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Section 5: Business Law

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

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01-618 Eldred v. Ashcroft

Ruling Below (Eldred v. Reno, D.C. Cir., 345 U.S. App. D.C. 89, 239 F.3d 372, 2001 U.S. App. Lexis 2335, 57 U.S.P.Q.2D (BNA) 1842, Copy. L. Rep. (CCH) P28,219)

The court held that the Copyright Term Extension Act of 1998 is neither in violation of the "limited times" nor the originality requirements of the Copyright Clause of the U.S. Constitution, nor in violation of the 1st Amendment. There is no 1st Amendment right to exploit the copyrighted works of others. The fact that Congress is extending copyright on existing works does not violate the originality clause. Finally, 70 years does not exceed "limited times" nor does the preamble of the Copyright Clause serve as a substantive limit on Congress' power.

Questiond Presented: Whether the 20-year extension of the terms of all copyrights, set forth in the Copyright Term Extension Act of 1998 violates the Copyright Clause of the Constitution or the 1st Amendment?

Eric ELDRED, et al., Appellants
v.
Janet RENO, in her official capacity as Attorney General, Appellee

United States Court of Appeals
For the District of Columbia Circuit

Decided February 16, 2001

GINSBURG, Circuit Judge:

The plaintiffs in this case, corporations, associations, and individuals who rely for their vocations or avocations upon works in the public domain, challenge the constitutionality of the Copyright Term Extension Act of 1998 (CTEA), Pub. L. No. 105-298, 112 Stat. 2827. This marks the first occasion for an appellate court to address whether the First Amendment or the Copyright Clause of the Constitution of the United States constrains the Congress from extending for a period of years the duration of copyrights, both those already extant and those yet to come. We hold that neither does.

I. Background

The CTEA amends various provisions of the Copyright Act of 1976, 17 U.S.C. § 101 *et seq.* The portions of the CTEA at issue here extend the terms of all copyrights for 20 years as follows: (1) For a work created in 1978 or later, to which an individual author holds the copyright, the Act extends the term to the life of the author plus 70 years. *See* Pub L. No. 105-298 § 102(b)(1), 112 Stat. 2827; 17 U.S.C. § 302(a). (2) For a work created in 1978 or later that is anonymous, or pseudonymous, or is made for hire, the term is extended from 75 to 95 years from the year of publication or from 100 to 120 years from the year of creation, whichever occurs first. *See* Pub. L. No. 105-298 § 102(b)(3), 112 Stat. 2827; 17 U.S.C. §

302(c). (3) For a work created before 1978, for which the initial term of copyright was 28 years, the renewal term is extended from 47 to 67 years, thereby creating a combined term of 95 years. *See* Pub. L. No. 105-298 § 102(d), 112 Stat. 2827; 17 U.S.C. § 304. In all three situations, therefore, the CTEA applies retrospectively in the sense that it extends the terms of subsisting copyrights. As a result, the CTEA better aligns the terms of United States copyrights with those of copyrights governed by the European Union. *See* S. Rep. No. 104-315, at 7-8 (1996); Council Directive 93/98, art. 7, 1993 O.J. (L 290) 9.

[The court reviewed the history of congressional extensions of the copyright term. Every extension has been applied to all existing and new copyrights. The first term was 14 years with an available 14 year renewal. Those terms lengthened gradually until 1976 when the term was increased to life of the author plus 50 years. If there was no known author, the term was 75 years from publication or 100 years from creation. CETA adds 20 years to all copyrights.]

The plaintiffs filed this suit against the Attorney General of the United States to obtain a declaration that the CTEA is unconstitutional. Among the plaintiffs are a non-profit association that distributes over the internet free electronic versions of books in the public domain; a company that reprints rare, out-of-print books that have entered the public domain; a vendor of sheet music and a choir director, who respectively sell and purchase music that is relatively inexpensive because it is in the public domain; and a company that preserves and restores old films and insofar as such works are not in the public domain, needs permission from their copyright holders -- who are often hard to find -- in order to exploit them. The district court entered judgment on the pleadings in favor of the Government[, concluding that the CTEA neither violates the First Amendment nor the Copyright Clause, which authorizes the Congress: "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."]

II. Analysis

The plaintiffs claim that the CTEA is beyond the power of the Congress and therefore unconstitutional for three reasons: first, the CTEA, in both its prospective and retrospective applications, fails the intermediate scrutiny appropriate under the First Amendment; second, in its application to preexisting works, the CTEA violates the originality requirement of the Copyright Clause; and third, in extending the term of subsisting copyrights, the CTEA violates the "limited Times" requirement of the Copyright Clause -- a requirement that they say is informed by the goal of "promoting the Progress of Science and useful Arts." Because each of these grounds presents a pure question of law, we consider them *de novo. See, e.g., United States v Popa*, 337 U.S. App. D.C. 411, 187 F.3d 672, 674 (D.C. Cir. 1999).

A. First Amendment

The First Amendment aspect of the plaintiffs' complaint attacks the CTEA not only in its application to subsisting copyrights but also insofar as it extends the terms of copyrights for works yet to be created. The Government questions plaintiffs' standing to complain in the latter regard.

1. Standing

[The court rejected the government's challenge to the plaintiffs' standing because the plaintiffs would benefit from the works becoming part of the public domain. The injury is traceable to the CTEA and could be redressed by voiding the CTEA. This is true whether applied to existing or new works].

* * *

2. The merits

The decisions of the Supreme Court in *Harper & Row Publishers Inc. v Nation Enters.*, 471 U.S. 539, 85 L. Ed. 2d 588, 105 S. Ct. 2218 (1985), and of this court in *United Video, Inc. v FCC*, 281 U.S. App. D.C. 368, 890 F.2d 1173 (1989), stand as insuperable bars to plaintiffs' first amendment theory. In *Harper & Row* the Court held that a magazine's advance publication of excerpts from the memoirs of former President Gerald Ford infringed the copyright thereon. 471 U.S. at 569. In doing so the Court explained how the regime of copyright itself respects and adequately safeguards the freedom of speech protected by the First Amendment.

[The court explained the principles pronounced in *Harper & Row* and *United Video*. The First Amendment guarantees that no one may copyright ideas or facts. However, forms of expression are copyrightable, and this is not an infringement of First Amendment rights, especially given the "fair use" protections granted for scholarship and comment. Copyrights are categorically immune from First Amendment challenges.

The plaintiffs attempted to distinguish the cases by arguing that the other cases involved parties attempting to use legitimately copyrighted material, whereas this case involved a challenge to the copyright, itself. The court rejected this line of reasoning because the works in question were already under copyright protection and the cases cited by the plaintiffs addressed content-based protections not present in the current case.]

* * *

B. Requirement of Originality

The plaintiffs' second challenge ostensibly rests upon *Feist Publications, Inc. v Rural Telephone Service Co.*, in which the Supreme Court held that telephone listings compiled in a white pages directory are uncopyrightable facts: "The *sine qua non* of copyright is originality." 499 U.S. 340, 345, 111 S. Ct. 1282, 113 L. Ed. 2d 358 (1991). "Originality is a constitutional requirement" for copyright because the terms "Authors" and "Writings," as they appear in the Copyright Clause, "presuppose a degree of originality." *Id.* at 346.

The plaintiffs reason from this that the CTEA cannot extend an extant copyright because the copyrighted work already exists and therefore lacks originality. Not so. Originality is what made the work copyrightable in the first place. [...]

The plaintiffs' underlying point seems to be that there is something special about extending a copyright beyond the combined initial and renewal terms for which it was initially slated. Nothing in *Feist* or in the requirement of originality supports this, however: All they tell us is that facts, like ideas, are outside the ambit of copyright. [...]

[The plaintiffs argued that Congress may not issue copyrights that would remove knowledge from the public domain, and therefore a work in the public domain must lack the originality needed to receive a copyright. While the court agreed this is one possible interpretation of *Feist*, it dismissed the argument as irrelevant to this case because the works in question were already copyrighted.]

C. The Limitation of "limited Times"

We come now to the plaintiffs' contention that the CTEA violates the constitutional requirement that copyrights endure only for "limited Times." This claim at last speaks to the duration rather than to the subject matter of a copyright: If the Congress were to make copyright protection permanent, then it surely would exceed the power conferred upon it by the Copyright Clause.

The present plaintiffs want a limit well short of the rule against perpetuities, of course. And they claim to have found it -- or at least a bar to extending the life of a subsisting copyright -- in the preamble of the Copyright Clause: "The Congress shall have power ... To promote the Progress of Science and useful Arts..." Their idea is that the phrase "limited Times" should be interpreted not literally but rather as reaching only as far as is justified by the preambular statement of purpose: If 50 years are enough to "promote ... Progress," then a grant of 70 years is unconstitutional. Here the plaintiffs run squarely up against our holding in *Schnapper v Foley*, 215 U.S. App. D.C. 59, 667 F.2d 102, 112 (1981), in which we rejected the argument "that the introductory language of the Copyright Clause constitutes a limit on congressional power." The plaintiffs, however, disclaim any purpose to question the holding of *Schnapper*; indeed, they expressly acknowledge "that the preamble of the Copyright Clause is not a substantive limit on Congress' legislative power." Their argument is simply that "the Supreme Court has interpreted the terms 'Authors' and 'Writings' in light of that preamble, and that this Court should do the same with 'limited Times.' "

The problems with this argument are manifest. First, one cannot concede that the preamble "is not a substantive limit" and yet maintain that it limits the permissible duration of a copyright more strictly than does the textual requirement that it be for a "limited Time." Second, although the plaintiffs claim that *Feist* supports using the preamble to interpret the rest of the Clause, the Court in *Feist* never suggests that the preamble informs its interpretation of the substantive grant of power to the Congress (which there turned upon the meaning of "Authors" and of "Writings," each standing alone). 499 U.S. at 345-47. Similarly, the *Trade-Mark Cases* cited in *Feist* rest upon the originality implied by "invention [and] discovery" and by the "writings of authors," and make no reference at all to the preamble. 100 U.S. at 93-94.

III. The Dissent

The foregoing suffices to dispose of plaintiffs' arguments -- as Judge Sentelle, dissenting, implicitly recognizes -- and hence to resolve this case.

[The court argued that the dissent adopted an argument from an amicus. The court found that it was improper to expand the scope of the appeal to include the argument of an amicus, especially as the parties to the case rejected the argument and thus it was not a constitutional issue before the court. Nor did the government prepare any counter-arguments because the plaintiffs did not adopt the argument.]

Even were we to proceed as urged by the

amicus and the dissent, however, we would only review the CTEA as we would any other exercise of a power enumerated in Article I. That is we would ask, following *McCulloch v Maryland*, 17 U.S. 316, 421, 4 L. Ed. 579 (1819), whether the CTEA is a "necessary and proper" exercise of the power conferred upon the Congress by the Copyright Clause; assuming Judge Sentelle is correct and *Schnapper* is wrong about the relationship of the preamble to the rest of that Clause, this would require that the CTEA be an "appropriate" means, and "plainly adapted" to the end prescribed in the preamble, "promoting Progress of Science and useful Arts." The Congress found that extending the duration of copyrights on existing works would, among other things, give copyright holders an incentive to preserve older works, particularly motion pictures in need of restoration. *See* S. REP. NO. 104-315, at 12 (1996). If called upon to do so, therefore, we might well hold that the application of the CTEA to subsisting copyrights is "plainly adapted" and "appropriate" to "promoting progress." *See Ladd v Law & Technology Press*, 762 F.2d 809, 812 (9th Cir. 1985) (upholding the deposit requirement of the Copyright Act of 1976 as "necessary and proper" because the purpose was "to enforce contributions of desirable books to the Library of Congress").

