuits stated the requisite connection in a slightly different formulation, the Fifth Circuit looked to cases where the facts were closer to the allegations in this case, i.e., where the alleged fraud was centered around the purchase or sale of an uncovered security like the CDs in this case. Accordingly, the court turned its attention to the "feeder fund" cases arising from the Madoff ponzi scheme and described three different approaches used by the courts: (1) whether the financial product purchased was a covered security (the product approach), (2) what was the separation between the investment in the financial product and the subsequent transactions in covered securities (the separation approach), (3) what were the purposes of the investment (the purposes approach).

Next, the Fifth Circuit returned to the "policy consideration" that the U.S. Supreme Court relied on in *Dabit* in determining the scope of the in connection with requirement and found persuasive Congress's explicit concern about the distinction between national, covered securities and other, uncovered securities. "That SLUSA would be applied only to transactions involving national securitiess appears to be Congress's intent." It also recognizes that "state common law breach of fiduciary duty actions provide an important remedy not available under federal law." The court also acknowledged the concern expressed by some members of Congress who filed an amicus brief: "The interpretation of SLUSA and the 'in connection with' requirement adopted by the District Court ... could potentially subsume any consumer claims involving the exchange of money or alleging fraud against a bank, without regard to the product that was being peddled."

Ultimately, the Fifth Circuit concluded that the standards articulated by the Second and Eleventh Circuits were too stringent and adopted the Ninth Circuit test -- a misrepresentation is "in connection with" the purchase or sale of securities if there is a relationship in which the fraud and the stock sale coincide or are more than tangentially related.

In applying the test, the Fifth Circuit agreed with the district court that the fact that the CDs were uncovered securities did not end the inquiry and that it must closely examine the schemes and purposes of the frauds alleged by the plaintiffs. It disagreed with the district court, however, about the importance of the representation that SIB's assets were invested in marketable securities because that was only one of many representations made to induce plaintiffs to purchase the CDs. Rather, the "heart, crux and gravamen" of the fraudulent scheme was the representation that the CDs were a "safe and secure" investment. It also dismissed the significance placed by the district court on the fact that at least one plaintiff sold covered securities to finance the purchase of CDs, because the fraud did not depend upon the defendant convincing the victims to sell their covered securities. Accordingly, in both instances, the representations were no more than "tangentially related" to the purchase or sale of covered securities.

"Supreme Court to Decide Scope of Preemption of State-Law Securities Class Actions by SLUSA"

Lexology
Joshua D. Yount
January 23, 2013

On Friday, the Supreme Court granted review in three consolidated cases: *Chadbourne & Parke LLP v. Troice*, No. 12-79, *Willis of Colorado v. Troice*, No. 12-86, and *Proskauer Rose LLP v. Troice*, No. 12-88. The Court's decision will clarify when the federal Securities Litigation Uniform Standards Act ("SLUSA") preempts state-law securities class actions.

After Congress tightened the pleading and proof requirements for class actions under the federal securities laws in 1996 in the Private Securities Litigation Reform Act, plaintiffs fled to state court and started bringing securities class actions under state law. In response to this evasion, Congress enacted SLUSA, which precludes most state-law class action claims that allege "a misrepresentation or omission of a material fact in connection with the purchase or sale of" securities covered by the statute. In the three *Troice* cases, the Supreme Court will determine when a misrepresentation is "in connection with" a securities transaction.

All three cases arise out of the Ponzi scheme that R. Allen Stanford allegedly operated. The plaintiffs had bought certificates of deposit from entities controlled by Stanford. CDs are not "covered securities" for SLUSA purposes. But the defendants argued that SLUSA barred the plaintiffs' state-law claims because (1) plaintiffs had alleged that a representation that the CDs were backed by a diversified portfolio of marketable securities helped induce the CD purchases and (2) some buyers sold covered securities to fund their CD purchases.

The district court agreed with the defendants, but the Fifth Circuit reversed. Roland v. Green, 675 F.3d 503 (5th Cir. 2012). Adopting a Ninth Circuit test, the Fifth Circuit ruled that there had to be "a relationship in which the fraud and the stock sale coincide or are more than tangentially satisfied." That test was not satisfied, the Fifth Circuit concluded, because the allegation that the CD issuer's portfolio was backed by covered securities was merely "tangentially related" to the "gravamen" of the alleged fraud that the CDs were a safe and secure investment. Several other circuits have taken different approaches, under some of which the plaintiffs' claims would be preempted.

We intend to keep our eye on this case, which could have big implications for the wide variety of investment vehicles that may not be covered securities themselves but arguably benefit from the performance of covered securities.

Unite Here Local 355 v. Mulhall

12-99

Ruling Below: *Mulhall v. Unite Here Local 355*, 667 F.3d 1211 (11th Cir. 2012), *cert granted*, 133 S.Ct. 2849 (2013).

Employee brought action against his employer and local labor union, seeking to enjoin enforcement of neutrality and cooperation agreement executed by employer and union on grounds that agreement allegedly violated the Labor Management Relations Act (LMRA). After the district court dismissed action for lack of standing, employee appealed. The Court of Appeals reversed and remanded. On remand, the United States District Court for the Southern District of Florida dismissed complaint for failure to state a claim. Employee appealed. Addressing issues of first impression for the court, the Court of Appeals for the Eleventh Circuit held that intangible organizing assistance offered by an employer to a labor union may be a "thing of value" that, if demanded or given as payment, could constitute a violation of the section of the LMRA making it unlawful for an employer to give or for a union to receive any "thing of value,"; and here, employee's allegations were sufficient to state a cause of action under the subject section of the LMRA.

Question Presented: Whether an employer and union may violate Section 302 of the Labor-Management Relations Act, 29 U.S.C. § 186, by entering into an agreement under which the employer exercises its freedom of speech by promising to remain neutral to union organizing, its property rights by granting union representatives limited access to the employer's property and employees, and its freedom of contract by obtaining the union's promise to forego its rights to picket, boycott, or otherwise put pressure on the employer's business.

Martin MULHALL, Plaintiff–Appellant,
v.
UNITE HERE LOCAL 355, Hollywood Greyhound Track, Inc., doing business as Mardi Gras Gaming, Defendants–Appellees.

United States Court of Appeals, Eleventh Circuit

Decided on January 18, 2012

[Excerpt; some footnotes and citations omitted.]

WILSON, Circuit Judge

On this appeal, we decide whether organizing assistance offered by an employer to a labor union can be a "thing of value" contemplated under § 302 of the Labor Management Relations Act ("LMRA"). Section 302 makes it unlawful for an employer to give or for a union to receive any “thing of value,” subject to limited exceptions. We hold that organizing assistance can be a thing of value that, if demanded or given as payment, could constitute a violation of § 302. Because the dismissal of Martin Mulhall's complaint was based on a contrary conclusion, we reverse.

I. BACKGROUND

Hollywood Greyhound Track, Inc., d/b/a Mardi Gras Gaming (“Mardi Gras”), and UNITE HERE Local 355 (“Unite”), a labor union, entered into a memorandum of agreement (“Agreement”) on August 23, 2004. In the Agreement, Mardi Gras promised to (1) provide union representatives access to non-public work premises to organize employees during non-work hours; (2) provide the union a list of employees, their job classifications, departments, and addresses; and (3) remain neutral to the unionization of employees. In return, Unite promised to lend financial support to a ballot initiative regarding casino gaming. Ultimately, Unite spent more than $100,000 campaigning for the ballot initiative. Additionally, if recognized as the exclusive bargaining agent for Mardi Gras's employees, Unite promised to refrain from picketing, boycotting, striking, or undertaking other economic activity against Mardi Gras.

Mulhall is a Mardi Gras employee opposed to being unionized. His complaint seeks to enjoin enforcement of the Agreement, contending that it violated § 302. The district court dismissed the complaint for failure to state a claim because it found that the assistance promised in the Agreement cannot constitute a “thing of value” under § 302.

This is not the first time this case has been before us on appeal. In a previous appeal addressing Mulhall's standing to bring the case, we stated that Mulhall “adequately alleged that the organizing assistance promised by Mardi Gras in the [Agreement] is valuable, and indeed essential, to Unite's effort to gain recognition.”

II. STANDARD OF REVIEW

An order granting a motion to dismiss for failure to state a claim is subject to de novo review.

III. DISCUSSION

Congress enacted the LMRA, commonly known as the Taft–Hartley Act, to curb abuses “inimical to the integrity of the collective bargaining process.” With certain exceptions, § 302 makes it unlawful for

> any employer ... to pay, lend, or deliver, any money or other thing of value ... to any labor organization, or any officer or employee thereof, which represents, seeks to represent, or would admit to membership, any of the employees of such employer....

Additionally, a person cannot request or demand a payment, loan, or delivery of money or other thing of value. As the Ninth Circuit explained, “The dominant purpose of § 302 is to prevent employers from tampering with the loyalty of union officials and to prevent union officials from extorting tribute from employers.”

In the context of § 302, the Eleventh Circuit has not addressed the meaning of the phrase “thing of value,” but it has commented on the phrase as it is used in various other criminal statutes. In *United States v. Nilsen*, the Court stated, “Congress' frequent use of ‘thing of value’ in various criminal statutes has evolved the phrase into a term of art which the courts generally construe to envelop[ ] both tangibles and intangibles.” Reasoning that “monetary worth is not the sole measure of value,” we held the expected testimony of a key government witness is a thing of value.

The Fourth and Third Circuits have addressed challenges to neutrality and cooperation agreements under § 302, and both courts found the assistance was not a thing of value. In *Adcock,* the plaintiff challenged an agreement in which the employer (1) granted the union access to private property, (2) promised neutrality during organizing campaigns, and (3) required some employees to attend union presentations on paid company time. The Fourth Circuit concluded the organizing assistance had no ascertainable value, and therefore the plaintiff had failed to state a § 302 claim. The court explained that the reading of § 302 was consistent with the purpose of the statute because the agreement could not be construed as a bribe or corrupt practice.

The Third Circuit reviewed a neutrality agreement and held that, regardless of whether the agreement benefitted an employer and a union, there was no § 302 violation because the organizing assistance does not qualify as a payment, loan, or delivery. The court also reasoned that any benefit “inherent in a more efficient resolution of recognition disputes does not constitute a ‘thing of value’ within the meaning of the statute.” Moreover, the court expressed concern that invalidating the suspect agreement for a § 302 violation would upset the balance of laws governing the recognition of unions.

No other circuit has published an opinion involving the precise facts presented on this appeal, but several have addressed what the term “thing of value” means in the § 302 context. The Sixth Circuit rejected the argument that under § 302 “a thing of value” is restricted to things of monetary value. In that case, General Motors gave high paying jobs to non-qualified relatives of union officials. The court found a violation of the statute occurred even though the thing of value was not money or some other tangible thing.