Judge Sentelle concludes otherwise only because he sees a categorical distinction between extending the term of a subsisting copyright and extending that of a prospective copyright. This distinction is not to be found in the Constitution itself, however. The dissent identifies nothing in text or in history that suggests that a term of years for a copyright is not a "limited Time" if it may later be extended for another "limited Time." Instead, the dissent suggests that the Congress -- or rather, many successive Congresses -- might in effect confer a perpetual copyright by stringing together an unlimited number of "limited Times," although that clearly is not the situation before us. The temporal thrust of the CTEA is a good deal more modest: The Act matches United States copyrights to the terms of copyrights granted by the European Union, *see* Council Directive 93/98, art. 7, 1993 O.J. (L 290) 9; in an era of multinational publishers and instantaneous electronic transmission, harmonization in this regard has obvious practical benefits for the exploitation of copyrights. This is a powerful indication that the CTEA is a "necessary and proper" measure to meet contemporary circumstances rather than a step on the way to making copyrights perpetual; the force of that evidence is hardly diminished because, as the dissent correctly points out, the EU is not bound by the Copyright Clause of our Constitution. As for the dissent's objection that extending a subsisting copyright does nothing to "promote Progress," we think that implies a rather crabbed view of progress: Preserving access to works that would otherwise disappear -- not enter the public domain but disappear -- "promotes Progress" as surely as does stimulating the creation of new works.

[The court also pointed out that the Copyright Act of 1790 applied to and extended the term of existing copyrights granted by the states. The court rejected the argument that this was merely the federal government asserting its new power to solely regulate copyright under the Supremacy Clause .]

* * *

Such guidance as the Supreme Court has given further confirms us in this view of the matter. The Court has made plain that the same Clause permits the Congress to amplify the terms of an existing patent. As early as 1843 it established that the status of a particular invention and its protections must depend on the law as it stood at the emanation of the patent, together with such changes as have been since made; for though they may be retrospective in their operation, that is not a sound objection to their validity; the powers of Congress to legislate upon the subject of patents is plenary by the terms of the Constitution[...]

McClurg v Kingsland, 42 U.S. 202, 206, 11 L. Ed. 102.

Within the realm of copyright, the Court has to the present era been similarly deferential to the judgment of the Congress. "As the text of the Constitution makes plain, it is Congress that has been assigned the task of defining the scope of the limited monopoly that should be granted to authors or to inventors in order to give the appropriate public access to their work product;" that "task involves a difficult balance between [competing interests]" as reflected in the frequent modifications of the relevant statutes. *Sony Corp. v Universal City Studios, Inc.*, 464 U.S. 417, 429, 78 L. Ed. 2d 574, 104 S. Ct. 774 (1984). And still more recently: "The evolution of the duration of copyright protection tellingly illustrates the difficulties Congress faces [in exercising its copyright power].... It is not our role to alter the delicate balance Congress has labored to achieve." *Stewart v Abend*, 495 U.S. 207, 230, 109 L. Ed. 2d 184, 110 S. Ct. 1750 (1990).

IV. Conclusion:

In sum, we hold that the CTEA is a proper exercise of the Congress's power under the Copyright Clause. [...]

* * *

SENTELLE, Circuit Judge, dissenting in part:

While I concur with much of the majority's opinion, insofar as it holds constitutional the twenty-year or more extension of copyright protection for existing works, I dissent. This issue calls upon us to consider the scope of one of the clauses granting enumerated powers to Congress, specifically, Art. I, § 8, cl. 8:

Congress shall have power ... to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries....

[The dissent argued that *United States v Lopez*, 514 U.S. 549, showed that congressional power is restrained by “outer limits.” The *Lopez* decision applied to the Commerce Clause, but the dissent extended it to all enumerated powers, including Copyright. The dissent argued that one test under *Lopez* is to see whether the rationale supporting the statute has a stopping point or whether it would lead to the regulation of all human activity. The majority’s interpretation of the copyright power created such an unlimited power.]

* * *

Citing *Gibbons v Ogden*, 22 U.S. (9 Wheat.) 1, 189-190, 6 L. Ed. 23 (1824), the *Lopez* Court acknowledged "that limitations on the commerce power are inherent in the very language of the Commerce Clause." 514 U.S. at 553. Just so with the Copyright Clause. [...]

That clause empowers the Congress to do one thing, and one thing only. That one thing is "to promote the progress of science and useful arts." How may Congress do that? "By securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries." The clause is not an open grant of power to secure exclusive rights. It is a grant of a power to promote progress. [...] The majority acknowledges that "if the Congress were to make copyright protection permanent, then it surely would exceed the power conferred upon it by the Copyright Clause." Maj. Op. at 10. However, there is no apparent substantive distinction between permanent protection and permanently available authority to extend originally limited protection. The Congress that can extend the protection of an existing work from 100 years to 120 years; can extend that protection from 120 years to 140; and from 140 to 200; and from 200 to 300; and in effect can accomplish precisely what the majority admits it cannot do directly. This, in my view, exceeds the proper understanding of enumerated powers reflected in the *Lopez* principle of requiring some definable stopping point.

* * *

The government has offered no tenable theory as to how retrospective extension can promote the useful arts. As the Supreme Court noted in *Lopez* and again in *United States v Morrison*, that Congress concluded a given piece of legislation serves a constitutional purpose "does not necessarily make it so." *Lopez*, 514 U.S. at 557 n.2 (internal quotes omitted); *Morrison*, 120 S. Ct. at 1752. Pressed at oral argument, counsel for the government referred to keeping the promise made in the original grant of exclusivity for a limited time. The easy answer to this assertion is that Congress is not empowered to "make or keep promises" but only to do those things enumerated in Article I. The second problem with the government's assertion is that Congress made no promise to commit such an extension but only to secure the exclusive rights for the original limited period. Thirdly, the means employed by Congress here are not the securing of the exclusive rights for a limited period, but rather are a different animal altogether: the extension of exclusivity previously secured. This is not within the means authorized by the Copyright Clause, and it is not constitutional.

The majority responds to this problem of the statute's exceeding the constitutional grant by reliance on *Schnapper v Foley*, 215 U.S. App. D.C. 59, 667 F.2d 102 (D.C. Cir. 1981), "in which we rejected the argument 'that the introductory language of the Copyright Clause constitutes a limit on congressional power.' " Maj. Op. at 10 (quoting 667 F.2d at 112).

* * *

However, it does not appear to me that this is the holding of *Schnapper*. [...]

Rather, the *Schnapper* analysis again takes us back to the *Lopez* approach to judicial interpretation of the enumerated powers clauses. In *Lopez*, one of the means employed to determine the constitutionality of extended application of the Commerce Clause is an elemental inquiry into whether in each case the purportedly regulated action "in question affects interstate commerce." 514 U.S. at 561. However, the jurisdictional element is not necessary under *Lopez* analysis of Commerce Clause regulation where Congress is directly regulating "the use of the channels of interstate commerce" or "persons or things in interstate commerce." *Id.* at 558. Similarly, I suggest that in analyzing the extent of congressional power under the Copyright Clause, the *Schnapper* holding that each individual application of copyright protection need not promote the progress of science and the useful arts does not mean that Congress's power is otherwise unlimited, anymore than the lack of a necessity for case-by-case analysis of the effect on interstate commerce validates anything Congress may wish to do under the rubric of the Commerce Clause. Though, under *Schnapper*, we may not require that each use of a copyright protection promote science and the arts, we can require that the exercise of power under which those applications occur meet the language of the clause which grants the Congress the power to enact the statute in the first place. This the extension does not do. It is not within the enumerated power.

The majority suggests that my reading of *Schnapper* is somehow foreclosed by the fact that it accepts the argument of an amicus. [...] Neither I nor the amicus raise any issue not raised by the parties to the case, nor disposed of by a majority of the court. [...] That the amicus argues more convincingly in appellants' favor on the issue raised by the appellants than they do themselves is no reason to reject the argument of the amicus.

* * *

Nor are we constrained by the parties' apparent agreement as to the state of the law under *Schnapper*. The Supreme Court has made it clear that [...] 'when an issue or claim is properly before the court, the court is not limited to the particular legal theories advanced by the parties, but rather retains the independent power to identify and apply the proper construction of governing law.' " *Id.* (quoting *Kamen v Kemper Fin. Servs., Inc.*, 500 U.S. 90, 99, 114 L. Ed. 2d 152, 111 S. Ct. 1711 (1991)).

I find two other arguments the majority invokes against my dissent unpersuasive. The enactment by the first Congress in 1790 regularizing the state of copyright law with respect to works protected by state acts preexisting the Constitution appears to me to be *sui generis*. Necessarily, something had to be done to begin the operation of federal law under the new federal Constitution. The Act of May 31, 1790, 1 Stat. 124, created the first (and for many decades only) federal copyright protection; it did not *extend* subsisting *federal* copyrights enacted pursuant to the Constitution. *Cf. Wheaton v Peters*, 33 U.S. (8 Pet.) 591, 661, 8 L. Ed. 1055 (1834) ("Congress, then, by this [copyright] act, instead of sanctioning an existing right, as contended for, created it."). The fact that the CTEA "matches United States copyrights to the terms of copyrights granted by the European Union," Maj. Op. at 13 (citing Council Directive 93/98, art. 7, 1993 O.J. (L 290) 9), is immaterial to the question. Neither the European Union nor its constituent nation states are bound by the Constitution of the United States. That Union may have all sorts of laws about copyrights or any other subject which are beyond the power of our constitutionally defined central government.

Therefore, I respectfully dissent.

'Limitless' Copyright Case Faces High Court Review

The Los Angeles Times

February 20, 2002

David G. Savage

The Supreme Court announced Tuesday that it will hear a major challenge to Congress' power to extend the copyrights of films, books and songs that first appeared in the 1920s and 1930s--a move that could result in hundreds of thousands of classic and forgotten works becoming freely available via the Internet.

Films such as "Gone with the Wind" and "The Wizard of Oz," the music of the jazz era and the compositions of George and Ira Gershwin, novels such as "The Great Gatsby" and "The Sun Also Rises," even Mickey Mouse and Donald Duck--all would have passed into the public domain had Congress in 1998 not extended their legal shield by 20 years [correction: copyrights for many of these works would not have lapsed until 2003 or later].

But this challenge to the copyright extension is not just about the classic books, music and movies that are well-loved today. Opponents of the extension say that if all the works published decades ago--and then forgotten--were in the public domain, many would have a second chance at popularity, thanks to Internet archivists who would make them easily accessible.

Under pressure from Hollywood studios and music publishers, Congress has extended the period of copyright protection 11 times over the last 40 years.

The result, say scholars and librarians, is "to transform a limited monopoly into a virtually limitless one."

The copyright laws are intended to encourage creativity by allowing authors, composers and filmmakers to profit from their works. But under the recent extension, the legal monopoly continues for 70 years after an individual author's or composer's death.

"How can you say you are creating incentives for authors who are long dead?" asked Jessica Litman, a law professor at Wayne State University in Detroit, one of 21 copyright law experts who urged the Supreme Court to take up the issue.

"Without some check on congressional power, it is unlikely that any of the cultural and historical works of the first half of the 20th century will ever enter the public domain," added UC Berkeley law professor Mark Lemley.

In a statement issued by his office, Jack Valenti, the president of the Motion Picture Assn. of America, said he had "absolute confidence that the Supreme Court will uphold the decision" of a lower court and "the wisdom of the Congress . . . in extending the term of copyright protection by 20 years to maintain parity with the European Union and other nations."

In their appeals, the scholars and Internet entrepreneurs said the copyright extensions have the unfortunate and unintended effect of burying works that could be resurrected.

The Gershwin tunes and "The Great Gatsby" will live on, they noted, and the copyright laws will determine only who profits from their existence.

But the same is not true of most original works. "Millions of copyrighted works are created every year; yet after 75 years, few remain in circulation," the copyright scholars said. In 1930, for example, 10,027 books were published in the United States. Only 174 remain in print today.

"Thousands of old movies sit in shelves deteriorating because the companies that hold the copyright make no efforts to restore them or make them available, while their copyright status prevents others from preserving these works," according to a brief filed on behalf of librarians and archivists.