The Second Circuit commented on the scope of the phrase “thing of value” when it explained that “[v]alue is usually set by the desire to have the ‘thing’ and depends upon the individual and the circumstances.” It recommended that common sense should inform determinations of whether an improper benefit has been conferred.

[I]t may be argued that a five-dollar Christmas tie is a “thing of value” and a Christmas present hopefully is to create good will in the recipient towards the donor. Countless hypothetical cases can be put, each on its facts approaching that evanescent borderline between the proper and the improper. No calculating machine has yet been invented to make these determinations with certainty. In the meantime the courts must rely upon the less mechanical judgment and common sense which under the present system is, and of necessity must be, lodged in judges and juries.

We are inclined to agree that, in circumstances like these where we search for the line between the proper and the improper, we must rely upon our common sense.

It seems apparent that organizing assistance can be a thing of value, but an employer does not risk criminal sanctions simply because benefits extended to a labor union can be considered valuable. Violations of § 302 only involve payments, loans, or deliveries, and every benefit is not necessarily a payment, loan, or delivery. For example, intangible organizing assistance cannot be loaned or delivered because the actions “lend” and “deliver” contemplate the transfer of tangible items.

Yet, a violation of § 302 cannot be ruled out merely because intangible assistance cannot be loaned or delivered. Section 302 also prohibits payment of a thing of value, and intangible services, privileges, or concessions can be paid or operate as payment. Whether something qualifies as a payment depends not on whether it is tangible or has monetary value, but on whether its performance fulfills an obligation. If employers offer organizing assistance with the intention of improperly influencing a union, then the policy concerns in § 302—curbing bribery and extortion—are implicated.

It is too broad to hold that all neutrality and cooperation agreements are exempt from the prohibitions in § 302. Employers and unions may set ground rules for an organizing campaign, even if the employer and union benefit from the agreement. But innocuous ground rules can become illegal payments if used as valuable consideration in a scheme to corrupt a union or to extort a benefit from an employer.

We need not address whether we require a “thing of value” to have monetary value. Here, Mulhall alleged and a jury could find that Mardi Gras's assistance had monetary value. As evidence of the value, Mulhall points to the $100,000 Unite spent on the ballot initiative that was consideration for the organizing assistance. Mulhall's allegations are sufficient to support a § 302 claim.

We also are unpersuaded by arguments that either the rule of lenity or concerns about constitutionally protected speech counsel against allowing neutrality agreements to be covered by § 302. The rule of lenity applies only when a statute is ambiguous, and here, the plain language of the statute is clear. The protected speech concerns arise out of a mistaken understanding that employers will be required to actively oppose unionization in order to avoid criminal sanctions under § 302. As we see it, an employer's decision to remain neutral or cooperate during an organizing campaign does not constitute a § 302 violation unless the assistance is an improper payment. If the assistance is not an improper payment, an employer's speech is not limited, and it may choose to oppose unionization.

Consequently, we find that Mulhall has stated a claim for relief, and we remand so that the district court can consider the § 302 claim and determine the reason why Unite and Mardi Gras agreed to cooperate with one another.

REVERSED AND REMANDED.

RESTANI, Judge, dissenting:

I respectfully dissent. I conclude that the reasoning of our sister circuits is correct. Therefore, I would affirm the dismissal granted by the District Court.

I also write because I do not agree that an improper intent on behalf of the union or employer in demanding or offering the types of concessions at issue here transforms an otherwise “innocuous” concession into a bribe or constitutes extortion in violation of § 302 of the Labor Management Relations Act (“LMRA”). Mulhall has not alleged that Mardi Gras offered these concessions as a bribe. Thus, I put this issue aside and focus on whether a union that demands these types of concessions with an improper intent commits extortion and thereby runs afoul of § 302.

Adding the element of intent is a non-starter because to do so conflicts with the purpose of the LMRA regardless of whether the focus is the concessions or the intent behind them. Unions demand these types of concessions, and may threaten to cause disruptions if the concessions are not given. The purpose is to make it easier to achieve collective bargaining rights on behalf of the target employees. The LMRA is designed to promote both labor peace and collective bargaining. The LMRA cannot promote collective bargaining and, at the same time, penalize unions that are attempting to achieve greater collective bargaining rights.

Even if the union has some other aim besides achieving collective bargaining rights (such as obtaining more members and dues without ever promoting the interest of the employees), such conduct implicates the union's duty to its members, not the collective bargaining process between the employer and the union. In such a situation, employees can decline to join the union and union members can leave the union or seek their own judicial remedies. We should not, however, turn § 302 upside down to protect against possible disadvantages resulting from some union actions.

Moreover, under the majority's holding, § 302 is not implicated unless the concessions at issue are “used as valuable consideration in a scheme to corrupt a union or to extort a benefit from an employer.” Thus, at the pleading stage, the complaint must contain sufficient factual allegations showing the union demanded these concessions as extortion or were offered by the employer as a bribe, and not just as regular ground rules of organizing.

Here, Mulhall's complaint makes no allegations of wrongdoing relating to the formation of the Agreement or Unite's motives at the time of contracting. Mulhall merely alleges that unions, in general, have or may have improper motives when negotiating for these concessions. Such general allegations are insufficient under our pleading standards. Thus, even under the majority's theory, Mulhall's complaint fails to state a cause of action and should be dismissed.

"U.S. Supreme Court Will Review Neutrality Agreements and Promises Between Employers and Unions"

Labor Relations Counsel
Tracy Scott Pyles
July 9, 2013

The U.S. Supreme Court announced that it will review the U.S Court of Appeals for the Eleventh Circuit's decision in *Mulhall v. UNITE HERE Local 355*, a significant decision in which the court revived an employee's claim that a neutrality agreement between his employer and Local 355 was unlawful.

In *Mulhall*, Mardi Gras Gaming and Local 355 had entered a Memorandum of Agreement (MOA) in which the company agreed to provide Local 355 with employee information, allow the union access to company property for organizing purposes, remain neutral during the union's organizing effort and conduct a card-check in lieu of a secret-ballot election. In the MOA, the union also promised that it would refrain from striking, picketing, boycotting or undertaking other economic pressure against the company, and would give approximately $100,000 in support of a slot machine ballot initiative benefitting the company. Assisted by the National Right to Work Foundation, an employee filed a lawsuit seeking to enjoin the MOA.

Mulhall concerns Section 302 of the Labor-Management Relations Act (the anti-bribery provision), which makes it illegal for an employer to deliver to a union, or for a union to receive from an employer, any "thing of value" (there are exceptions not relevant to this dispute). The issue is whether a "thing of value" extends to promises employers make in neutrality agreements. The district court concluded that while the LMRA provides an individual with a private right of action, the employee did not have standing to sue because the types of assistance promised in the MOA were not a "thing of value" under the LMRA.

A divided Eleventh Circuit disagreed, ruling that a "thing of value" could extend to the promises an employer makes in a neutrality agreement. The court explained:

> "a violation of § 302 cannot be ruled out merely because intangible assistance cannot be loaned or delivered. Section 302 also prohibits payment of a thing of value, and intangible services, privileges, or concessions can be paid or operate as payment. Whether something qualifies as a payment depends not on whether it is tangible or has monetary value, but on whether its performance fulfills an obligation. If employers offer organizing assistance with the intention of improperly influencing a union, then the policy concerns in § 302—curbing bribery and extortion—are implicated."

The Eleventh Circuit remanded the case and instructed the district court to consider what motivated the cooperation between the company and Local 355. The Eleventh Circuit further clarified that an agreement setting ground rules is permissible, but

Section 302 may be violated if the company was wrongfully attempting to influence the union in its representation duties.

Local 355 challenged the Eleventh Circuit's decision. The issue for the U.S. Supreme Court is whether a neutrality agreement violates Section 302 – that is, do promises by an employer that it will remain neutral and provide the union with access to employees and facilities during an organizing drive, and, in exchange, promises by the union to not boycott or picket that employer, violate Section 302?

The U.S. Supreme Court has never before agreed to review a decision that so closely implicates neutrality agreements. The Supreme Court's decision to address Mulhall during its October 2013 term puts the use of neutrality agreements in a state of flux. If the Supreme Court endorses neutrality agreements, they will likely become even more commonly used as an organizing strategy. Neutrality agreements are already a powerful tool in corporate campaigns, where companies are pressured to cooperate with a union or face negative publicity and regulatory pressure. On the other hand, the Supreme Court could affirm the Eleventh Circuit's decision and curtail the use of neutrality agreements, thereby weakening unions' corporate campaign arsenals. Employers and labor practitioners will be closely watching for clarification from the Supreme Court about what is a "thing of value" under the LMRA's anti-bribery provision.

“High Court to Review Sweetheart Deals Between Unions, Management”

Washington Examiner
Sean Higgins
July 2, 2013

Unite Here Local 355 approached Mardi Gras Gaming, owner of a Florida dog track and gambling casino, in 2004 with a proposition: It would run ads in favor of a local gambling ballot initiative the company wanted to pass. In exchange, the company would make it as easy as possible for the union to organize its workers.

To further sweeten the deal, Unite Here promised "labor peace" to the company. In other words, it vowed not to strike, protest, picket or otherwise disrupt the company's business. It was a win-win deal for everyone — except the employees.

Last week, the Supreme Court announced that it would take up the case of *Unite Here Local 355 v. Mulhall*. In its own way, this case may be as important as the Voting Right Act or gay-marriage decisions. It could potentially hobble a major union organizing practice: striking deals with management before they try to organize workers.

The case specifically deals with the question of what constitutes a bribe or similar inducement in labor union organizing cases. Can it extend to something non-monetary, like employee contact information? That's what the 11th Circuit Court of Appeals ruled.

Unions were eager to appeal that ruling. "The theory is implausible on its face. No employer would think to bribe a union by making it easier for the union to organize," Unite Here said in a statement last week.

Well, an employer might if the deal was as sweet as the one Unite Here struck with Mardi Gras Gaming. And that's why the case is important.

The classic image of workplace organizing from movies like Norma Rae is of an up-from-the-grassroots effort by ordinary people. But a lot of organizing is done in the opposite way: with outside labor organizers striking "top down" deals with the management first, then trying to get the workers on board. Unite Here has used it in dozens of cases involving casinos.

The union's deal with Mardi Gras required the company to turn over employee contact information, allow union officials onto company property and not counter the union's effort to organize its workplace in any way. Employees would only hear what the union told them without anyone from the company to contradict them.

Once the union claimed it had a majority of employees signed up, Mardi Gras would then waive its right to contest the election to the National Labor Relations Board.

This wasn't a bad deal for Mardi Gras. Its workers might get unionized but the union wouldn't be able to strike, giving the company plenty of leverage in contract negotiations.

Martin Mulhall, a 40-year Mardi Gras employee, realized he could wake up one morning to find he suddenly was represented by a union that wouldn't do much for him. With the help of the National Right to Work Legal Defense Foundation, he challenged the deal.