To illustrate their point, they cited Frank Capra's 1946 film "It's a Wonderful Life," which had a second life when its copyright was allowed to lapse because of an oversight. This forgotten movie "lay gathering dust in a movie studio until the early 1970s," when its copyright expired.

Once it passed into the public domain, several public broadcasting stations aired it during the Christmas season. Within a few years, the forgotten film became a classic and a Christmas tradition.

And now, thanks to digital technology and the Internet, millions of such works can be restored and made available to the public, the librarians and archivists told the court.

The justices considered the appeals for several weeks before voting to grant the case, known as Eldred vs. Ashcroft, 01-618.

Its lead plaintiff, Eric Eldred, runs an Internet library that posts works in the public domain. But perhaps more important, his appeal was filed by Stanford law professor Lawrence Lessig, one of the foremost legal experts on the Internet and the law.

His appeal challenges the Sonny Bono Copyright Term Extension Act of 1998, which added 20 years to most copyrights. Because of that law, "an extraordinary range of creative invention will be blocked from falling into the public domain at least until 2019--or longer if Congress extends the copyright term again," Lessig said.

This, he argues, is unconstitutional.

First, he says, the Constitution gives Congress a limited power to protect copyrights. It says Congress can "promote the Progress of Science" by granting "exclusive rights" to authors for "limited times."

Lessig argues that Congress has violated this clause by "creating in practice an unlimited term" for copyrights.

The nation's Copyright Act in 1790 protected written works for 14 years, after which authors could seek a renewal for 14 more years. This 28-year limit continued until 1909, when Congress doubled the limit to a possible 56 years.

Since 1962, Congress has repeatedly extended the maximum term, usually under pressure from movie producers and the music industry.

"The real beneficiaries of this are big media companies, because they own the copyrights," said Washington lawyer Daniel H. Bromberg. "The 1998 bill was snidely referred to as 'The Mickey Mouse Extension Act' because it was seen as protecting Disney's characters."

Before Congress, proponents of the extension argued that creators of works that remain valuable deserve to profit from them.

And Tuesday, underscoring the importance of traditional characters, Walt Disney Co. executives trotted out Mickey Mouse, Peter Pan and "Beauty and the Beast's" Belle at the company's shareholder meeting in Hartford, Conn.

These Disney characters are "extraordinary assets," Disney President Bob Iger said. "They are among the reasons the Disney brand is so incredibly strong by any measure."

Under the law being challenged, works for hire, including films, are protected for 95 years after their release. Works by individual authors or composers are protected for 70 years after their deaths.

In their appeal, Lessig and his colleagues also say the extended copyright monopolies violate the 1st Amendment's guarantee of freedom of speech. Usually, the government should not limit free speech more than necessary, and a 95-year shield for some works is well more than necessary, Lessig argues.

Last year, the U.S. Court of Appeals in Washington rejected a challenge to the copyright extension on a 2-1 vote. Its judges said only Congress could determine a reasonable time period for a copyright. Moreover, the appeals court said old films and books are more likely to survive if their copyright value is preserved.

"Extending the duration of copyrights on existing works would, among other things, give copyright holders an incentive to preserve older works, particularly motion pictures in need of restoration," the judges wrote.

U.S. Solicitor Gen. Theodore B. Olson said he agreed and urged the court to reject the challenges to the law. There is "no 1st Amendment right to exploit the work that Congress has purported to protect," Olson said.

The American Library Assn., the Internet Archive and dozens of legal experts filed briefs in recent months urging the high court to rethink that presumption.

So far, however, the Supreme Court has heard only from those groups that oppose the copyright extension. They will file their legal briefs in several months, and the case will not be heard before the high court until the fall.

Copyright Crusader

The Boston Globe Magazine

August 29, 1999

Daren Fonda

The day Eric Eldred decided to launch a Web site, he didn't think many people would care. He was doing it to inspire his triplet teenage daughters to read more. Emma, Anna, and Bonnie had come home from Pinkerton Academy in Derry, New Hampshire, complaining about Nathaniel Hawthorne's *The Scarlet Letter*. The three sophomores, especially Emma, were put off by the old-style language and found the book boring.

It was the spring of 1995, and Eldred, a technical analyst for a computer magazine, was looking for a hobby. "I thought to myself: 'This is a great work of literature. It's the first piece of literature teenagers are exposed to. Can I do something to get them more interested in it?'"

Eldred went on the Internet to see if there were any resources to liven up the book.

Like many classics, it had been put on line by several nonprofit sites. But Eldred felt these electronic editions were inferior to their print versions; they had typos, or relied on outdated texts, or were difficult to read since they'd been scanned in crudely. He decided to create his own on-line edition, sprucing it up with a glossary, a time line, illustrations, and a biography of Hawthorne.

Then he thought, why not put other books on line, too? He envisioned a global electronic library that would make unusual and out-of-print books available for people who couldn't find them in libraries or used-book stores. His e-library would be accessible to the blind through text-to-speech generators. Getting permission from publishers wouldn't be a problem, he thought, since the works he wanted were all in the public domain, their copyrights expired.

Eldred filled his digital shelves with books that suited his tastes. There were texts on small boats, 19th-century natural histories, children's stories for parents to read aloud to kids. He published *The Life of the Caterpillar*, by amateur entomologist J. Henri Fabre, to show children that you don't need a PhD to do good science. He put up a novel called *Wooden Crosses*, by Roland Dorgeles, because he thought it was a terrific, though forgotten, World War I story. He even scanned in a book of poetry by his mother.

At first, not many people noticed the Web site: eldred.ne. mediaone.net. But as time went by, a steady flow of visitors streamed in, and the response was strong. People around the world e-mailed praise. His daily hit count grew to 20,000. In 1997, the National Endowment for the Humanities recognized his Eldritch Press as one of the 20 best humanities sites on the Web. More recognition came when both the Nathaniel Hawthorne Society and the William Dean Howells Society endorsed Internet links to his pages. To Eldred, the recognition was thrilling, and he planned an ambitious agenda, hoping to scan in rare works with copyrights that were scheduled to expire.

Then something happened that would change not only Eldred's homespun Web site, but his life as well.

October 27, 1998, as the nation was riveted by the impeachment scandal, President Clinton quietly signed into law the Sonny Bono Copyright Term Extension Act. The lack of ceremony belied the far-reaching implications of the law, whose impact would be felt from the corporate headquarters of Disney to the back rooms of small New England publishers. The act, sponsored by the late singer-songwriter and congressman, extended protection by 20 years for cultural works copyrighted after January 1, 1923. Works copyrighted by individuals since 1978 got "life plus 70" rather than the existing "life plus 50"; works made by or for corporations, known as "works made for hire," got 95 years. Works copyrighted before 1978 were shielded for 95 years, regardless of how they were produced.

Pop icons such as Mickey Mouse, books such as *The Great Gatsby*, films such as *The Jazz Singer*, musicals such as *Show Boat* tens of thousands of works copyrighted under earlier laws and poised to enter the public domain were covered until at least 2019.

The law ensured that the estates of writers and composers would continue to collect royalties from the artists' works. It was also crucial for large publishing houses and movie studios like Disney and Warner Bros., which rely on revenues from licensing their old copyrighted products. (Mickey Mouse, copyrighted in 1928 as Steamboat Willie, would have entered the public domain in 2004; Mickey - through Disney's consumer products division and theme parks helped bring in $8 billion in 1998, according to the New York investment bank Salomon Smith Barney.)

The Bono Act, however, also affected noncommercial interests like Eldred's. He could still publish *The Scarlet Letter*, but a couple of favorites were now off-limits: an out-of-print collection of stories by Sherwood Anderson, *Horses and Men*, and an edition of Robert Frost's poetry collection *New Hampshire*, , the only one, Eldred claims, with the correct punctuation. Both works, published in 1923, were covered under Bono.

Eldred wasn't just angry about the act's impact. He and other critics didn't like the way the bill became law. In 1995, it had been introduced in the House and the Senate, and both chambers held hearings. But the bill never made it out of committee, because restaurant and bar owners wanted a broader exemption on paying royalties for music broadcast in their establishments. It took three years for the restaurateurs to win their exemption. The bill cleared the House in March 1998 but stalled in the Senate. Finally, in October, just before the end of the congressional term, a similar version reached the Senate floor, passed by unanimous consent, and cleared the House the same day in a voice vote. No members of Congress had to go on record with their votes. It didn't help the bill's critics that the Starr Report had recently been delivered and the Washington press corps was preoccupied with the midterm elections and Bill Clinton's impeachment hearings.

Opponents thought the bill had been slipped through when no one would notice. "There wasn't any debate," says Eldred, "no public consideration of the trade-offs being made. Where were the people charged with protecting the public domain historians, archivists, free speech advocates? I was writing letters to newspapers, trying to get attention to the issue. But the public didn't realize what was going on; they didn't understand the consequences."

One person who had come forward was Arizona State University law professor Dennis Karjala, a copyright expert [...]. "For the first time in our history, almost nothing is entering the public domain," says Karjala. "You have some famous copyrights in danger of expiring. Their owners didn't relish their money stream drying up."

Many of these copyright owners had made it clear to Congress that they wanted an extension bill passed. According to the nonprofit Center for Responsive Politics, in Washington, media companies and their political action committees contributed more than $6.5 million to members of Congress during the 1997-98 election cycle. Representative Howard Coble, a Republican from North Carolina and cosponsor of the House bill, got $63,000 in individual and PAC donations. A Senate cosponsor, Republican Orrin Hatch of Utah, received $50,000 from major donors, including the seven major movie studios, the Motion Picture Association of America, and the American Society of Composers, Authors, and Publishers.

Disney was one of the biggest donors. Eight of the Senate bill's 12 sponsors received contributions from Disney, as did 10 of the original House bill's 13 sponsors. Democrat Patrick Leahy of Vermont, the ranking minority member on the Senate Judiciary Committee (which passed the bill) and a man who very publicly forgoes PAC contributions, got nearly $20,000 from individual Disney employees. (Only Time Warner's employees contributed more. They gave Leahy $36,000.)

Disney chairman Michael Eisner even lobbied personally. One week after he flew to Washington to meet with Senate Majority Leader Trent Lott of Mississippi, Lott signed on as a cosponsor. That day, Lott's campaign committee received a check from Disney for $1,000, and 11 days later, Disney donated $20,000 in unrestricted "soft money" to the National Republican Senatorial Committee.

The reason for all this lobbying was clear: Even bigger money - was at risk. As the Bono bill's advocates pointed out, the nation's "copyright industries" - publishing, film, music contributed $280 billion to the US economy in 1996. Though most of these revenues come from recent works, old copyrights are also highly lucrative. The Rodgers and Hammerstein Organization, for instance, earns $10 million annually in royalties and licensing fees. A nationwide license for a Gershwin song, worth between $45,000 and $75,000 15 years ago, now earns more than $250,000. (George Gershwin's *Rhapsody In Blue*, copyrighted in 1924 and scheduled to enter the public domain on January 1, 2000, under the old law, became United Airlines's theme song for an estimated $500,000.)

Perhaps the lobbyists' most effective argument was that American copyright law should be made to conform with that of the European Union, where most American culture is consumed. The PACs noted that America's intellectual property is its most successful export, earning $60 billion annually on foreign shores. If US law was not harmonized with the European standard of "life plus 70 years," copyrights on US media would expire in

Europe before they did at home, unfairly penalizing American corporations and creators. Rock star Carlos Santana, speaking for his colleagues, testified, "I find it unacceptable that I am accorded inferior copyright protection in the world marketplace."

Protect American interests abroad who could argue with that? Senator Edward M. Kennedy remarked in the Senate Judiciary Committee report: "Harmonization [with European law] will yield significant economic benefits to our Nation generally and to our creators in particular - benefits which, in turn, will stimulate future creativity and eventually lead to a broader and richer public domain." Republican Senator Strom Thurmond of South Carolina later concurred: "This bill will greatly benefit the American copyright community."

To professor Karjala, though, Bono was little more than corporate welfare. "The media companies gave heavily in return for extra protection," he says. "It's as simple as that." He calls the harmonization argument a smokescreen. "Our trade surpluses [with Europe] are dependent on current works like *Jurassic Park*, not on the relatively few works from the 1920s and 1930s whose copyright owners benefit from term extension. The biggest market for these older works is right here at home. So it's mainly American consumers who wind up paying more. It's hard to argue that the law would have much impact on our balance of trade."

* * *

[Daren Fonda is a freelance writer based in New York City]

Supreme Court to Review Copyright Term Extensions

E-Business Law Bulletin

March 18, 2002

The U.S. Supreme Court will decide whether Congress violated the Constitution when it passed the Copyright Term Extension Act of 1998, which added 20 years to the length of copyrights for existing works. The Constitution says copyrights should last for only a limited time, but Congress' repeated term extensions, most recently embodied in the CTEA, amount to a perpetual term of copyright protection for authors, the plaintiffs argued. Eldred et al. v. Ashcroft, No. 01-618, cert. granted (U.S., 19-FEB-02).

Last February the U.S. Court of Appeals for the District of Columbia Circuit ruled that Congress had the authority to extend copyright protection terms for existing works without violating the Constitution's requirement that a copyright last for only a limited time.

The court's decision came in the wake of a challenge by a group of individuals, corporations and associations which sought to exploit creative works that would have entered the public domain but for passage of the CTEA.

The CTEA amended the Copyright Act, 17 U.S.C. Section 101 et seq., by extending the amount of time that certain types of copyrighted works would be protected and by applying the extension to both new works and existing works that were protected by copyright. It did not restore copyright protection for works that were already in the public domain at the time of enactment. The purpose of the CTEA was to bring U.S. copyright law in line with laws of the European Union.

The plaintiffs alleged that the CTEA violated both their First Amendment rights to exploit the works that would have entered the public domain and Article 1, Section 8 of the Constitution, the Patent and Copyright Clause. That clause states: "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."

In its ruling upholding the CTEA, the D.C. Circuit said the plaintiffs have no First Amendment interest in copyrighted works owned by others. The Copyright Act's fair-use provisions take care of concerns about copyright law impinging on free-speech rights, the court said.

The panel also rejected the plaintiffs' novel argument that copyrights in existing works cannot be extended because at the time of extension, the works are no longer original, since they have not changed in any way since they were created. The court said nothing in the Constitution prevents Congress from extending copyrights for existing works.

The panel rejected the plaintiffs' argument that it should interpret the phrase "limited Times" in light of the Copyright Clause's preamble, which states, "The Congress shall have power '[t]o promote the Progress of Science and useful Arts.'" In other words, the plaintiffs argued that "limited Times" means only the length of time necessary to achieve the purpose of "promot[ing] the Progress of Science and useful Arts."

Judge David B. Sentelle dissented from the majority opinion, saying the Constitution requires some "outer limit" for congressional power.

The 'Installment Plan'

The plaintiffs sought review of the decision from the Supreme Court, arguing that the CTEA will keep a wide range of works under copyright until 2019, or longer if Congress again extends the term of protection.

"By abstracting the term 'limited Times' from the full text of the Copyright Clause, the circuit court has rendered meaningless the Framers' plain and express intent to restrict the duration of monopolies over speech," the plaintiffs said in their petition. "Under the authority of this case, Congress can now continue the practice of extending the term of subsisting copyrights without limit. It can thus achieve a perpetual copyright term 'on the installment plan.'"

The Department of Justice urged denial of the petition.

"The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals," the DOJ said. "Petitioners cite no decision of any court holding that Congress cannot, consistent with the Copyright Clause, enact legislation that extends the term of existing copyrights. They cite no decision of any court striking down an extension of copyright terms on First Amendment grounds. And they cite no decision of any other court addressing, much less rejecting, the validity of the Copyright Term Extension Act of 1998."

The DOJ is represented by Solicitor General Theodore B. Olson, Assistant Attorney General Robert D. McCallum Jr., and DOJ attorneys William Kanter and John S. Koppel.

The plaintiffs are represented by Geoffrey S. Stewart, Daniel H. Bromberg and H. Brian Holland of Jones, Day, Reavis & Pogue in Washington, D.C.; Lawrence Lessig of the Center for Internet & Society at Stanford Law School in Stanford, Calif.; and Charles R. Nesson and Jonathan L. Zittrain of the Berkman Center for Internet & Society at Harvard University in Cambridge, Mass.

In Step with the World

The National Law Journal

March 6, 2002

Edward Samuels

The U.S. Supreme Court has granted certiorari in *Eldred v Ashcroft*, No. 99-5430, to review the holding by the U.S. Court of Appeals for the D.C. Circuit that the 1998 Sonny Bono Copyright Term Extension Act is constitutional. Some of the D.C. Circuit's reasoning may indeed be questionable. The court concluded that the preamble to the Constitution's copyright clause (granting Congress the power "To promote the Progress of Science and useful Arts, by securing" exclusive rights "for limited Times") "is not a substantive limit on Congress' legislative power." The court goes on to conclude that "copyrights are categorically immune from challenges under the First Amendment" because of the idea/expression dichotomy, the fair use doctrine and other limiting principles that already factor in the constitutional considerations. These extreme views oversimplify complicated issues.

But while the restrictive view of the D.C. Circuit may not be ideal, it would be a major mistake to jump to the other pole and hold that Congress does not have the power to grant copyright protection, as it did in the 1998 act, for the life of the author plus 70 years (for works created since 1978), or for a total of 95 years (for works created before 1978).

A 1978 extension, from a maximum of 56 years after publication, to life of the author plus 50 years, was simply a response to what had become the copyright norm in the rest of the world. Indeed, such a term was the minimal requirement without which we would not have been able to join the Berne Convention in 1988, almost exactly 100 years after it had been adopted throughout much of the rest of the world.

The 1998 extension, in turn, was designed to catch up to the term of copyright recently adopted throughout the European Union and by other countries. Under Article 7(8) of the Berne Convention, countries with a life-plus-70 term do not have to recognize the rights of foreign authors whose works have expired in their own countries. In other words, for American creators of books, music, movies and computer programs to take advantage of the additional 20 years of copyright in other countries, the United States had to extend its own term to life plus 70.

Professor Lawrence Lessig has spearheaded publisher Eric Eldred's case and argued on his behalf before the D.C. Circuit. In his recent book "The Future of Ideas," Lessig purports to explain the history of copyright term extensions. He characterizes them as essentially a power grab by giant American corporations bent on squeezing every last dollar from their copyrights. He doesn't even consider the international context in which Congress acted. Lessig suggests that the United States adopt a short copyright term, subject to renewal every five years. This proposal, or indeed any proposal for a term of less than life of the author plus 50 years, would be in violation of our treaty obligations under Berne.

WHAT'S NEW?

The argument that the 1998 act might be unconstitutional is perhaps strongest in its application to the extension of copyright terms for existing works. As emphasized by D.C. Circuit Judge David Sentelle in his dissent, such works have already been created. An extension of copyright is therefore not necessary to encourage their creation. Yet, it would be a dangerous analysis to accept Eldred's suggestion that every single amendment to the copyright act must be justified by a showing that it results in the creation of additional works. After all, the term extension did not take a single work out of the public domain; the copyrights in works published before 1923 were not revived.

The only "retroactive" application of the amendment was to extend the term of copyright for works that had not yet expired and fallen into the public domain. While Eldred may have had an expectation that certain works would go into the public domain at some future date, and that he would be able to publish them without limit, that expectation was still subject to the power of Congress to extend the term of copyright before its actual expiration. Indeed, the much more likely candidate for constitutional attack is 17 U.S.C. 104A, the only general copyright amendment that specifically restored copyright in works already in the public domain. That amendment was also driven by international considerations, in this case the requirements of the Uruguay Round Agreement of the World Trade Organization.

It may be appropriate for the Supreme Court to reject the D.C. Circuit's restrictive reading of the constitutional limits on Congress in passing copyright laws, but a reversal and remand for further proceedings would put the whole of copyright law under an unnecessary constitutional cloud. The high court should instead apply its own constitutional analysis -- a flexible analysis -- to the issue of congressional power in this area. A proper constitutional test should not be simplistic and rigid, but should, as in other constitutional contexts, reflect a range of considerations based on some sense of reasonableness. Was it reasonable for Congress to pass a term extension act that brought the United States term into conformity with that in many other countries and allowed U.S. copyright owners to get the benefit of increased international protection? I believe that, on reflection, the extension adopted by Congress will meet any reasonable standard applied by the Supreme Court.

Breyer Seen as Key Justice on Copyright Issue

The National Law Journal

February 22, 2002

Victoria Slind-Flor

A key to the U.S. Supreme Court's handling of a major intellectual property case may lie in a law review article written by a young professor in 1970.

That professor, Stephen G. Breyer, is now a high court justice. But more than three decades ago, he published an article in the *Harvard Law Review* saying that courts should "hesitate to extend or strengthen" copyright protection. "The Uneasy Case for Copyright," 84 Harv. L. Rev. 281 (1970).

Breyer's piece seems to indicate that he is an opponent of what is generally called "copyright creep," by which the term of copyright protection has been extended 11 times since Congress was empowered in the Constitution to create copyrights and patents "for limited times."

On Feb. 18, the high court agreed to hear a challenge to the most recent term extension, one signed into law in 1998 granting protection for a work of art for 70 years after the death of its creator or 95 years for the creation of a work done for hire. *Eldred v Ashcroft*, No. 01-618.

Several leading IP lawyers surmise that it may well have been Breyer's interest in copyright issues that led the Court to agree to review the act.

Professor Thomas F. Cotter, who teaches intellectual property law at the University of Florida, says that Breyer's interest in the subject is so great that "we might expect" him to write the Court's opinion.

"The fact that they took the case indicates that at least some of the justices want to overturn the D.C. Court's opinion," says Morgan Chu, a partner at Los Angeles' Irell & Manella.

At Breyer's 1994 confirmation hearing, speaking of his law review article, he said, "I don't know that I have to change that view."

OTHER PLAYERS

Besides Breyer, well-known figures connected to the case include a legal academic of a libertarian bent; a now-dead member of a 1960s pop singing duo and his widow; the head of an entertainment trade group; and an animated rodent.

The Sonny Bono Copyright Term Extension Act of 1998 was named after its original proponent, the pop singer turned congressman who died in 1998 after hitting his head against a tree in a freak skiing accident. His widow, Mary Bono, succeeded to his seat in the House and continued his copyright campaign.

She told Congress "Sonny wanted the term of copyright protection to last forever," but added, "I am informed by staff that such a change would violate the Constitution." She proposed the change from 50 years past the creator's death to life plus 70 years and noted that Jack

Valenti, head of the Motion Picture Association of America, had suggested a term of "forever less one day."

Stanford University professor Lawrence Lessig thinks all three ideas stink. Lessig is the author of "The Future of Ideas," in which he warns that expansion of IP rights can stifle creativity and economic growth.

He is far from alone. Cotter calls the Bono Act "special-interest legislation that was crafted to satisfy the interests of copyright owners who were afraid their works would fall into the public domain in the next few years."

Cotter asks a question that other term-extension opponents often ask. The framers envisioned copyright as a vehicle to give authors a monopoly right for a limited period of time by offering them an incentive to create works. "But does continually extending the copyright term extend the progress of science and the useful arts? Just how much of an incentive do we need to give?"

Lessig challenged the new law in a District of Columbia suit in 1999. His plaintiff is Eric Eldred, a former government computer systems analyst who operates the Internet book publishing company of Eldrich Press from Derry, N.H. The trial court and the U.S. Court of Appeals for the D.C. Circuit upheld the law.