The Appeals Court ruled that the employee contact list Unite Here got constituted a "thing of value" to the union and therefore violated the anti-bribery sections of federal labor law.

This was a novel reading of the law. The dissenting judge wrote: "Even if the union has some other aim besides achieving collective bargaining rights (such as obtaining more members and dues without ever promoting the interest of the employees), such conduct implicates the union's duty to its members, not the collective bargaining process between the employer and the union."

In others words, it may be wrong but it isn't illegal. That is essentially the position of Unite Here too.

"The aspects of the agreement attacked by Mulhall ... have been regular features of labor relations since Taft-Hartley was passed (in 1947)," it said. To change this now would "wreak havoc" with labor law.

The Supreme Court will now determine whose interest the collective bargaining process is meant to promote: the workers' or the union's.

"Supreme Court Scrutiny of 'Neutrality' Pacts Could Be Another Blow to Unions"

In These Times
Bruce Vail
June 27, 2013

The U.S. Supreme Court announced this week that it will accept a case for review next year on the use of labor-management "neutrality" agreements in union organizing campaigns. An anti-union decision from the high court would make labor organizing more difficult and threaten labor organizations at a national level, labor experts say.

At issue are the so-called neutrality agreements between unions and employers in which the employer agrees beforehand not to actively oppose the union organizing process at a specific workplace. Typically, such agreements specify that both sides refrain from inflammatory or divisive tactics, and that the workers be allowed to choose or oppose union representation free from any pressure or intimidation from either side.

Such agreements have been an essential part of some high-profile victories for union organizing campaigns in recent years, says veteran union organizer Stewart Acuff. The International Brotherhood of Teamsters, the United Auto Workers (UAW), UNITE HERE, the Service Employees International Union (SEIU) and the Communications Workers of America (CWA) have all successfully employed neutrality agreements in big victories over the last ten years, the former director of the AFL-CIO organizing department says.

The case that will come before the Supreme Court next year, *Mulhall v UNITE HERE Local 355*, has its origins in a 2004 neutrality agreement between the hospitality workers union and Mardi Gras Gaming, the operator of a dog racing track and gambling casino in Hallandale Beach, Fla., according to court documents available at the on-line news site SCOTUSblog. That agreement specified that the company would not actively oppose UNITE HERE's organizing efforts and that Mardi Gras would provide the union with useful information about its employees, including the home addresses and phone numbers of workers.

One Mardi Gras worker who opposed unionization was Martin Mulhall. He was so strongly opposed that in 2008 he brought a lawsuit against UNITE HERE with the assistance of the anti-union group National Right to Work Legal Defense Foundation. According to a statement this week from Foundation President Mark Mix, the legal argument was that the neutrality agreement caused Mardi Gras to provide "money or other thing of value" to the union in violation of the anti-corruption provisions of Taft-Hartley Act.

After some complicated legal maneuvering, the case reached the U.S. Court of Appeals for the 11th Circuit in Atlanta. In 2012, the circuit court ruled in favor of Mulhall, prompting UNITE HERE to appeal the decision to the Supreme Court. According to a statement this week from UNITE HERE General Counsel Robert G. McCracken:

> UNITE HERE is very pleased the Supreme Court granted its petition to review the 11th Circuit Court of Appeals' decision....The 11th Circuit's decision is out of step with all of the other courts that have considered the theory advanced by the plaintiff in Mulhall...The plaintiff's theory is that organizing agreements such as the one between the plaintiff's employer (Mardi Gras casino in Florida) and UNITE HERE Local 355 violate the ant-bribery part of the Taft-Hartley Act passed in 1947. The theory is implausible on its face. No employer would think to bribe a union by making it easier for the union to organize.

The Right to Work Foundation is also pleased that the case will get Supreme Court review, but for reasons quite different than UNITE HERE. Mix's statement explained that the group believes that "the 11th Circuit's decision was too narrowly tailored" in restricting unions and employers. "We hope the Supreme Court will expand upon the 11th Circuit's landmark ruling and ensure that union organizers can't cut backroom deals with management," he stated. In other words, to sharply limit or prohibit neutrality agreements.

That's a danger that should not be taken lightly, says Acuff. The anti-democratic tendencies of the current members of the Supreme Court were sharply highlighted this week, in its decision to invalidate a section of the Voting Rights Act, he said.

"Since 1935, the National Labor Relations Act has said it shall be the policy of the United States to encourage collective bargaining, and that the right to form unions is essential to collective bargaining," Acuff says. "Neutrality agreements are simply following the letter and the spirit of the law. ... It takes right-wing intellectual gymnastics of Olympian proportions to conclude that is illegal for a company to respect the rights of its workers," by entering in to neutrality agreements.

It is the practical success of neutrality agreements that has attracted the opposition of the Right to Work Foundation, Acuff adds, not any legalistic argument based on Taft-Hartley. The Teamsters, for example, were able to organize some 10,000 truck drivers in 2007 at the United Parcel Service freight division based on a neutrality agreement. Some 8,000 hospital workers became members of the SEIU under a neutrality agreement with Tenet Healthcare Corp. at about the same time [PDF]. And UNITE HERE has successfully used such agreements in dozens of hotel and casino organizing campaigns over the last decade, most recently at a Caesar's casino under construction in Baltimore. There are many other examples, Acuff concludes, and any new Supreme Court restrictions on such agreements would certainly hinder organized labor's attempt to rebuild membership.

"**Supreme Court to Decide Legality of Neutrality Agreements, Dynamics of Union Organizing Hang in the Balance**"

Labor Relations Today
Brennan W. Bolt
June 27, 2013

The Supreme Court agreed earlier this week to consider whether the Labor-Management Relations Act's prohibition on employers from providing a union with any "thing of value" extends to the promises an employer makes in a neutrality agreement. Section 302 of the Labor-Management Relations Act, the federal labor anti-bribery statute, makes it unlawful for an employer "to pay, lend, or deliver...any money or other thing of value" to a labor union that seeks to represent its employees, and prohibits the labor union from receiving the same. Neutrality agreements set ground rules for union organizing campaigns and typically include employer promises to remain neutral and recognize the union upon a showing of majority support (often with a card check) as well as to provide the union access to information and employees, and union promises to forego the rights to picket, boycott, or otherwise put pressure on the employer's business. Accordingly, if the Supreme Court holds that such promises are unlawful under § 302, unions' ability to engage in "top-down" organizing through corporate campaigns will suffer a serious blow.

The Third and Fourth Circuits have held that neutrality agreements and the promises typically included therein are not "payment" of "things of value" proscribed by § 302. However, in *Mulhall v. Unite Here Local 355*, 667 F.3d 1211 (11th Cir. 2012), the Eleventh Circuit disagreed and held that "organizing assistance can be a thing of value that, if demanded or given as payment, could constitute a violation of § 302."

In *Mulhall*, the employer and a labor union entered into an agreement where the employer promised to:

(1) provide union representatives access to non-public work premises to organize employees during non-work hours; (2) provide the union a list of employees, their job classifications, departments, and addresses; and (3) remain neutral to the unionization of employees.

In return, the union promised to lend substantial financial support to a ballot initiative favoring the employer and to refrain from picketing, boycotting, striking or undertaking other economic activity against the employer.

The Eleventh Circuit's decision focused on what constitutes a "thing of value," and stated that it "must rely upon our common sense" to answer that question. As such, the Eleventh Circuit held that "intangible services, privileges, or concessions can be paid or operate as payment," and thus implicate the policy concerns in § 302:

It is too broad to hold that all neutrality and cooperation agreements are exempt from the prohibitions in § 302. Employers and unions may set ground rules for an organizing campaign, even if the employer and union benefit from the agreement. But innocuous ground rules can become illegal payments if used as valuable consideration in a scheme to corrupt a union or to extort a benefit from an employer.

How the Supreme Court resolves this circuit split will have serious ramifications for both employers and unions regarding how employees are unionized. If the Supreme Court agrees with the Third and Fourth Circuits, unions could be emboldened and would likely increase their use of corporate campaigns to secure neutrality agreements.

On the other hand, if the Supreme Court finds that the types of employer promises generally seen in neutrality agreements are considered unlawful payments under § 302, then unions' ability to engage in "top down" organizing will be severely limited. While that will not spell the end of corporate campaigns, it will likely undermine their effectiveness and force unions to focus much more on traditional "grass roots" organizing strategies. One such strategy could be to ramp up efforts to exploit the Board's decision in *Specialty Healthcare*, in which the Board signaled that it now believes that smaller units--such as units that consist of only one department or even one job classification--should be permitted. Under that scenario, unions would likely target an employer by first organizing a very small group of employees (i.e., a 'micro union') to gain access and market themselves to other groups of employees at that employer.

The case before the Supreme Court is *Unite Here Local 355 v. Mulhall*, Case No. 12-99.

DaimlerChrysler AG v. Bauman

11-965

Ruling Below: *Bauman v. DaimlerChrysler Corp.*, 644 F.3d 909 (9th Cir. 2011), *cert granted*, 133 S.Ct. 1995 (2013).

Argentinian residents brought suit against German corporation under the Alien Tort Statute (ATS), and the Torture Victims Protection Act (TVPA), alleging that its wholly-owned Argentinian subsidiary collaborated with state security forces to kidnap, detain, torture, and kill the plaintiffs and/or their relatives during Argentina's "Dirty War." The United States District Court for the Northern District of California dismissed the case for lack of personal jurisdiction, and plaintiffs appealed. The Court of Appeals for the Ninth Circuit held that (1) wholly-owned United States subsidiary, which served as the general distributor of German manufacturer's automobiles in the United States, was manufacturer's agent for general jurisdictional purposes; and (2) exercising personal jurisdiction over German automobile manufacturer comported with fair play and substantial justice.

Question Presented: Whether it violates due process for a court to exercise general personal jurisdiction over a foreign corporation based solely on the fact that an indirect corporate subsidiary performs services on behalf of the defendant in the forum state.

Barbara BAUMAN; Gregory Grieco; Josefina Nunez; Gabriele Nunez; Miriam Nunez; Silvia Nunez; Emilio Guillermo Pesce; Mirta Haydee Arenas; Graciela Gigena; Guillermo Alberto Gigena; Nuria Gigena; Amelia Schiaffo; Elba Leichner; Anunciacion Spaltro De Belmonte; Hector Ratto; Eduardo Olasiregui; Ricardo Martin Hoffman; Eduardo Estiville; Alfredo Manuel Martin; Juan Jose Martin; Jose Barreiro; Alejandro Daer, Plaintiffs–Appellants,

v.

DAIMLERCHRYSLER CORPORATION; DaimlerChrysler AG, Defendants–Appellees.

United States Court of Appeals, Ninth Circuit

Decided on May 18, 2011

[Excerpt; some footnotes and citations omitted.]

REINHARDT, Circuit Judge

I.