For his Supreme Court appeal, Lessig has assembled an impressive array of supporters, including the American Association of Law Libraries and most of the nation's leading legal copyright academics. Two conservative groups, the Washington-based Cato Institute and Phyllis Schlafly's Eagle Forum of Alton, Ill., have joined to submit an amicus brief on his side.

Lessig calls the law "the Mickey Mouse Protection Act." Before the measure passed, Disney copyrights on some of the earliest Mickey material were scheduled to expire in 2003. He says owners "are not going to give up without a fight over works they think are still valuable."

Daniel H. Bromberg, a Washington partner for Jones, Day, Reavis & Pogue, represents sheet music companies and film restorers that use work that is already in the public domain. Bromberg says the Bono bill perverts the framers' intent.

"The purpose of copyright power was not just to encourage existing authors, but also to create a public domain that would provide a source of enjoyment for the public and a source of inspiration to future authors and artists," he argues.

The 70-year-plus-life term puts the United States in conformity with Europe, notes Christopher Ottenweller, a Silicon Valley partner for Orrick, Herrington & Sutcliffe. If it is repealed, "you could have the loss of rights in one jurisdiction and the continuation of rights in another," he notes.

Many opponents to term extension say that it could limit the availability of material on the Internet. But Bart A. Lazar, a partner in Chicago's Seyfarth Shaw, says that "there is so much content on the Internet today that to pull 100,000 pieces a year off won't harm the Internet."

Irell & Manella's Chu says, "The Court will either uphold the statute as the D.C. Circuit did, strike down all or several of the extensions in the past, or just strike down the 95-year work-for-hire extension."

Chu sees an avalanche of legal work if the Court revokes the extension, particularly if the Court applies that revocation retroactively.

"The reliance of parties in entering into commercial transactions would have been misplaced," he says.

Studios May Have the Most to Lose Courts: The Ownership of Early Depictions of Favorite Characters and Music Could Be at Stake

The Los Angeles Times

February 21, 2002

Henry Weinstein, Ann W. O'Neill, and Meg James

Billions of dollars and the future earning power of some of the nation's most cherished cultural icons are at stake as the U.S. Supreme Court considers a constitutional challenge to a 1998 copyright extension law, legal experts said Wednesday.

The experts agreed that the high court's decision to consider Eldred vs. Ashcroft, until Tuesday an obscure appeal, could lead to the most important copyright decision in more than 100 years.

Movie studios, record companies, publishers and experts in intellectual property law were caught by surprise when the high court announced Tuesday that it would review a 1st Amendment challenge mounted by a coalition of Internet entrepreneurs and legal scholars to the 1998 Sonny Bono Copyright Term Extension Act. That act extended copyrights for an additional 20 years.

"This is a really big deal," said Stephen Gillers, vice dean of New York University Law School. "This case is sexy because it's about money and the arts at the same time."

"This is it," agreed Dennis S. Karjala, who teaches copyright and intellectual property law at Arizona State University Law School. "It's hard to think of a bigger copyright case" since the landmark 1879 decision that divided intellectual property into functional works, which are patented, and artistic works, which are copyrighted.

Any ruling by the Supreme Court would affect early depictions of Mickey Mouse, first copyrighted in 1928, and film classics such as "Gone With the Wind" and "The Wizard of Oz," novels such as "The Great Gatsby" and "The Sun Also Rises," as well as early jazz music and compositions by George and Ira Gershwin.

"I think just about everybody in the [entertainment] business will be impacted. Somebody's going to get hurt here," said Gerry Margolis, of Manatt, Phelps & Phillips.

David Nimmer, a visiting law professor at UCLA, said that although many of the recent copyright cases considered by the Supreme Court have affected just a narrow portion of copyright holders, "This case has the potential to affect every copyright owner."

Nimmer and Gillers predicted that with so much at stake, the Supreme Court case is likely to generate millions in new legal business.

"Probably billions of dollars ride on this decision, so millions of dollars will be spent on lawyers and amicus briefs and research on the history of copyright going back to King James," Gillers said.

Walt Disney Co. Chairman Michael Eisner said it was "too early to comment" extensively on possible fallout from any change in the copyright law. He attempted to minimize the impact.

"All that has happened is that two courts upheld Congress' extension of the copyright law, and we don't consider it unusual that it is going to the last court of appeal, the Supreme Court," Eisner said.

"If it went bad, and I don't think it will, we're talking about the very early images [of Mickey Mouse and others], we're not talking about our trademarks ... this is not taking away those values," Eisner said.

But legal and financial analysts anticipate a huge impact.

"The people who are freaking out are the studios," said Los Angeles lawyer Neville Johnson, who has a copyright infringement case involving a 1920s jazz song pending in U.S. District Court in Los Angeles. "It's Mickey Mouse, is why they're all freaked out."

"In the case of Mickey Mouse, this is a huge issue," agreed Kevin Lane Keller, a Dartmouth College marketing professor and an expert on Disney marketing. "Mickey has huge symbolic value and he still has a lot of commercial value.

"These characters and brands have so much earning potential," Keller said. "They can be licensed and merchandised in so many ways. The amounts are staggering. In a lot of cases, we're talking about billion-dollar brands."

Metro-Goldwyn-Mayer Inc. and Warner Bros., which have Hollywood's largest film libraries, also could feel a huge impact. The studios had no comment.

Wall Street analysts say it's difficult, if not impossible, to come up with an exact dollar value for some of the studios' most popular characters or movies. Companies are loath to put a value on their properties, and usually lump revenue from those characters or properties into "intangible assets."

But licensing revenue offers a glimpse into the value of some of these properties. For example, Disney has said that Winnie the Pooh and the Hundred Acre Woods characters generate a third of all of their licensing revenue.

In the late 1990s, Pooh generated $2 billion a year for Disney and its licensees.

Chris McGurk, chief operating officer at MGM, said, "Copyright is the only thing that protects us from people taking our properties, copying them, exploiting them, doing whatever they want for free."

MGM's James Bond franchise is said to be worth more than $1 billion for the Santa Monica studio. It is about a fourth of the estimated $5-billion value of MGM's 4,100 film library, analysts have said.

Supporting the appeal, copyright scholars and Internet entrepreneurs said the extensions have the unfortunate, and unintended, effect of burying works that could be resurrected. The Gershwin tunes and "The Great Gatsby" will live on, they said, and the copyright laws will determine only who profits from their existence.

To illustrate their point, they cited in court papers an exception to the rule. Frank Capra's 1946 film "It's a Wonderful Life" had a second life when its copyright was allowed to lapse because of an oversight. This forgotten movie "lay gathering dust in a movie studio until the early 1970s" when its copyright expired, the papers said.

Once it passed into the public domain, several public broadcasting stations aired it during the Christmas season. Within a few years, the forgotten film became a classic and a Christmas tradition.

But Margolis, whose firm represents high profile copyright holders, called such arguments disingenuous.

"We're not talking about people who want to make intellectual property available to the free world, we're talking about people who want to go into business," he said. "The opposition is not free-speechers. They're people who want to go into business and make a profit on what yesterday was someone else's property."

Arizona State's Karjala played a key role in organizing 60 law professors to send a letter to Congress in 1998 opposing the Sonny Bono law, contending that it "would impose substantial costs on the United States general public without supplying any public benefit."

He said Wednesday that the case "is an issue of tremendous importance. It is one where we simply can never expect Congress to follow the constitutional requirements because there is a built-in bias in the legislative process for copyright. The beneficiaries are organized and the general public is not organized. It's no one's fault. It's structural. It's a problem of democracy."

The Mouse That Ate the Public Domain : Disney, the Copyright Term Extension Act, and *Eldred v. Ashcroft*

FindLaw.com

March 5, 2002

Chris Sprigman

Unless you earn your living as an intellectual property lawyer, you probably don't know that the Supreme Court has granted certiorari in *Eldred v Ashcroft*, a case that will test the limits of Congress's power to extend the term of copyrights. But while copyright may not seem inherently compelling to non-specialists, the issues at stake in *Eldred* are vitally important to anyone who watches movies, listens to music, or reads books.

If that includes you, read on.

Mickey Mouse Goes to Washington

Back in 1998, representatives of the Walt Disney Company came to Washington looking for help. Disney's copyright on Mickey Mouse, who made his screen debut in the 1928 cartoon short "Steamboat Willie," was due to expire in 2003, and Disney's rights to Pluto, Goofy and Donald Duck were to expire a few years later.

Rather than allow Mickey and friends to enter the public domain, Disney and *its* friends a group of Hollywood studios, music labels, and PACs representing content owners told Congress that they wanted an extension bill passed.

Prompted perhaps by the Disney group's lavish donations of campaign cash more than $6.3 million in 1997-98, according to the nonprofit Center for Responsive Politics Congress passed and President Clinton signed the Sonny Bono Copyright Term Extension Act.

The CTEA extended the term of protection by 20 years for works copyrighted after January 1, 1923. Works copyrighted by individuals since 1978 got "life plus 70" rather than the existing "life plus 50". Works made by or for corporations (referred to as "works made for hire") got 95 years. Works copyrighted before 1978 were shielded for 95 years, regardless of how they were produced.

In all, tens of thousands of works that had been poised to enter the public domain were maintained under private ownership until at least 2019.

So far so good as far as Disney and its friends were concerned, at least. In 1999, a group of plaintiffs led by Eric Eldred, whose Eldritch Press offers free on-line access to public domain works, filed a challenge to the statute. Eldred argues that the CTEA is unconstitutional on two grounds: first, because the statute exceeds Congress's power under the Copyright Clause; and, second, because the statute runs afoul of the First Amendment by substantially burdening speech without advancing any important governmental interest.

Eldred lost before the district court and the D.C. Circuit. However, there is good reason to believe that he may yet prevail in the Supreme Court.

The CTEA Exceeds Congress's Copyright Clause Power

Most likely to succeed is Eldred's argument that the CTEA exceeds Congress's power under the Constitution's Copyright Clause (Article I, Section 8), which provides that

The Congress shall have Power . . . To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.

The Copyright Clause does two things. First, it empowers Congress to "promote the Progress of Science and useful Arts." Second, the text of the Copyright Clause limits the means that Congress may adopt in exercising the enumerated power. Congress is limited to granting rights to authors for "limited Times" there can be no perpetual ownership of intellectual property.

Clear thinking about the scope of Congress' Copyright Clause power requires careful separation of ends from means. The end the enumerated power itself is the promotion of progress, a fact the Supreme Court recognized in *Graham v John Deere Co*, where it held that the "qualified authority" that the Copyright Clause grants "*is limited to the promotion of advances in [science and] the 'useful arts'.*" In contrast, the copyright grant is not itself the enumerated power; it is merely the instrument through which progress may be realized.

Seen in this light, the CTEA cannot survive. Because already existing works cannot be created anew, extension of subsisting copyrights does not "promote progress." Congress is not empowered merely to provide copyright holders with an additional boon that is not "progress", but corporate welfare.

This is the point on which the D.C. Circuit's opinion in *Eldred* should collapse. The lower court relied on prior circuit authority holding that the "promote . . . Progress" language does not restrict Congress's power. But that authority is palpably at odds with the Supreme Court's statement in *Graham* that the promotion of progress *is* the Copyright Clause power.

The D.C. Circuit leaned also on a snippet in the CTEA's legislative history asserting that extending subsisting copyrights would encourage preservation of older works. But if Congress really wanted to encourage preservation, it could simply have offered the *quid* of an extended copyright in exchange for the *quo* of the copyright holder taking steps to preserve the copyrighted work for example, by digitizing it and depositing it in an electronic archive (such as the non-profit Internet Archive. There is no such *quid pro quo* in the CTEA; rather, the statute is a giveaway to content owners, a *quid pro nihilo*.

What About Future Copyrights?

The argument set forth above deals only with the CTEA's grant of retroactive extensions. Eldred advances another, somewhat more doubtful, Copyright Clause argument that applies to future extensions. The argument is that Congress's repeated extensions (the CTEA is but the latest of 11 acts that have stretched the copyright term from 14 years to beyond 100 years) have rendered meaningless the stricture that exclusive rights may be granted only for "limited times."