Plaintiffs–Appellants (the "plaintiffs"), twenty-two Argentinian residents, bring suit against DaimlerChrysler Aktiengesellschaft (DCAG) alleging that one of DCAG's subsidiaries, Mercedes–Benz Argentina (MBA) collaborated with state security forces to kidnap, detain, torture, and kill the plaintiffs and/or their relatives during

Argentina's "Dirty War." Some of the plaintiffs are themselves former employees of MBA and the victims of the kidnapping, detention, and torture, while others are close relatives of MBA workers who were "disappeared" and are presumed to have been murdered. The only question before us is whether the district court had personal jurisdiction over DCAG. The district court granted DCAG's motion to dismiss the case for lack of such jurisdiction. We conclude, however, that DCAG was subject to personal jurisdiction in California through the contacts of its subsidiary Mercedes–Benz USA (MBUSA). We hold that MBUSA was DCAG's agent, at least for personal jurisdictional purposes, and that exercise of personal jurisdiction was reasonable under the circumstances of this case.

II.

A.

The plaintiffs here were workers or relatives of workers at the Gonzalez–Catan plant of Mercedes–Benz Argentina (MBA), a wholly owned-subsidiary of DaimlerChrysler AG's predecessor-in-interest. The plaintiffs allege that MBA sought to brutally punish plant workers whom MBA viewed as union agitators, and that MBA collaborated with the Argentinian military and police forces in doing so. They also allege that MBA had knowledge that the result of this collaboration would be the kidnapping, torture, detention and murder of those workers, and that the plan was implemented, in part, in the following manner. First, MBA labeled the appellants as "subversives" and "agitators" and passed on this information to the state security forces. Second, MBA "had members of the military and police forces stationed within" the Gonzalez–Catan plant. Third, MBA opened the plant to periodic raids by those forces. Fourth, MBA hired Ruben Lavallen, the police station chief who had been behind much of the reign of terror and installed him as Chief of Security, providing legal representation to him when he was "accused of human rights abuses." The plaintiffs further allege that MBA was pleased with the results of the raids and detentions because those actions helped to end a strike, restoring maximum production at the plant.

B.

Plaintiffs brought suit against DCAG in the District Court for the Northern District of California under the Alien Tort Statute ("ATS"), and the Torture Victims Protection Act of 1991 ("TVPA"). After attempting to serve process at one of DCAG's headquarters in Stuttgart, Germany, they learned that DCAG purported to maintain an operational headquarters in Auburn Hills, Michigan. They then attempted to serve DCAG in Michigan. *Bauman v. DaimlerChrysler AG (Bauman I)*. DCAG moved to quash service and to dismiss the case for lack of personal jurisdiction. In support of its opposition to these motions, the plaintiffs submitted DCAG's proxy statement which stated that, following the merger of Daimler–Benz and Chrysler, DCAG would "maintain two operational headquarters—one located at the current Chrysler headquarters, 1000 Chrysler Drive, Auburn Hills, Michigan 48326–2766, and one located at the current Daimler–Benz headquarters, Epplestrasse 225, 70567 Stuttgart, Germany." The language referring to dual operational headquarters was repeated four times in the proxy statement. The plaintiffs also submitted a document from DCAG's website, entitled "Investor Questions and Answers." This document also discussed the "dual operational headquarters" and went on to note that the Co–Chairmen and Co–Chief Executive Officers of DCAG, Jurgen E. Schrempp (former Chairman of Daimler–Benz AG) and Robert J. Eaton (former Chairman and CEO of Chrysler Corporation) both had "offices and staff in both locations." After this evidence was submitted, DCAG withdrew its motion to quash service.

C.

As discussed in more detail below, the District Court for the Northern District of California did not hold an evidentiary hearing when it ruled on DCAG's motion to dismiss for lack of personal jurisdiction; therefore, the plaintiffs "need *only* demonstrate facts that *if true* would support jurisdiction over the defendant."

DCAG was a German stock company, but according to DCAG, sales of its vehicles in the United States "accounted for 1% of the nation's Gross Domestic Product (GDP)." In the annual report DCAG filed with the SEC in 2006, DCAG further admits that "*a significant* portion of our business, primarily in the case of the Mercedes Car Group, depends in part on export sales to the United States." Mercedes–Benz USA, LLC ("MBUSA") was a Delaware limited liability company with its principal place of business in New Jersey. MBUSA was a wholly-owned subsidiary of the holding company DaimlerChrysler North America Holding Corporation, which was, in turn, a wholly-owned subsidiary of DCAG. MBUSA was the single largest supplier of luxury vehicles to the California market; according to DCAG's figures, MBUSA's sales in California alone accounted for 2.4% of DCAG's total worldwide sales.

MBUSA had a regional office in Costa Mesa, California, a Vehicle Preparation Center in Carson, California, and a Classic Center in Irving, California. Because of MBUSA's extensive contacts with California, DCAG does not dispute that MBUSA is subject to general jurisdiction in California.

DCAG manufactured Mercedes–Benz motor vehicles and parts primarily at factories in Germany. MBUSA purchased Mercedes–Benz vehicles from DCAG in Germany for distribution in the United States….

The final subsidiary that is relevant to this case is the DaimlerChrysler Corporation (DCC). As the district court noted, when the Chrysler Corporation and Daimler–Benz AG merged, they both became wholly-owned subsidiaries of DCAG. At that point, Chrysler Corporation changed its name to DaimlerChrysler Corporation.

D.

The relationship between DCAG and MBUSA is governed by a General Distributor Agreement ("the Agreement") which establishes extensive requirements for MBUSA as the general distributor of Mercedes–Benz cars in the U.S. Because the Agreement is the critical legal document that defines DCAG's relationship with MBUSA, we will discuss its provisions at some length.

Sales Figures

According to the Agreement, DCAG and MBUSA agree every year upon a set of quantitative and qualitative objectives, that can include a "minimum or specific number of Vehicles to be sold by [MBUSA] and its Authorized Resellers to end users ... [and] a minimum or a specific market share in defined vehicle segments" in the United States.

Sales Network

DCAG has extensive oversight over MBUSA's network of Authorized Resellers. MBUSA must "consult" with DCAG before establishing its sales and service network of Authorized Resellers, and before making *any* adjustments to that sales and service network. MBUSA must make "*any* changes or adjustments" to that network requested by DCAG. MBUSA must receive approval from DCAG before entering into an agreement with any Authorized Reseller….

Standards

MBUSA must also comply with all Dealership Standards promulgated by DCAG. MBUSA cannot appoint an Authorized Reseller who does not agree to comply with the Dealership Standards….

Business Systems

DCAG must approve of the accounting, order, inventory control and warranty claim processing systems used by MBUSA and its Authorized Resellers. DCAG must also approve of the "electronic data storage, transmission and communication system" used by MBUSA and its Authorized Resellers. MBUSA must further observe all of DCAG's "rules, terms and conditions" relating to the use of these business systems.

Customer Information

DCAG dictates what customer information is to be collected by MBUSA….

Management Personnel

According to the Agreement, MBUSA must employ a "General Manager, a Parts Manager, a Service Manager, and a Sales Manager." MBUSA cannot combine these positions without the "prior consent" of DCAG. These employees "shall not, without the prior consent of [DCAG], engage or participate in *operating,* selling or servicing, as the case may be, of any brand of vehicles other than" Mercedes–Benz vehicles. …It is significant also that the Chairman of DCAG, Dieter Zetsche, was simultaneously the Chairman of MBUSA. Zetsche was also the head of the Mercedes Car Group at DCAG….

Service

DCAG sets the standards and requirements for the vehicle servicing conducted by MBUSA and its Authorized Resellers. The servicing must comply with DCAG's

Dealership Standards as well as DCAG's "requirements and other manuals, guidelines, or materials."…

Warranty

DCAG sets the warranty terms applicable to MBUSA. MBUSA may not provide additional warranties without the prior consent of DCAG….

Vehicle Alteration

MBUSA cannot "alter or modify" any Vehicle without DCAG's "prior approval and then only in the manner [DCAG] authorizes," unless the vehicle has been ordered and the modification specifically requested by an end user.

Technical Publications

MBUSA and its Authorized Resellers must each maintain an "organized library of [DCAG's] technical service publications."

Promotion and Advertising

The Agreement requires MBUSA to "actively market" the Mercedes–Benz vehicles. The Agreement gives DCAG the discretionary power to conduct a yearly review of MBUSA's "comprehensive advertising and marketing plan." If DCAG exercises this right of review, MBUSA cannot pursue the advertising and marketing strategy without the approval of DCAG. …

Signage

MBUSA and its Authorized Resellers must display "appropriate signs and fascia" to identify each facility. DCAG "reserves the right to approve or disapprove of each sign's type, design and size."…

Prices

Although the sales *volume* is set yearly by agreement between DCAG and MBUSA, DCAG has the authority to unilaterally set and change *prices.* DCAG simply must "notify" MBUSA "from time to time of the prices and charges for Contract Goods." Even though the Agreement locks MBUSA into a precise sales amount on an annual basis, DCAG may change the prices "at any time, and make the changes effective immediately."…

MBUSA's Authority and Ownership

MBUSA must request the approval of DCAG before it changes its management control or ownership interests, the name or form of its legal entity, or the location of its principal place of business.

Working Capital

MBUSA and its Authorized Resellers must maintain a "working capital level and financing capability" level that is "acceptable" to DCAG. In fact, "[a]t no time may [MBUSA's] working capital dedicated to its operations related to the Contract Goods be less than the amount specified by [DCAG] from time to time."…

Sales Numbers

DCAG requires MBUSA to "make all reasonable efforts" to limit the amount of Mercedes–Benz vehicles sold by any Authorized Reseller or group of Resellers to

15% of the total sales of Mercedes–Benz vehicles in the United States….

Related Agreements

DCAG can require MBUSA and its Authorized Resellers to execute "*any agreement* relating to ... any other matter related to this Agreement in the form from time to time adopted by [DCAG]" as long as those Agreements are not an "unreasonable burden" on MBUSA.

E.

On November 22, 2005, the district court issued an order "tentatively granting defendant's motion to dismiss" for lack of personal jurisdiction. The district court applied the two part test for general jurisdiction developed in *Helicopteros Nacionales de Colombia, S.A. v. Hall*: 1) whether defendant had "systematic and continuous" contacts with California, and 2) whether the assertion of general jurisdiction was reasonable. The district court found that it did not have general jurisdiction over DCAG because DCAG did not have "systematic and continuous contacts" with California, the court found that DCAG itself did not have such contacts and, moreover, that the plaintiffs had failed to show that MBUSA was DCAG's agent such that MBUSA's contacts could be imputed to DCAG.

The district court acknowledged that "without MBUSA or another distributor, DCAG would not be able to sell Mercedes–Benz vehicles in California." In deciding that there was no agency relationship, however, the district court relied heavily on its conclusion that "it is not clear that [DCAG] would be required to perform such functions itself to avail itself of the California, luxury-vehicle market." The district court admitted that the agency question was a "close question," but found that MBUSA's contacts should not be imputed to the defendant.