Eldred also advances a First Amendment challenge: both subsisting and future copyright extension, Eldred argues, substantially burden speech by foreclosing use of expression that would otherwise be available in the public domain, while advancing no important government interest. Lining the pockets of generous campaign contributors is not, Eldred maintains, a legitimate let alone important - government interest.

But although the CTEA may be struck down, Disney and its fellow media giants will inevitably be back in Congress pushing a substitute bill. Accordingly, it is worthwhile to consider briefly why copyright extension is bad policy, as well as bad law.

The CTEA vs. The Public Domain

When copyright expires, works are said to "fall into" the public domain, where they are usable without charge or need of authorization.

The linguistic convention by which works "fall" when they enter the public domain is revealing: immanent in the phrase is the notion that a work is debased when no longer copyrighted. Perhaps it is this view that allows statutes that shrink the public domain to gain widespread support.

But disparagement of the public domain is out of step with our constitutional history, with the economics of information markets, and with the real way in which art, literature, and music are produced in our culture.

The Framers, Viewing Intellectual Property As Monopoly, Sought To Constrain It

The Framers of our Constitution viewed inventions and expression not as "property", but as public goods to which exclusive rights may be granted purely as a means of incenting production. Thomas Jefferson expressed the then-dominant view with characteristic felicity in an 1813 letter:

If nature has made any one thing less susceptible than all others of exclusive property, it is the action of the thinking power called an idea, which an individual may exclusively possess as long as he keeps it to himself; but the moment it is divulged, it forces itself into the possession of every one, and the receiver cannot dispossess himself of it. Its peculiar character, too, is that no one possesses the less, because every other possesses the whole of it. He who receives an idea from me, receives instruction himself without lessening mine; as he who lights his taper at mine, receives light without darkening me . . . . Inventions then cannot, in nature, be a subject of property. Society may give an exclusive right to the profits arising from them, as an encouragement to men to pursue ideas which may produce utility, but this may or may not be done, according to the will and convenience of the society, without claim or complaint from anybody.

Correspondence between Jefferson and Madison regarding the drafting of the Copyright Clause evidences the same concern: both men classify copyrights and patents as "monopolies" sufferable only for limited periods, and only for the purpose of incenting invention.

We Don't Know How Much Incentive Is Enough, And How Much Is Too Much

Many policymakers (and even some intellectual policy mavens) view IP rights as a one-way street - they assume that the more IP rights we grant, and the broader and more durable we make those rights, the more society will benefit through increased production of books, music, movies, etc. The matter isn't even remotely that simple.

First, the creation of exclusive rights involves a difficult trade-off between *creation* and *dissemination*. To the extent that a piece of expression enjoys a market value, its price is likely to be higher if it is subject to copyright, as the copyright owner will be entitled to limit or eliminate competition in the provision of that expression to others. At the margin between life plus 50 and life plus 70 which is the margin in which the CTEA operates the proponent of a longer term should be prepared to show that the social value of the additional incentive outweighs the harm caused by another two decades of supra-competitive pricing and consequent reduced dissemination of valuable copyrighted work.

That is no mean task, not least because, as Professor (now Justice) Breyer observed in *The Uneasy Case for Copyright: A Study of Copyright in Books, Photocopies, and Computer Programs*, it is not clear that the promise of exclusive rights is a necessary prod to artistic creation:

Authors in ancient times, as well as monks and scholars in the middle ages, wrote and were paid for their writings without copyright protection. Taken as a whole . . . the evidence now available suggests that, although we should hesitate to abolish copyright protection, we should equally hesitate to extend or strengthen it.

What was true in ancient Greece and Rome and in medieval Florence is equally true today in Brooklyn's DUMBO painters paint, and writers write, for reasons other than the size of the royalty check. But even if you assume that exclusive rights do make some difference, there was no attempt back in 1998 (nor has there been since) to justify the CTEA's 20-year extension. Of course, \$6.3 million in campaign contributions can make up for quite severe deficiencies in the data.

Artists Depend On A Rich Public Domain

If we know little about the utility of longer copyright terms, there is abundant evidence regarding the vital importance to the progress of our culture of a robust stock of public domain works.

Most artists, if pressed, will admit that the true mother of invention in the arts is not necessity, but theft. And this is true even for our greatest artists. Shakespeare's *Romeo and Juliet* (1591) was taken from Arthur Brooke's poem *Romeus and Juliet* (1562), and most of Shakespeare's historical plays would have infringed Holingshead's *Chronicles of England* (1573). For the third movement of the overture to *Theodora*, Handel drew on a harpsichord piece by Gottlieb Muffat (1690-1770). Passages of both works are compared at this very interesting web site.

Cultural giants borrow, and so do corporate giants. Ironically, many of Disney's animated films are based on Nineteenth Century public domain works, including *Snow White and the Seven Dwarfs*, *Cinderella*, *Pinocchio*, *The Hunchback of Notre*

Dame, *Alice in Wonderland*, and *The Jungle Book* (released exactly one year after Kipling's copyrights expired).

Borrowing is ubiquitous, inevitable, and, most importantly, good. Contrary to the romantic notion that true genius inheres in creating something completely new, genius is often better described as opening up new meanings on well-trodden themes. Leonard Bernstein's reworking in *West Side Story* of *Romeo and Juliet* is a good example.

None of this is intended as an argument that art should be "freed" from copyright. Our copyright regime is almost as old as our Constitution, and the creation of exclusive rights for limited periods is as sensible an approach now as it was at the Founding. What is needed is a more balanced approach to assessing the costs and benefits of the expanding scope and duration of IP rights, including copyright terms. Perhaps if campaign finance reform succeeds in helping good arguments compete against ready cash, copyright will right itself.

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01-653 Federal Communications Commission v. NextWave Personal Communications
01-657 Arctic Slope Regional Corp. v. NextWave Personal Communications

Ruling Below: (NextWave v. FCC, D.C. Cir., 254 F.3d 130, 2001 U.S. App. Lexis 13923)

The court held the FCC violated federal bankruptcy law by revoking the broadband PCS license of the owner of the license for failure to pay under commission regulations.

Question Presented: Whether Section 525 of the Bankruptcy Code, 11 U.S.C. 525, which prevents government entities from revoking debtors' licenses solely for failure to pay debts dischargeable in bankruptcy, conflicts with and displaces the Federal Communications Commission's rules for congressionally authorized spectrum auctions, which provide that wireless telecommunications licenses obtained at auction automatically cancel upon the winning bidder's failure to make timely payments to fulfill its winning bid?

NEXTWAVE Personal Communications Inc. and NextWave Power Partners Inc., Petitioners
v.
FEDERAL COMMUNICATIONS COMMISSION and United States of America, Respondents;
BELLSOUTH Corportaion, et al., Intervenors

United States Court of Appeals
For the District of Columbia Circuit

Decided June 22, 2001.

TATEL, Circuit Judge:

This case concerns the extent to which the Bankruptcy Code limits a federal agency--here, the Federal Communications Commission--acting to implement the provisions of its own statute. Seeking to comply with its statutory duty to ensure small business participation in auctions of broadband PCS licenses, the Commission allowed winning bidders to pay for their licenses in installments. As part of this scheme, the Commission took and perfected security interests in the licenses, and provided for license cancellation should a bidder fail to make timely payments. When appellants, winning bidders on several licenses, declared bankruptcy and ceased making payments, the Commission canceled their licenses. Applying the fundamental principle that federal agencies must obey all federal laws, not just those they administer, we conclude that the Commission violated the provision of the Bankruptcy Code that prohibits governmental entities from revoking debtors' licenses solely for failure to pay debts dischargeable in bankruptcy. The Commission, having chosen to create standard debt obligations as part of its licensing scheme, is bound by the usual rules governing the treatment of such obligations in bankruptcy.

I

[Congress gave the Federal Communications Commission the authorization to award spectrum licenses via competitive bidding in 1993. Congress directed the FCC to (1) encourage development and rapid deployment of technologies, (2) make money off the licenses, (3) encourage the efficient and widespread use of the spectrums, and (4) promote competition by disseminating licenses to a wide variety of applicants. The FCC auctioned licenses for broadband personal communication services (PCS). To promote diversity among the successful bidders, it set aside two blocks of licenses for small businesses and allowed them to pay in installments. The FCC believed this would remove financing obstacles for such businesses, but announced that failure to pay on time would be grounds for revocation of the license.

NextWave Personal Communications, Inc. was awarded a number of licenses, upon which it made a down payment and filed agreements which gave the FCC first claim to the licenses should the company default on its payments. Subsequently, Nextwave had difficulty obtaining further financing, so the FCC suspended the company's payment obligations and offered it several ways to surrender some or all of the company's licenses for forgiveness of its debt. None of the restructuring options were appealing to Nextwave, and unable to work anything else out, it filed for Chapter 11 bankruptcy in New York.

The Bankruptcy Code provides for (1) an automatic stay on all attempts to collect or enforce debts, (2) an automatic stay on any attempt to obtain possession or control over property, with an exception for governmental units acting within their regulatory power, and (3) an automatic stay on any attempt to enforce any lien against property.

The bankruptcy court asserted jurisdiction on the basis that NextWave's claim did not involve regulatory conduct on the part of the FCC, but the debtor-creditor relationship between the FCC and NextWave. It agreed with NextWave that its bid far exceeded fair market value and voided the excess portion of the fee.

The Second Circuit reversed, and NextWave prepared a new plan to pay its entire debt, including interest and late fees. The FCC objected, arguing that the licenses had automatically cancelled when it missed its first payment deadline. The FCC then announced a public auction of NextWave's licenses. The parties returned to court.

The bankruptcy court declared the FCC cancellation null and void, being in violation of automatic stay provisions of the Bankruptcy Code. The court held that the timely payment requirement lacked a regulatory purpose.

The Second Circuit again reversed. It elaborated on its previous holding, emphasizing that the bankruptcy court may not interfere with the licensing decisions of the FCC.

NextWave filed a petition with the FCC, requesting reconsideration of the cancellation in light of the new plan. The FCC denied the petition on procedural grounds, but went on to discuss and reject the petition on the merits.]

* * *

NextWave now challenges the Commission's decision on two basic grounds. First, it claims that the license cancellation is "patently unlawful," Appellants' Opening Br. at 16, under the provisions of the Bankruptcy Code described earlier: the anti-discrimination provision (section 525), the automatic stay provision (section 362), and the provision of the Code allowing debtors to "cure" their defaults (section 1123). Second, citing our decision in *Trinity Broadcasting of Florida, Inc. v FCC*, 341 U.S. App. D.C. 191, 211 F.3d 618, 631 (D.C. Cir. 2000), where we held that an agency may not "sanction a company for its failure to comply with regulatory requirements" without first providing "fair notice" of those requirements, NextWave argues that even if the license cancellation is not barred by the Bankruptcy Code, it is invalid because the Commission failed to provide adequate notice that the timely payment regulations apply to Chapter 11 debtors. The Commission, supported by Intervenors (the Cellular Telecommunications Industry Association and several telecommunications companies) defends its decision.

II

[The court held it had jurisdiction under 47 U.S.C. § 402(b), which allows appeals from FCC decisions by holder of any station license, that NextWave filed a timely appeal, and that Nextwave's Bankruptcy Code arguments were not barred by res judicata.]

* * *

III

NextWave argues that the Commission's cancellation of its licenses violated sections 525, 1123, and 362 of the Bankruptcy Code. Under the Administrative Procedure Act, we must "hold unlawful and set aside agency action ... found to be ... not in accordance with law [or] ... in excess of statutory jurisdiction, authority, or limitations." 5 U.S.C. § 706(2). This provision requires us to invalidate agency action not only if it conflicts with an agency's own statute, but also if it conflicts with another federal law. [citations omitted].