In its tentative order, the district court also found that personal jurisdiction over DCAG would not be reasonable, although it made a number of factual findings that caused it to question the correctness of that finding. It found that DCAG had purposefully interjected itself into California by "initiating lawsuits in California courts to challenge the state's clean air laws and to protect DCAG's patents and other business interests." Moreover, it found that the sale of DCAG's vehicles in California "is not an isolated occurrence but arises from the efforts of DCAG to serve the California market." The district court recognized that DCAG would be slightly burdened if it was forced to litigate the case in the United States; but, it found that the burden would be "minimal"…The district court concluded "that California has at least an abstract interest in adjudicating plaintiffs' dispute," but found that California had "little direct interest" in adjudicating the case…. The district court tentatively held that exercise of personal jurisdiction would be unreasonable, however, primarily because it found that Argentina was available as an alternative forum. Because the question was a close one, the district court did not issue a final decision; instead, it allowed for limited jurisdictional discovery regarding the agency relationship between DCAG and

MBUSA and the availability of Argentina and Germany as alternative fora.

On February 12, 2007, following the limited jurisdictional discovery, the district court issued its final order granting DCAG's motion to dismiss….

The appellants timely appealed, asserting that the district court erred in finding that it lacked jurisdiction over DCAG.

III.

DCAG argued in the district court that the court did not have personal jurisdiction over DCAG or subject matter jurisdiction over plaintiffs' claims. The district court chose to resolve the personal jurisdiction question first. The district court's discretionary decision to do so was proper. Therefore, the only question before us is whether the district court had personal jurisdiction over DCAG.

We review a dismissal for lack of personal jurisdiction *de novo.* In doing so, we apply the following rule: "[w]hen a district court acts on a ... motion to dismiss [for lack of personal jurisdiction] without holding an evidentiary hearing, the plaintiff need make only a *prima facie* showing of jurisdictional facts to withstand the motion." In other words, when as here, the district court did not hold an evidentiary hearing, the plaintiffs "need *only* demonstrate facts that *if true* would support jurisdiction over the defendant."

IV.

In evaluating the appropriateness of personal jurisdiction over a nonresident defendant, we ordinarily examine whether such jurisdiction satisfies the "requirements of the applicable state long-arm statute" and "comport[s] with federal due process." Because California "permits the exercise of personal jurisdiction to the full extent permitted by due process," we need only determine whether jurisdiction over DCAG comports with due process….

We [] turn to an examination of whether general jurisdiction over DCAG in California comports with due process; in doing so, we conduct a two-part inquiry. First, we examine whether "the defendant ha[d] the requisite contacts with the forum state to render it subject to the forum's jurisdiction." Second, if it did, we then turn to an examination of whether the assertion of jurisdiction is fair and reasonable.

A. Requisite Contacts

In determining the requisite contacts of a defendant, we look to whether its activities in the forum are " 'substantial' or 'continuous and systematic,' even if the cause of action is unrelated to those activities." … Here, there is no doubt that MBUSA has the requisite contacts. The question is whether MBUSA's extensive contacts with California warrant the exercise of general jurisdiction over DCAG.

Under the controlling law, if one of two *separate* tests is satisfied, we may find the necessary contacts to support the exercise of personal jurisdiction over a foreign parent company by virtue of its relationship to a subsidiary that has continual operations in the forum. The first test, not directly at issue here, is the "alter ego" test. It is predicated upon a showing of parental *control* over the subsidiary….

The second test, which *is* applicable here, is the "agency" test. That test is predicated upon a showing of the *special importance* of the services performed by the subsidiary:

The agency test is satisfied by a showing that the subsidiary functions as the parent corporation's representative in that it performs services that are sufficiently important to the foreign corporation that if it did not have *a representative* to perform them, the corporation's own officials would undertake to perform substantially similar services.

For the agency test, we ask: Are the services provided by MBUSA sufficiently important to DCAG that, if MBUSA went out of business, DCAG would continue selling cars in this vast market either by selling them itself, or alternatively by selling them through a new representative? We answer this question in the affirmative. In addition, this test requires the plaintiffs to show an element of control, albeit not as much control as is required to satisfy the "alter ego" test. We conclude that DCAG has more than enough control to meet the agency test, because DCAG has the right to control nearly every aspect of MBUSA's operations.

Application of the Agency Test
1. Sufficient Importance

… The purpose of examining sufficient importance is to determine whether the actions of the subsidiary can be understood as a manifestation of the parent's presence….

Our starting point for the sufficient importance prong is that a subsidiary acts as an agent if the parent would undertake to perform the services itself *if it had no representative at all* to perform them. As the Second Circuit explained, a court "may assert jurisdiction over a foreign corporation" when it affiliates itself with a local entity whose services "are sufficiently important to the foreign entity that the corporation itself would perform equivalent services *if no agent* were available."

Selling Mercedes–Benz vehicles is a critical aspect of DCAG's business operations; DCAG's charter defines its goals as the "development, manufacture, and *sales* of products." When this suit was filed, the United States market accounted for 19% of the sales of Mercedes–Benz vehicles worldwide, and MBUSA's sales in California alone accounted for 2.4% of DCAG's total worldwide sales. DCAG simply could not afford to be without a U.S. distribution system.

The services that MBUSA currently performs are sufficiently important to DCAG that they would almost certainly be performed by other means if MBUSA did not exist, whether by DCAG performing those services itself or by DCAG entering into an agreement with a new subsidiary or a non-subsidiary national distributor for the performance of those services…. contractors may be considered representatives, and contracting with an independent contractor to achieve the same end—distributing cars in the United States—means, in practice, obtaining a "representative" to "undertake ... substantially similar services."

Therefore, the plaintiffs have established the importance to DCAG of the services performed by MBUSA and met the sufficiently important test, because even if DCAG were to replace MBUSA with an independent entity, that entity would still be considered a representative for purposes of that test.

2. Control

We turn now to an examination of the element of control. As we have stated, the principal focus of our agency test for purposes of personal jurisdiction is the importance of the services provided to the parent corporation. In *Unocal,* we conducted a thorough analysis of a potential agency relationship and based our decision solely on the failure to meet the sufficient importance test. We then added that control alone was insufficient to overcome that failure.

Control nevertheless plays a role in determining whether personal jurisdiction is established because control is a traditional element of agency under common law principles. DCAG contends that a right to control is not sufficient, and that the parent must actually exercise control over the operations of its subsidiary on a day-to-day basis in order to meet the agency test. This argument is in error because it conflates the agency and alter ego tests. We have previously explained that these two tests are distinct and involve considerations of distinct factors. As explained in the Restatement (Third) of Agency:

> A principal's right to control the agent is a constant across relationships of agency, but the content or specific meaning of the right varies. Thus, a person may be an agent although the principal lacks the right to control the full range of the agent's activities, how the agent uses time, or the agent's exercise of professional judgment. *A principal's failure to exercise the right of control does not eliminate it,* nor is it eliminated by physical distance between the agent and principal....

As we recently held, "[t]o form an agency relationship, both the principal and the agent must manifest assent to the principal's *right to control* the agent." We went on to make clear that actual control was not necessary by noting that a principal must either "actually control[ ]" the agent, *or* the principal and the agent must agree that the principal has the *right* to do so. We can think of no clearer manifestation of assent to the principal's right to control than the comprehensive written agreement between DCAG and MBUSA….

We must remember that we are considering the contours of the test for agency to be applied in the context of personal jurisdiction. We are not examining the rules governing the test for vicarious liability, or for holding DCAG financially liable for the actions of MBUSA. Moreover, when we consider control here, it is as part of a test that primarily considers whether the services are of "sufficient importance." …

3. DCAG's Right to Control

The degree of control that DCAG exercises over MBUSA is more than sufficient for the purpose of establishing personal jurisdiction. To repeat, we must take plaintiffs' alleged facts as true, because plaintiffs need make only a prima facie showing of personal jurisdiction here.

DCAG contends that the General Distributor's Agreement is evidence of an “arms-length” relationship with MBUSA. We do not read the agreement as DCAG appears to. DCAG has the right to control nearly all aspects of MBUSA's operations… MBUSA must comply with all of DCAG's current requirements and all future requirements that may be set forth in any future document promulgated by DCAG….

Because MBUSA's services were sufficiently important to DCAG and because DCAG had the right to substantially control MBUSA's activities, we conclude that MBUSA was DCAG's agent for general jurisdictional purposes.

B. Reasonableness

Because we hold that there is ample evidence of an agency relationship between DCAG and MBUSA, and, thus, that MBUSA's contacts with California may be imputed to DCAG, we now must turn to the second part of our test: whether the assertion of jurisdiction is “reasonable.”

Once plaintiffs have made the requisite showing of minimum contacts in the forum state, “[t]he burden ... shifts to the defendant to present a *compelling* case that jurisdiction would be unreasonable.” We weigh seven factors in resolving this question:

> the extent of purposeful interjection; the burden on the defendant; the extent of conflict with sovereignty of the defendant's state; the forum state's interest in adjudicating the suit; the most efficient judicial resolution of the dispute; the convenience and effectiveness of relief for the plaintiff; and the existence of an alternative forum.

No one factor is dispositive; nor is the answer dictated by whether the majority of factors favors one side or the other. Rather we take into consideration all seven factors and then conduct an overall evaluation of the question.

1. The Extent of Purposeful Interjection

DCAG has purposefully and extensively interjected itself into the California market through MBUSA. The district court found that DCAG had purposely availed itself of the California market, primarily through its design of cars to meet California's air quality standards, its manufacture of a fuel cell for the California Fuel Cell Partnership, and the fact that DCAG built a prototype fuel cell vehicle specifically for the United Parcel Service (“UPS”) to use in California. The district court also found that DCAG had purposefully interjected itself into California by “initiating lawsuits in California courts to challenge the state's clean air laws and to protect DCAG's patents and other business interests.” … In addition, we note that DCAG established DaimlerChrysler Research and Technology North America and headquartered the company in “the heart of Silicon Valley.”…

The district court also found it relevant that DCAG has retained permanent counsel in

California and is listed on the Pacific Stock Exchange located in San Francisco. … Finally, according to DCAG's own figures, MBUSA's sales in California alone account for 2.4% of DCAG's total worldwide sales.

The first factor, therefore, weighs heavily in favor of "reasonableness," as a corporation that "has continuously and deliberately exploited the [California] market ... must reasonably anticipate being haled into court there...."

2. The Burden on the Defendant

The burden on the defendant, a large international corporation, to litigate the case in California is not so weighty as to preclude jurisdiction—particularly since "modern advances in communications and transportation have significantly reduced the burden of litigating in another country." …

Here, the burden on the defendant of producing records and witnesses in California, when the events in question took place in Argentina, would be no greater than if the case were instead litigated in Germany. Moreover, DCAG's official language is English, so it will not be disadvantaged in that respect by litigating in the forum selected by the plaintiffs.

This factor weighs slightly in DCAG's favor, because there is *some* burden in having to litigate in a foreign country. It is not, however, a particularly significant factor, in part because the burden for an international corporation is ordinarily slight, and in part because "the Supreme Court has preferred non-jurisdictional methods of lessening the inconvenience faced by defendants."

3. The Extent of Conflict with Sovereignty of the Defendant's State

Third, we have held that the extent of the conflict with the sovereignty of the defendant's state "is not dispositive because, if given controlling weight, it would always prevent suit against a foreign national in a United States court." Although it is true that "[g]reat care and reserve should be exercised when extending our notions of personal jurisdiction into the international field," that same consideration will always be present in claims under the ATS and the TVPA.

Although German courts have expressed some concern that this suit may impinge upon German sovereignty, we do not agree. In applying this factor, we examine "the presence or absence of connections to the United States in general, not just to the forum state." …

DCAG has "manifested an intent to serve and to benefit from the United States market." It has chosen to place itself at risk of litigation by engaging in extensive business in the United States through the operations of its agent MBUSA and its asset DCC. We do not violate Germany's sovereignty by exercising jurisdiction to hear this suit, even though it involves a German citizen corporation. This factor again weighs only slightly in DCAG's favor.

4. The Forum State's Interest in Adjudicating the Suit

Fourth, although the events at issue did not take place in California and although the plaintiffs are not California residents, the forum state does have a significant interest in adjudicating the suit. California partakes in "the shared interest of the several States in furthering fundamental substantive social policies." Here, as the claims are predicated upon the ATS and TVPA, that policy is providing a forum to redress violations of international law by defendants who have enough connections with the United States to be brought to trial on our shores, even though the injury is to aliens and occurs outside our borders—"a small but important step in the fulfillment of the ageless dream to free all people from brutal violence." American federal courts, be they in California or any other state, have a strong interest in adjudicating and redressing international human rights abuses. As the Second Circuit held shortly after the turn of the century:

> The new formulations of the Torture Victim Protection Act convey the message that torture committed under color of law of a foreign nation in violation of international law is our business, as such conduct not only violates the standards of international law but also as a consequence violates our domestic law. In the legislative history of the TVPA, Congress noted that universal condemnation of human rights abuses provide[s] scant comfort to the numerous victims of gross violations if they are without a forum to remedy the wrong. This passage supports plaintiffs' contention that in passing the Torture Victim Prevention Act, Congress has expressed a policy of U.S. law favoring the adjudication of such suits in U.S. courts.

We agree and have previously cited *Wiwa* with approval for this exact point. The policy of the TVPA is that these "suits should not be facilely dismissed on the assumption that the ostensibly foreign controversy is not our business." In light of the important interest we have recognized, this factor weighs in favor of the reasonableness of exercising personal jurisdiction.

5. The Most Efficient Judicial Resolution of the Dispute

The fifth factor, which examines which forum is most efficient, "involves a comparison of alternative forums." Because we have primarily looked to where the witnesses and evidence are located in order to determine the most efficient forum, there is no difference between the United States and Germany insofar as this factor is concerned. Here, the witnesses and evidence are located primarily in Argentina. Therefore, if that forum were an available alternative forum as discussed below, it would likely be the most efficient. … In the end, the factor is a draw; there is no difference insofar as the efficiency factor is concerned between the United States and Germany, and Argentina is not a truly available forum as discussed below.

6 & 7. The Convenience and Effectiveness of Relief for the Plaintiff; and the Existence of an Alternative Forum

We have traditionally evaluated the sixth and seventh factors together. The plaintiffs contend that Germany does not recognize human rights suits against corporate defendants and will not allow equitable tolling. Argentinian courts, the plaintiffs assert, provide no means of redress against corporations that collaborated with Argentine security forces in carrying out the Dirty War, and would bar this suit on account of the statute of limitations. Most important for our purposes is whether Argentina would be an adequate forum, as that country, where the events at issue in this lawsuit took place, would be the most natural location in which to litigate the case, were all other factors equal. The plaintiff "bears the burden of proving the unavailability of an alternative forum," although as mentioned earlier, the overall burden with respect to reasonableness lies with the defendants.

The plaintiffs' arguments that Argentina would not be a fully adequate forum—if it is a forum at all—are persuasive, at this stage of the litigation. A recent Supreme Court case in Argentina has held that human rights civil cases arising out of the Dirty War are subject to a two-year and three-month statute of limitations. This suit would, for that reason, be barred—which makes Argentina unavailable as an alternative forum.

As to Germany, there is conflicting expert testimony about whether equitable tolling, or an equivalent within the German legal system, would allow the suit to proceed. The answer is not clear; indeed, the district court concluded that "it appears that plaintiffs' claims, which are based on events that occurred in 1976 and 1977, would not *necessarily* be time-barred." DCAG argues that Germany *does* allow human rights suits against corporate defendants, and that plaintiffs are incorrect when they assert a contrary position. Plaintiffs argue, however, that when DCAG was arguing before the German courts about the need to stay the plaintiffs' service of process, DCAG argued that plaintiffs could *not* allege a cause of action in the German courts.

Furthermore, in *Harris Rutsky,* we considered the defendant's amenability to service of process in the alleged alternative forum in deciding whether that forum was truly an alternative. Given the concerns discussed above, and the issues that have already arisen with respect to plaintiffs' efforts to serve DCAG in Germany, we cannot say that Germany is an adequate forum such that personal jurisdiction elsewhere should be defeated…. For the reasons stated above, factors six and seven weigh in favor of the plaintiffs with respect to Argentina, but the answer is unclear as to Germany or possibly, because of the burden of proof applicable to the evaluation of this factor, the balance should be struck in favor of Germany.

Even if Argentina and Germany were, as DCAG argues, both adequate fora for redressing any alleged wrongs, the availability of an alternative forum is not the deciding factor in the personal jurisdiction analysis….

Overall Evaluation of the Factors

The question before us is ultimately whether exercising personal jurisdiction over DCAG comports with fair play and substantial justice. We find that it does. As the Second Circuit held in evaluating the exercise of personal jurisdiction over the Royal Dutch/Shell Group:

While it is true that certain factors normally used to assess the reasonableness of subjection to jurisdiction do favor the defendants (they are foreign corporations that face something of a burden if they litigate here, and the events in question did not occur in New York), litigation in New York City would not represent any great inconvenience to the defendants. The defendants control a vast, wealthy, and far-flung business empire which operates in most parts of the globe. They have a physical presence in the forum state [through their agent], have access to enormous resources, face little or no language barrier, have litigated in this country on previous occasions, have a four-decade long relationship with one of the nation's leading law firms, and are the parent companies of one of America's largest corporations, which has a very significant presence in New York. New York City, furthermore, where the trial would be held, is a major world capital which offers central location, easy access, and extensive facilities of all kinds. We conclude that the inconvenience to the defendants involved in litigating in New York City would not be great and that nothing in the Due Process Clause precludes New York from exercising jurisdiction over the defendants.

Many or all of those considerations apply with equal force in this case. For much the same reasons, we conclude that it is reasonable to exercise jurisdiction over DCAG in California, a state that has itself become a major hub for world commerce and attracts business not only from all over Europe, but from all over Asia as well.

In *Harris Rutsky*, we found that jurisdiction was reasonable even though there was an "obvious alternative forum" and the balance of the seven factors was essentially a wash, "since some of the reasonableness factors weigh in favor of [the defendant], but others weigh against it." Here, the defendants present a far less compelling case than did the defendants in *Harris Rutsky*. Most important, DCAG's contacts with California and with the U.S. are *far* more extensive than the defendant's contacts in *Harris Rutsky*....

In light of DCAG's pervasive contacts with the forum state through MBUSA, including the extensive business operations of that subsidiary, the interest of California in adjudicating important questions of human rights, our substantial doubt as to the adequacy of Argentina as an alternative forum, and the various issues discussed above with respect to Germany, we hold that DCAG "has not met its burden of presenting *a compelling case* that the exercise of jurisdiction would not comport with fair play and substantial justice."

V. Conclusion

At the time this suit was filed, MBUSA's business was sufficiently important to DCAG that without MBUSA or another representative, DCAG would have performed those services itself. Moreover, DCAG had the right to control to one extent or another nearly every aspect of MBUSA's business. Therefore, we conclude that, at least for the limited purpose of determining general jurisdiction, MBUSA was DCAG's agent.

The Supreme Court “long ago rejected the notion that personal jurisdiction might turn on ‘mechanical’ tests” that fail to take account of reality. The reality is that in an increasingly complex and globalized economy, international corporations such as DCAG reap enormous profits from the sale of their goods in the United States. The sales are achieved through the use of major distributors, frequently in the form of subsidiaries. Many international companies organize their corporate structure and establish subsidiaries for the sole purpose of obtaining the maximum benefit from the American market. To the ordinary American, and certainly to us, it would seem odd, indeed, if the manufacturer of Mercedes–Benz vehicles, which are sold in California in vast numbers by its American subsidiary, for use on the state's streets and highways, could not be required to appear in the federal courts of that state. Mercedes–Benz cars are ubiquitous in California, and Mercedes–Benz dealerships, required to display the signage mandated by DCAG, have a highly visible presence.

The numbers bear out our perception. At the time that this suit was filed, MBUSA's sales in California alone accounted for 2.4% of DCAG's total worldwide sales. Moreover, when considering burdens on the defendant and the issue of state sovereignty, we cannot overlook the fact that when this suit was filed, nearly 50% of DCAG's overall revenue came from the United States, and that in order to make this income, DCAG created a wholly-owned subsidiary, MBUSA, to sell Mercedes–Benz vehicles in the United States.

Our test for personal jurisdiction must take these realities into account in determining whether it is reasonable to subject a parent company to the jurisdiction of the courts of this nation on the basis of the acts of its agent. After applying this test, we have no doubt that DCAG is subject to personal jurisdiction in California, and that the exercise of such jurisdiction is not only reasonable, but fair and just. Therefore we reverse and remand for further proceedings consistent with this opinion.

REVERSED and REMANDED.

"Supreme Court to Review Bauman v. DaimlerChrysler"

Opinio Juris
Kenneth Anderson
July 17, 2013

About the same time (April 2013) that the US Supreme Court released its opinion in *Kiobel v. Royal Dutch Petroleum*, the Court also granted review of a Ninth Circuit case, *Bauman v. DaimlerChrysler*. Just ahead of the July 4th weekend, the Obama administration submitted what John Bellinger, in a lucid post over at Lawfare, describes as a "remarkably strong" amicus brief urging the Court to

> reverse the Ninth Circuit's decision in *Bauman v. DaimlerChrysler*. The Justice Department argued that the Ninth Circuit's 2011 decision finding personal jurisdiction in California over Daimler AG, a German company, for the actions of a subsidiary in Argentina, was "seriously flawed" and contrary to the Supreme Court's subsequent 2011 decision in Goodyear. The brief faults the Ninth Circuit for trying to hold a foreign corporation with few contacts to California to "answer in that State for any claim against it, arising anytime, anywhere in the world."