* * *

We begin with section 525:

[A] governmental unit may not deny, revoke, suspend, or refuse to renew a license ... or other similar grant to, ... discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is ... a bankrupt or a debtor under the Bankruptcy Act ... solely because such bankrupt or debtor ... has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.

11 U.S.C. § 525(a). No one disputes that the Commission is a "governmental unit" that has "revoked" a license for purposes of section 525, nor that NextWave is a "bankrupt or a debtor under the Bankruptcy Act." Pointing to the fact that the Commission has filed proofs of claim in bankruptcy court based on its security interests in PCS licenses, *see, e.g.*, Proof of Claim, *In re NextWave Pers. Communications, Inc.*, No. 98 B 21529 (Bankr. S.D.N.Y. Dec. 16, 1998) (filed on behalf of creditor The United States of America), NextWave argues that the installment payment obligations were dischargeable debts under the Bankruptcy Code. *See* 11 U.S.C. § 1141(d) (stating that dischargeable debts under Chapter 11 generally include "any debts that arose before the date of ... confirmation" of the debtor's reorganization plan). And because failure

to make installment payments was the "sole triggering mechanism" for automatic cancellation, NextWave continues, its licenses canceled "solely because" it failed to pay dischargeable debts. Appellants' Reply Br. at 8.

The Commission never denies that if NextWave had made its payments, the company could have retained its licenses. Nor does the Commission dispute that NextWave's license fee obligations were at least in part genuine, enforceable debts-indeed, the Commission's own regulations provide for their collection if left unpaid. * * * Instead, the Commission offers a series of unpersuasive arguments intended to demonstrate why, notwithstanding section 525's apparent applicability, the provision does not bar cancellation of NextWave's licenses.

First, the Commission [...] [and] Intervenors suggest that "it would make little sense for Congress to exempt governmental 'regulatory' actions from the stay [under subsection 362(b)(4)] but then flatly forbid them in [section] 525. Basic structural coherence requires the conclusion that [section] 525 does not prevent a license cancellation already correctly found exempt from the stay as regulatory." Intervenors' Br. at 18.

This is an interesting argument, but it fails for several reasons. To begin with, it is inconsistent with section 525's plain language. Section 525 clearly and explicitly prohibits governmental units, for *whatever* reason, from canceling licenses for failure to pay a dischargeable debt * * * Various bankruptcy and district courts, accordingly, have held that section 525 can apply even if the automatic stay does not. [citations omitted.]

* * *

Moreover, contrary to Intervenors' argument, this interpretation of section 525 does not render the Code "structurally incoherent." Though this reading does mean that an action exempted under subsection 362(b)(4) might nonetheless be barred by section 525, it does not render subsection 362(b)(4) meaningless, because that subsection covers a different and wider variety of actions than section 525.

* * *

Even if the Commission were correct that section 525 should be read to permit all actions exempted from the automatic stay by subsection 362(b)(4), that argument would be inapplicable to this case because subsection 362(b)(4) does not apply to the stay of acts to "create, perfect, or enforce" liens against property of the estate or of the debtor imposed by subsections 362(a)(4) and (5). Here, NextWave executed security agreements giving the Commission a "first lien" on the company's interest in the licenses, and under subsections 362(a)(4) and (5), "a creditor holding a lien on property of the estate may not enforce the lien by seizure, foreclosure, or otherwise." 3 COLLIER ON BANKRUPTCY P 362.03[6] (15th ed. rev. 2000). Stayed actions include "self-help remedies against collateral" such as "repossession." *Id.* P 362.03[6][b]. Before the bankruptcy court, Commission counsel acknowledged that canceling the licenses and seeking to collect on the debt was "tantamount ... to foreclosing on collateral." Hearing Tr. at 14, *In re NextWave Pers. Communications, Inc.*, No. 98 B 21529 (Bankr. S.D.N.Y. May 26, 1999). Thus, contrary to the Commission's argument, and notwithstanding the applicability of the regulatory power exception, section 362's automatic stay *does* apply here. This is thus not a case in which section 525, if applicable, would bar an action exempt from the automatic stay.

The Commission next argues that section 525 is inapplicable because NextWave's license fee obligation was not a "dischargeable" debt. In support of this proposition, the Commission offers two arguments. First, it claims that the New York bankruptcy court could not have discharged NextWave's debt because the Second Circuit, whose decisions are binding on that court, held in its initial opinion that so long as NextWave retained its licenses, its payment obligation was subject to neither modification nor discharge in bankruptcy. As a result, the Commission concludes, the payment obligation was not a debt "dischargeable" in bankruptcy while the license was held.

We disagree. To begin with, it is unclear that the Second Circuit in fact thought the bankruptcy court lacked power to alter or discharge the payment obligation while NextWave held the licenses. [...] Even if the Commission's reading of the Second Circuit's opinion is correct, the Commission's argument assumes that the phrase "debt that is dischargeable ... under this title" in section 525(a) refers to the bankruptcy *court's* power to modify or discharge a payment obligation. The provision's plain language, however, refers to a payment obligation that can be modified or discharged under the Bankruptcy *Code*; and as we read the Second Circuit's opinion, the court merely decided that insofar as timely payment was a condition for license retention, the bankruptcy court had no authority to modify it. It never decided that a court of competent jurisdiction (such as this one) could not modify or discharge it under section 525.

The Commission also argues [...] that because (for legitimate regulatory motives) it made timely payment a regulatory requirement, it should be permitted to cancel licenses for failure to meet that requirement despite section 525's plain language ("a governmental unit may not ... revoke ... a license ... to ... a bankrupt ... solely because such bankrupt ... has not paid a debt that is dischargeable ... under this title"). But basic principles of statutory interpretation preclude such a result. To begin with, section 525 contains several exceptions, but none for agencies fulfilling regulatory purposes. * * * This in itself suggests that Congress did not intend to provide a regulatory purpose exception to section 525. * * * Moreover, other parts of the Bankruptcy Code contain explicit regulatory purpose exceptions. Section 362, as we have seen, exempts from certain provisions of the automatic stay any "governmental unit" exercising its "police or regulatory power." 11 U.S.C. § 362(b)(4). Section 362 also contains a series of narrower exceptions for certain named agencies that have entered lending relationships, allowing them to engage in particular acts of foreclosure and other actions. *See, e.g.*, 11 U.S.C. § 362(b)(8) (exception permitting HUD Secretary to foreclose on certain mortgages insured under the National Housing Act). To us, these express exceptions demonstrate that section 525 contains neither an implied regulatory power exception for governmental units in general nor an implied agency-specific exception allowing the Commission to enforce an automatic cancellation policy pursuant to an installment payment scheme under section 309(j) of the Communications Act.

* * *

Next, Intervenors argue that even if the license fee obligation itself is a dischargeable debt, the Commission did not cancel NextWave's licenses "solely because" of failure to pay that debt. * * * [The] license cancellation was intended not to induce payment but instead to "protect the integrity of [the] auction.

* * *

We are unconvinced. Intervenors argue that "solely because" should be read to mean "solely because of creditor interests in receiving the money due." But the statute says nothing about an agency's motives in canceling a license for failure to pay a dischargeable debt--it simply says governmental units may not cancel licenses "solely because" a debtor "has not *paid*" such a debt. *See* 11 U.S.C. § 525(a) (emphasis added). [...] Adopting Intervenors' intent-based reading of section 525 would allow governmental units to escape section 525's limitations simply by invoking a regulatory motive for their concern with timely payment, and as we have already explained, section 525 contains no implicit regulatory purpose exception.

... Intervenors point to legislative history stating that section 525 "does not prohibit consideration of ... factors such as future financial responsibility or ability ... if applied nondiscriminatorily," H.R. REP. NO. 95-595, at 367 (1977), and that "in those cases where the causes of the bankruptcy are intimately connected with the license grant ... an examination into the circumstances surrounding the bankruptcy will permit governmental units to pursue appropriate regulatory policies and take appropriate action without running afoul of bankruptcy policy." Duffey v. Dollison, 734 F.3d 265, 271. But these passages do not lead us to conclude that section 525 is inapplicable here. To begin with, we may not "resort to legislative history to cloud a statutory text that is clear." *Ratzlaf v United States*, 510 U.S. 135, 147-48, 126 L. Ed. 2d 615, 114 S. Ct. 655 (1994). Moreover, while the quoted passages do suggest that agencies may make regulatory decisions (including perhaps canceling the licenses of bankrupt debtors) based on factors such as future financial responsibility or ability, they do not state that an agency may use timely payment of a dischargeable debt as the sole indicator of such responsibility, as the Commission has done here. *Cf.* H.R. REP. NO. 95-595, at 165 ("The purpose of [section 525] is to prevent an automatic reaction against an individual for availing himself of the protection of the bankruptcy laws.").

* * *

Finally, noting that section 525 is entitled "Protection against discriminatory treatment," and that the House Report on the bankruptcy bill provides that section 525 "extends only to discrimination or other action based solely ... on the basis of nonpayment of a debt discharged in the bankruptcy case," H.R. REP. NO. 95-595, at 366-67, the Commission suggests that the provision is inapplicable here because "all licensees lost their licenses if they failed to meet the payment deadline." Appellee's Br. at 23.

The text of section 525, however, includes "discrimination" only as an item in a series of prohibited actions: "a governmental unit may not deny, revoke, suspend, or refuse to renew a license ... to, [*or*] condition such a grant to, [*or*] discriminate with respect to such a grant against, [*or*] deny employment to, [*or*] terminate the employment of, *or* discriminate with respect to employment against a person that is ... a debtor under this title...." 11 U.S.C. § 525(a) (emphasis added). Another prohibited action in the series is (as we have just seen) to "revoke" the license of a bankrupt "solely because such bankrupt" has "not paid a debt dischargeable" under the Bankruptcy Code--precisely what happened in this case. And the House

Report itself explicitly states that section 525 "extends only to discrimination *or other action* based solely ... on the basis of nonpayment of a debt discharged in the bankruptcy case...." H.R. REP. NO. 95-595, at 366-67 (emphasis added); *see also Walker v Wilde (In re Walker)*, 927 F.2d 1138, 1142-43 (10th Cir. 1991) (invalidating under section 525 a license cancellation policy that applied to bankrupts and non-bankrupts alike).

We have no doubt that in developing its installment payment plan, the Commission made a good faith effort to implement Congress's command to encourage small businesses with limited access to capital to participate in PCS auctions. We are also mindful that, as the Commission suggests, allowing NextWave to retain its licenses may be "grossly unfair" to losing bidders and licensees who "complied with the administrative process and forfeited licenses or made timely payments despite their financial difficulties." Appellee's Br. at 9. Any unfairness, however, was inherent in the Commission's decision to employ a licensing scheme that left its regulatory actions open to attack under Chapter 11 of the Bankruptcy Code, the very purpose of which is "to permit successful rehabilitation of debtors." *NLRB v Bildisco & Bildisco*, 465 U.S. 513, 527, 79 L. Ed. 2d 482, 104 S. Ct. 1188 (1984). * * * The Code expressly contemplates that bankrupts will sometimes avoid the consequences of late or non-payment they might have faced had they not filed for bankruptcy. * * * And the Code's restrictions have been applied even to the official actions of Government agencies. *See, e.g., Whiting Pools*, 462 U.S. at 209 (enforcing the Bankruptcy Code against the IRS to prevent seizure of property under a tax lien and concluding that "nothing in the Bankruptcy Code or its legislative history indicates that Congress intended a special exception for the tax collector"). Here, as we have explained, we think section 525 prevents the Commission, whatever its motive, from canceling the licenses of winning bidders who fail to make timely installment payments while in Chapter 11.