The background to *Bauman v. DaimlerChrysler*, Bellinger explains, is that in May 2011 a Ninth Circuit panel

> held that that Daimler AG, a German parent company with no operations or employees in the United States, could be sued under the Alien Tort Statute and the Torture Victim Protection Act (as well as common law and state law) by a group of Argentine nationals for human rights abuses allegedly committed by an Argentine subsidiary in collaborating with the Argentine government during the "Dirty War" in the 1970s, solely on the basis that a different U.S. subsidiary now distributes Mercedes Benz vehicles in the United States. Applying an agency theory, the panel concluded that Daimler AG had sufficient contacts with the state of California by virtue of the actions of its subsidiary Mercedes Benz USA to give California personal jurisdiction over the German parent , even though Mercedes Benz USA had no involvement with the alleged facts in Argentina.

I agree with Bellinger that the likelihood, following *Kiobel*, is that the Court is moving to restrain jurisdictional assertions by Federal courts, and is pushing back toward stricter grounding in the traditional bases of jurisdiction by national courts. My own larger, political view is that this is connected to a perception that although broad assertions of US jurisdiction through such vehicles as the Alien Tort Statute over foreign parties for acts on foreign territory can certainly be framed as enforcing universal international law through national courts, it is better understood as assertions of something quite different – what I've sometimes called the "law of the hegemon." That is an increasingly contested position as a matter of international politics spilling over into international law, and between the rise of new great powers and the Obama administration's political embrace of decline, it seems to me unsurprising that the

Obama administration would embrace a more traditional, much more restrictive understanding of jurisdiction.

But it also seems the Court is also generally on board with this pull-back. As Bellinger says, many observers (me included) believe that

> the Court would not have accepted the case unless it plans to reverse the Ninth Circuit. Conservative justices are loathe to miss an opportunity to try to curb the Ninth Circuit's consistent efforts to be a world court, and the more liberal justices may have wanted to demonstrate (as Justice Breyer argued in his concurrence in *Kiobel*) that the extraterritorial reach of the Alien Tort Statute can be limited by other jurisdictional restrictions.

I agree. Despite the obvious clash of approaches between the Roberts majority and the Breyer minority in *Kiobel*, they do have an important common ground – an intention to limit extraterritorial jurisdiction through a stricter application of the traditional bases of jurisdiction.

The DaimlerChrysler case gives Justice Breyer an opportunity to put sharper teeth, if that's his inclination, into the third alternative test for finding jurisdiction that he proposed in *Kiobel* – an interest of the United States, including its interest in not harboring persons or assets of the "common enemies of mankind." Over at Volokh, I suggest that this reproduces the same basic problem as the Sosa test for restricting causes of action: the test is impeccable in theory, but unhelpful in practice. Why?

On either Sosa's restrictive test (norms of same content and specificity as would have obtained in 1789) or Breyer's new test (US interests, including not shielding the persons or assets of common enemies of mankind), the problem lies in how – or whether – such formulations prevent a lower court from applying them in ever broader ways. The Ninth Circuit has lived happily with the Sosa limits for a decade; it simply views so many, many things as being as well established today as the equivalent 1789 norms. It is very hard for me to see that the same thing won't happen with Breyer's formulation of US interests. But potentially the DaimlerChrysler case gives him an opportunity to do so. And it's not, by the way, that I think the Roberts' way of reining things in is perfect, either – the presumption against extraterritoriality is finally merely a presumption, and the Ninth Circuit would presumably have not much greater trouble batting it away than it would dealing with the Breyer restriction. It's telling that the Roberts' opinion feels obliged, after stating that the presumption against extraterritoriality applies to the ATS, to conclude by adding that mere corporate presence is not enough to turn something extraterritorial into something territorial (which tees up DaimlerChrysler as well).

There are many questions left open regarding the involvement of US courts extraterritorially. One is structural: *Kiobel* has the effect of favoring economic activity abroad by foreign corporations and disfavoring US corporations. Of course US corporations should have to respond somewhere – the problem is that it is a very uneven playing field, and *Kiobel* has made it more uneven, rather than less. I assume this will arise quite quickly in some case in which a US corporation continues to assert in court the proposition that *Kiobel* did not finally address – corporate liability and aiding and abetting liability. I don't see how the Court will avoid finally having to address this. In addition, there is the consideration that OJ's *Kiobel* discussions have raised several times – a shift in these claims from Federal to state court. The twists and turns of extraterritoriality are not over.

"Supreme Court Could Redraw The Reach Of America's Courts"

Forbes
Michael Bobelian
April 29, 2013

A few days after issuing the *Kiobel* ruling restricting the scope of the Alien Tort Statute (ATS), the Supreme Court has agreed to hear another case dealing with the ambiguous law often used to bring civil actions for human rights violations committed abroad.

In many ATS cases, both the underlying facts and litigants have few connections to the United States. That was the case in *Kiobel*, which involved Nigerian plaintiffs suing a Nigerian subsidiary of the oil giant Shell for alleged actions taking place in Nigeria.

In *Kiobel*, the Court held that there was a strong presumption against the extraterritorial application of American law to actions taking place outside of the nation's borders. This presumption, the opinion authored by Chief Justice John Roberts Jr. held, barred an American court from establishing jurisdiction over Shell.

DaimlerChrysler AG v. Bauman, which the Court will hear in its next term, asks the Court to resolve a different but related question: can an American court exercise jurisdiction "over a foreign corporation based solely on the fact that an indirect corporate subsidiary performs services on behalf of the defendant" in the United States? The plaintiffs in the case have accused an Argentinean subsidiary of DaimlerChrysler (the auto companies were still together when the case was filed) of collaborating with Argentinean officials in kidnapping, torturing, and killing former employees of the subsidiary. They sued DaimlerChrysler, a German company, in California by obtaining jurisdiction through the automaker's American subsidiary.

On the surface, it looks like another ATS case. Perhaps the Court, as Justice Anthony Kennedy suggested in his concurring opinion in *Kiobel*, will provide further guidance on the scope and reach of the statute. The Court may do just that. The case also provides the Court with an opening to change the law far beyond the ATS, which only saw about a dozen new cases a year, by redefining the contours of the reach of America's courts.

The series of facts that led to a lawsuit in a federal court in California for actions committed thousands of miles away is typical of the complexities that arise in establishing jurisdiction, which tends to be among the trickiest areas of the law. Generally, a court can establish jurisdiction over a person that has connections to the court's locale. It makes little sense, for instance, to try a case in Missouri of two New Yorkers who get into a car accident in New York: neither the parties nor the dispute in this example have any connections to the Show-Me state.

With corporations, however, the issue of jurisdiction gets more complicated. Multinational corporations rely upon a host of subsidiaries, joint-ventures, and other business partnerships to run their global operations: Daimler listed 557 subsidiaries and other related entities across the world in 2011. Should an act by one of these units allow a court to establish jurisdiction with any of its sister organizations or the parent in charge of the entire enterprise?

In earlier rounds of the case, the plaintiffs pointed out that Daimler conducted a significant amount of business in the United States – and California in particular. Daimler's American operations also included a regional office in Costa Mesa, California and a vehicle preparation center about 30 miles away. After a lengthy but typical analysis, the Ninth Circuit Court of Appeals found that a district court in California could establish jurisdiction over Daimler, the parent corporation, through its American subsidiary's extensive and continuous activities in the U.S.

It's not clear what the Court will do in *Bauman* at this point. The justices have left some hints along the way, however. During *Kiobel*'s first round of oral arguments last February, Justice Samuel Alito questioned the applicability of American law to the lawsuit:"What does a case like that have in the courts of the United States?" Before the council responded to his question, the justice answered: "There's no connection to the United States whatsoever."

Justice Stephen Breyer also provided some potential insight on the issue in his separate opinion in *Kiobel*. He argued for a different application of the ATS – one not based on the concept of extraterritorial application. Yet, the looser standard he recommended would have led to the same result reached by the majority ruling. A small corporate presence, Justice Breyer explained, referring to the connection of the Shell parent companies based in Europe to the United States, were insufficient to establish jurisdiction.

In *Kiobel*, the plaintiffs tried to establish jurisdiction over Shell in much the same way as *Baumann*: through the connection of two separate subsidiaries – one in the U.S., one abroad – to a company headquartered in Europe. At first glance, that similarity points to an identical and straightforward result for the Court. On the other hand, the justices could use the case as an opportunity to redefine the jurisdictional reach of American courts over large-scale corporations.

"Daimler Must Face Argentina Abuse Lawsuit in U.S."

Reuters
Jonathan Stempel
May 18, 2011

Daimler AG was ordered on Wednesday to face a U.S. lawsuit alleging it participated in the kidnapping, torture and death of Mercedes-Benz workers in Argentina's "Dirty War" three decades ago.

A three-judge panel of the 9th U.S. Circuit Court of Appeals in San Francisco revived a seven-year-old case brought by 22 residents ofArgentina, including victims of violence and relatives of former workers presumed to have been killed.

The panel said a federal judge erred in 2007 when he decided he lacked jurisdiction, and that the case should be brought in Argentina or Germany, home of Stuttgart-based Daimler (DAIGn.DE). The panel sent the case back to the federal district court in San Jose, California.

"Daimler AG intends to appeal this jurisdictional decision," spokesman Han Tjan said in an email. "However, no ruling or judgment has been made as to the underlying allegations, which Daimler AG steadfastly denies."

Human rights groups in Argentina have said as many as 30,000 people were killed from 1976 to 1983 in a state-sponsored crackdown on leftist dissent while the country was under a military dictatorship, following the ouster of President Isabel Peron.

In the Daimler case, plaintiffs said Mercedes-Benz collaborated with state security forces in causing the detention, kidnapping, torture or death of workers at the Gonzalez-Catan plant near Buenos Aires.

"Our clients were trade union leaders and members in Argentina who were 'disappeared' by national police after the company identified them as troublemakers," Terry Collingsworth, a lawyer for the plaintiffs, said in an interview. "Now that we have jurisdiction, we have a straight shot at the merits."

Collingsworth said his clients seek "substantial" damages.

In the 9th Circuit ruling, Judge Stephen Reinhardt said Daimler, through its Mercedes-Benz unit, had "pervasive" contacts with California.

He also said Argentine courts would conclude the plaintiffs waited too long to sue, and that it was unclear whether German courts would consider the plaintiffs' claims.

Daimler "has not met its burden of presenting a compelling case that the exercise of jurisdiction would not comport with fair play and substantial justice," he said.

The U.S. case was brought under the Alien Tort Claims Act, a 1789 law sometimes used to sue companies in U.S. courts for acts committed abroad.

The case is *Bauman et al v. DaimlerChrysler Corp et al*, 9th U.S. Circuit Court of Appeals, No. 07-15386.

"Supreme Court Revisits (and May Rein In) Personal Jurisdiction"

Lexology
Grant J. Esposito & Brian R. Matsui
May 21, 2013

Introduction

On April 22 2013 the Supreme Court granted review in a personal jurisdiction case: *DaimlerChrysler AG v Bauman*. The question presented in *DaimlerChrysler* is:

> "*Whether it violates due process for a court to exercise general personal jurisdiction over a foreign corporation based solely on the fact that an indirect corporate subsidiary performs services on behalf of the defendant in the forum State*".

The Supreme Court previously granted certiorari in a specific personal jurisdiction case: *Walden v Fiore*. The question presented in *Walden* is "[w]hether due process permits a court to exercise personal jurisdiction over a defendant whose sole 'contact' with the forum State is his knowledge that the plaintiff has connections to that State".

Both *DaimlerChrysler* and *Walden* arose from the Ninth Circuit. They will be argued in Autumn 2013, with a decision expected no later than the end of June 2014.

Both of these cases are of significant interest to businesses, as personal jurisdiction delimits a court's ability to hail a defendant into court and subject that defendant to the court's power and punishment. The Supreme Court has frequently declined to engage in issues of personal jurisdiction. Indeed, until this pair of decisions during the 2010 term, the Supreme Court had not significantly addressed personal jurisdiction since 1987, when the court splintered in its decision governing specific personal jurisdiction in *Asahi Metal Industry Co v Superior Court of Cal, Solano Cty*.

DaimlerChrysler addresses the standard for general personal jurisdiction based on imputing the contacts of in-forum subsidiaries to foreign parent corporations.

Walden addresses what it means for a defendant to "expressly aim" its conduct at a forum, such that a state has specific personal jurisdiction over an alleged intentional tortfeasor.

These two grants follow closely on the heels of the Supreme Court's June 2011 rulings in *Goodyear Dunlop Tires Operations* and *J McIntyre Machinery*, in which it limited the ability of state courts to assert personal jurisdiction over foreign defendants.

DaimlerChrysler

DaimlerChrysler addresses the circumstances in which an in-state subsidiary's contacts with the forum state are sufficient for the forum state to have general jurisdiction over the foreign parent corporation.

In *DaimlerChrysler* the plaintiffs are residents of Argentina who allege human rights violations against them and their relatives at the hands of Argentina's military dictatorship during the 'dirty war' in the late 1970s and early 1980s. During that time the plaintiffs were employed by DaimlerChrysler's subsidiary in Argentina. The plaintiffs claimed that the Argentine subsidiary collaborated with the Argentine military in carrying out the alleged abuses. DaimlerChrysler is a German company that manufactures Mercedes-Benz automobiles in Germany. It does not manufacture, market or sell any products in the United States.

The plaintiffs filed suit in California, maintaining that DaimlerChrysler was subject to general personal jurisdiction in California – not because it was present in California, but rather on an agency theory by attributing to DaimlerChrysler the California contacts of a different, indirect subsidiary incorporated in Delaware (Mercedes-Benz USA LLC). The Delaware subsidiary takes title to the luxury cars in Germany and then distributes them in the United States, including through dealerships in California. The plaintiffs thus argued that DaimlerChrysler was subject to general jurisdiction in California based on the contacts that its Delaware subsidiary has with California and, as a result, the German parent company could be forced to defend itself in California against the human rights violations allegedly committed by its Argentine subsidiary in Argentina.

The district court permitted discovery into the jurisdictional question. The court found that there was no agency relationship and granted DaimlerChrysler's motion to dismiss for lack of personal jurisdiction.

In a curious turn of events at the Ninth Circuit, this decision was first affirmed in a divided panel opinion and subsequently reversed by the same panel nine months later. DaimlerChrysler's petition for rehearing *en banc* was denied, although eight judges dissented from that denial.

In the Ninth Circuit there are two separate tests for determining whether a subsidiary's contacts can be imputed to a parent corporation for general jurisdiction purposes. One test examines whether the subsidiary is merely an alter ego of the parent. The other test – the agency test – is at issue in *DaimlerChrysler*. This test requires two showings:

- whether the subsidiary was established for, or is engaged in, activities that the parent would have to undertake itself but for the existence of the subsidiary; and
- whether the parent effectively controls the subsidiary's internal affairs or day-to-day operations.

The Second Circuit generally also applies this test. Where the foreign defendant is a holding company that by definition does not conduct operations itself and can do business only through subsidiaries, the agency test ordinarily is not satisfied. Yet in the case at hand, the Ninth Circuit reformulated the agency test so that, as Judge O'Scannlain, dissenting from the denial of rehearing *en banc*, explained, the court "now seemingly rejects respect for corporate separateness, a well-established 'principle of corporate law deeply ingrained in our economic and legal systems'".

At least five other circuits – the Fourth, Fifth, Sixth, Seventh and Eighth Circuits – have rejected the agency test for general jurisdiction. Those courts require the subsidiary to be an alter ego of the foreign parent – in other words, due process requires a plaintiff to show that the foreign parent controlled and dominated the day-to-day activities of its domestic subsidiary to the extent that the corporate form should be disregarded and the two should be treated as alter egos. These circuits generally view the following as indicia of corporate separateness sufficient to reject imputing jurisdictional contacts of a domestic entity to a foreign parent:

- separate books and records;
- separate offices, bank accounts and tax returns;
- separate boards of directors and employees;
- observation of corporate formalities; and
- proof that the domestic entity ran the actual day-to-day operations (eg, marketing and sales).

The plaintiffs, now respondents before the court, argued that the facts – specifically, that DaimlerChrysler and its indirect, wholly owned Delaware subsidiary have the same chairman, sets prices for the cars sold in the United States and has rights under a distribution agreement to exert control over the subsidiary's business activities, as applied to the Ninth Circuit's agency test – support the holding below that DaimlerChrysler is subject to personal jurisdiction.

The plaintiffs also maintained that it was not unreasonable for DaimlerChrysler to defend itself in California in light of:

- the revenue that it generates from sales in California;
- the fact that it has litigated in the California courts;
- the fact that it has a research centre in the state; and
- the fact that it trades on the Pacific Stock Exchange.

The plaintiffs further noted that technological advancements have lessened the traditional burdens on foreign defendants litigating in the United States, and that neither Argentina nor Germany provided an adequate forum.

Walden

Walden addresses when a forum state has specific jurisdiction over an alleged intentional tortfeasor. In this case, the only contact between the tortfeasor and the forum state was its knowledge that the victims of its tort resided in the forum state.

The plaintiffs are two professional gamblers who were detained in Atlanta, Georgia by a Drug Enforcement Administration (DEA) agent. The plaintiffs' destination was Las Vegas, Nevada. The plaintiffs maintained that they were residents of both Nevada and California, but provided the DEA agent with California identification only. The DEA agent suspected that the significant amount of cash that the plaintiffs had in their possession – approximately $97,000 – was evidence of illegal narcotics transactions, rather than the legitimate proceeds of legal gambling. The DEA agent seized the money and subsequently filed a probable cause affidavit for forfeiture of the funds. Ultimately, the US Attorney's Office determined there was no probable cause for forfeiture and returned the money to the plaintiffs.

The plaintiffs brought suit in the US District Court for the District of Nevada against the DEA agent responsible for seizing the cash. The agent moved to dismiss for lack of personal jurisdiction, citing his absolute absence of contacts with the state: he had no contact with anyone in Nevada, owned no property there and conducted no personal business in the state. The district court dismissed the case for lack of personal jurisdiction.

The Ninth Circuit reversed in a divided opinion. The court held that Nevada had specific jurisdiction over the DEA agent. The Ninth Circuit concluded that the DEA agent had purposefully directed his conduct to the forum state (ie, Nevada) because he knew that the plaintiffs had a connection with Nevada at the time that the probable cause affidavit had been filed. Specifically, the appeal court held that the DEA agent had committed an intentional act – the filing of a false affidavit – expressly aimed at Nevada (where the plaintiffs resided). The court further concluded that the DEA agent's intentional act had foreseeable effects in the forum.

Eight judges of the Ninth Circuit dissented from the denial of a petition for rehearing *en banc* in two separate dissents. As Judge McKeown's dissent explained:

> "*With the stroke of a pen, our circuit returns to a discredited era of specific personal jurisdiction, where foreseeability reigns supreme and purposeful direction is irrelevant. That approach was, of course, rejected in* Burger King Corp. v. Rudzewicz*; the Supreme Court was unequivocal that 'foreseeability is not a sufficient benchmark for exercising personal jurisdiction.' 471 U.S. 462 (1985). Instead, the Due Process Clause requires that before a distant state exercises specific jurisdiction over a defendant, the defendant must purposefully direct activities at forum residents resulting in injuries arising out of or relating to those activities. Under the majority's construct, mere knowledge of the potential out-of-state plaintiff's residence, along with a wrongful act, confers specific personal jurisdiction. This virtually limitless expansion of personal jurisdiction runs afoul of both due process guarantees and Supreme Court precedent*".

As the Ninth Circuit's opinions and the briefing at the certiorari stage suggest, the appeal courts have divided over what it means for a party to "expressly aim" its conduct at a forum state. At least six circuits have required that a defendant expressly aim its conduct at the forum state – not merely at a known forum resident. Meanwhile, the Ninth Circuit and Eleventh Circuit have embraced a seemingly broader standard permitting specific personal jurisdiction where a defendant has undertaken intentional acts with the knowledge that the plaintiff resides in the forum state. The Supreme Court in *Walden* aims to resolve this confusion.

Next steps

Briefing in both *DaimlerChrysler* and *Walden* will occur in Summer 2013 and the cases are likely to be argued in Autumn 2013. Decisions in the two cases will be handed down by June 2014.

The Supreme Court has demonstrated respect for corporate form in recent years and this likely will shape the court's consideration of *DaimlerChrysler*. Ultimately, if the Supreme Court reverses in these two cases, it will further limit the ability of state courts (and federal courts exercising diversity jurisdiction) to assert personal jurisdiction over non-state defendants. On the other hand, should the court affirm the Ninth Circuit in either decision, this would potentially open corporate defendants to broader assertions of jurisdiction, requiring corporate defendants to defend against a broader range of civil suits in more places.

Finally, because multinational companies generally organise themselves through separate corporations to achieve benefits ranging from limited liability to favourable tax treatment, those advising such companies should pay particular attention to the court's reasoning when it decides *DaimlerChrysler*. Should the court weaken the traditional principles of corporate separateness in any way, the consequences could be far broader than merely increasing the cost and burden of defending litigation in a foreign forum.