We do not think this conclusion frustrates the purposes of the Communications Act, because nothing in the Act required the Commission to choose the licensing scheme at issue here. Although section 309(j) suggests the possibility of using guaranteed installment payments of some kind, the statute also suggests alternative methods of facilitating small business participation. *See* 47 U.S.C. § 309(j)(4)(A). Indeed, in 1998, the Commission decided that "until further notice, installment payments should not be offered in auctions as a means of financing small businesses and other designated entities seeking to secure spectrum licenses." *See Competitive Bidding Proceeding*, 63 Fed. Reg. 2315, 2318-19 (Jan. 15, 1998). Moreover, irrespective of the Commission's decision to use installment payments as part of its licensing scheme, nothing in the Act required it to enter a creditor relationship with winning bidders, take liens on licenses, or--most important for our decision here--make timely payment a license condition. For example, the Commission could have required winning bidders to obtain third party guarantees for their license fee obligations, or required full upfront payment from C Block licensees and helped them obtain loans from third parties. The Commission could also have made license grants conditional on periodic checks of financial health, a more extensive credit check, or some other evidence that winning bidders were capable of using their licenses in the public interest. Having chosen instead a scheme that put it in a creditor-debtor (and lienholder) relationship with its licensees and conditioned licenses on timely payment of their debts, and having as a consequence run afoul of section 525 of the Bankruptcy Code, the Commission may not escape that provision's clear command simply because it acted for a regulatory purpose.

IV

In view of our conclusion that the Commission violated section 525 of the Bankruptcy Code in canceling NextWave's licenses, we need not consider NextWave's remaining Bankruptcy Code arguments, nor its arguments that the cancellation violated principles of due process and fair notice. We therefore reverse and remand to the Commission for proceedings not inconsistent with this opinion.

Justices Agree to Resolve Wireless Dispute

The Legal Intelligencer

March 5, 2002

Tony Mauro

The Supreme Court agreed yesterday to step into the multibillion-dollar battle over NextWave's effort to reclaim its prized wireless phone spectrum licenses.

With virtually every major telecommunications practice taking part in some aspect of the dispute, *Federal Communications Commission v NextWave Personal Communications*, No. 01-653, which will be argued in the fall, promises to be one of the next term's major business cases.

"There is so much money at stake, the court probably felt it had to settle it," said Donald Verrilli Jr. of Jenner & Block, who had opposed high court review on behalf of NextWave. NextWave stock fell in price in the hours after the court action was announced. NextWave is also represented by Gibson Dunn & Crutcher, whose former partner Theodore Olson argued for the company in the courts below. Olson, now solicitor general, has already recused himself in the case, leaving his deputy Paul Clement to sign the government briefs filed on behalf of the FCC. Olson's late wife, Barbara, also was a lawyer and lobbyist on behalf of NextWave and some of its investors.

NextWave had won a 1996 auction for the spectrum licenses with a $5 billion bid, but filed a Chapter 11 bankruptcy petition soon after, swept up in the crash of the wireless industry. It had paid a $500 million installment, but the FCC repossessed the licenses, prompting litigation by NextWave. A second FCC auction that ended in January 2001 produced bids of more than $15 billion for the same spectrum, and already more than $3 billion in deposits have gone into government coffers.

But last June, the U.S. Court of Appeals for the D.C. Circuit reversed the FCC's actions, producing what one lawyer described as a "train wreck" among bidders for the spectrum licenses. The appeals panel said the Bankruptcy Code precluded the FCC from canceling NextWave's licenses while the company was in Chapter 11.

In its petition to the high court, the FCC says the appeals court "effectively confiscated" the licenses from bidders who valued the spectrum more highly than NextWave, and that the decision "dramatically expands" the reach of bankruptcy law into regulatory decision-making.

Yesterday, FCC chairman Michael Powell welcomed the court's action to "clarify the relationship between public spectrum auctions and the U.S. bankruptcy laws."

The high court's action, which means that the dispute could go unresolved for a year or more, could also revive efforts to reach a settlement among the parties. Late last year, telecommunications companies and the government agreed to an arrangement in which the results of the second auction would stand and NextWave would also be compensated. But congressional approval was needed, and despite intense lobbying, Congress did not act on the agreement by a Jan. 1 deadline.

Michael Wack, NextWave senior vice president, indicated that the company is not bothered by the delay in finality that yesterday's court action signifies. "We're engaged in a rollout of our network in 95 markets, so we have a full plate through the end of this year."

* * *

NextWave's Wireless Rights to Get High Court Scrutiny

Bloomberg News

March 4, 2002

Greg Stohr and Jonathan Cox

The U.S. Supreme Court agreed to consider the Bush administration's attempt to reclaim 63 wireless licenses from NextWave Telecom Inc., reviving an industrywide dispute over airwaves once valued at $16 billion.

The justices will step into a six-year-old fight that centers on NextWave's bankruptcy reorganization and its efforts to keep the airwaves that are its only valuable asset. NextWave shares fell $3.10, or 53 percent, to $2.80.

The court may delay a resolution of the case for two years and comes at a bad time for an industry that is having trouble finding new subscribers. Companies such as Verizon Wireless Inc. and Cingular Wireless are looking to add capacity, possibly by buying the NextWave spectrum, so they can offer new services for existing customers. "The mess just got messier," said David Kaut, associate analyst with Legg Mason in Washington. "This adds a new round of litigation that a lot of people didn't think was going to happen. It scrambles the equation further."

The Federal Communications Commission wants to reinstate the results of a second auction it held after revoking the NextWave licenses because of missed payments. The second auction raised $15.9 billion from 21 carriers, including Verizon and companies backed by AT&T Wireless Services Inc. and Cingular.

The licenses cover metropolitan areas that include New York, Los Angeles, Boston and Washington.

Verizon Deposit

The justices will review an appeals court's decision that regulators can't revoke the licenses and must wait in line for payment with other NextWave bankruptcy creditors.

The court will hear appeals of that ruling from both the Bush administration and a group of companies that includes Deutsche Telekom AG's VoiceStream Wireless Corp.

Verizon at one point was pressing its own Supreme Court petition in the NextWave case. The company then dropped that appeal and now wants the U.S. to give back the $1.7 billion down payment it made in the second auction.

"We want finality and we want our deposit back now," Verizon Wireless spokesman Jim Gerace said. All told, companies may revive demands for refunds totaling $3.2 billion.

Verizon shares fell 66 cents to $47.93. Shares of BellSouth, an owner of the Cingular venture, rose 31 cents to $39.71. AT&T Wireless fell 29 cents to $8.31.

More Litigation

Supreme Court review may add two years to the litigation. If the court were to side with the government, the case would return to the appellate court level, where NextWave could press additional arguments for keeping the spectrum. The high court will schedule oral arguments and rule by June of next year.

NextWave won the airwaves with a $4.7 billion bid at a 1996 auction designed to put spectrum in the hands of fledgling wireless companies. The value of the frequencies quickly fell, in large part, NextWave says, because the FCC flooded the market with additional airwaves.

The company filed for bankruptcy protection after paying only $500 million. NextWave now says it can pay the full amount.

"We are disappointed that there will be additional litigation and the accompanying delay to full commercial deployment of our licenses," NextWave Senior Vice President Michael Wack said.

NextWave last year said it had lined up $5.5 billion in financing to build a nationwide network. That figure includes a $300 million investment from Qualcomm Inc. and a $2.5 billion loan commitment from UBS Warburg LLC.

Settlement Talks

NextWave and its more established rivals may now enter a new round of settlement talks, some analysts said. The Hawthorne, New York, company may have to settle for less than the $5 billion it would have received under a plan last year involving Verizon, Cingular, Sprint PCS and AT&T Wireless.

NextWave's settlement position is now "grossly impaired," said Christopher J. Wright, a Washington telecommunications and appellate lawyer with Harris, Wiltshire & Grannis and former FCC general counsel. "The Supreme Court reverses about two-thirds of the cases it hears."

Gerace, however, said Verizon Wireless was skeptical the sides could reach a settlement. The earlier agreement collapsed when Congress didn't approve it by the Dec. 31, 2001, deadline.

"We don't think another settlement is realistic given that the FCC is really interested in winning the case," Gerace said.

Verizon may try to get some of the airwaves from NextWave at a lower price, analysts said. Mobile-hone companies

Similar Cases

The U.S. Court of Appeals for the D.C. Circuit concluded the FCC had no right to rescind the NextWave licenses. The 3-0 ruling pointed to a provision in federal law barring the government from revoking a license solely because an entity "has not paid a debt that is dischargeable" in bankruptcy.

The government argues that the FCC licensing rules supersede that requirement because the agency's interests go beyond the money it might collect.

"Only by requiring winning bidders to make good on their bid obligations can the commission prevent speculative or insincere bidding," the U.S. appeal said.

NextWave urged the Supreme Court not to hear the appeal, saying the lower court was correct.

"The FCC looked to one factor and one factor only in revoking the licenses: NextWave's nonpayment of a debt," the company argued.

The case is FCC v. NextWave Personal Communications, 01-653.

The Price of FCC Integrity: $15 Billion

Wall Street Journal

August 8, 2001

Harold Furchtgott-Roth

Earlier this year, a federal circuit court ruled that the Federal Communications Commission had unlawfully deprived NextWave Telecom of wireless licenses it had won at auction. On Monday, the government announced it was appealing to the Supreme Court.

Government officials claim the appeal is necessary to preserve the "integrity of the auction process" by which the licenses were assigned. While there are doubtlessly many reasons the government has appealed the decision, integrity is not one of them. The primary reason for the appeal is money, and lots of it.

If it stands, the lower-court decision means the sudden disappearance of more than $15 billion in federal receipts--money the FCC made by rashly reauctioning NextWave's licenses before the court decisions. Federal government circles are abuzz with the problem of how to make up the shortfall. But the real scandal is why the government ever risked its own integrity to trample property rights.

As required by a new law, the FCC began auctioning rights for licenses among competing parties in the mid-1990s. A simple auction process as required by law would be difficult to violate, but the FCC tarnished the integrity of the process by allowing winning bidders to pay through installments, a method not required by law.

NextWave, a once-and-future wireless company, sought bankruptcy protection after having acquired many wireless licenses in auctions, but having only partially paid for them. The government and NextWave went to court. The government claimed that, by nonpayment of debt, NextWave forfeited the licenses. NextWave claimed the rights to the licenses remained its property in bankruptcy court. The federal government tried different tacks in a series of court battles. But after the recent circuit court's unusually stinging decision in favor of NextWave, the government is looking at very long odds by appealing to the Supreme Court.

To complicate matters further, the FCC, in the middle of litigation, recklessly reauctioned the disputed NextWave licenses--over objections from both inside and outside the agency. A champion of the integrity of the auction process--as the FCC now claims to be--would not have held the auction for at least three reasons.

First, the FCC did not have clear legal control of the licenses; pending litigation might, and subsequently did, return them to NextWave. The FCC even stipulated to the court that, should NextWave prevail, it would receive the licenses.

Second, the litigation was expected to end in a matter of months, giving little reason not to wait for legal resolution.

Third, the mere spectacle of auctioning property of dubious legal ownership would frighten away legitimate bidders. And those who would participate in such an auction would doubtless bid less than they would if the commission had clear title. Even if the FCC were to have won in court, American taxpayers would have been better off if it had waited to get clear title.

Companies such as Verizon, VoiceStream, and new affiliates of AT&T and Cingular bid in excess of $15 billion for the rights to the NextWave licenses. The auction participants were betting that the FCC would ultimately prevail in court, but they calibrated their bids downward to account for the legal risk. Some tried to reduce the risk by making substantial efforts to buttress the FCC's doomed position in court.

The prospect of money blurred legal and even moral decisions. Not only did the FCC vigorously promote and support the reauction, but other parts of the federal government did as well. The Department of Justice helped with litigation. The budget agencies treated the winning bids, which were little more than lottery tickets, as if they were money in the bank.

Unfortunately, a government that yielded to temptation rather than better judgment has yet to grasp the errors of its ways. Governmental discussions have not revolved around how to compensate NextWave or the parties induced to participate in what courts have now ruled to be an unlawful auction. No, the government's foremost concern seems to be how it will fill the $15 billion shortfall. The FCC is reportedly considering offering NextWave some money to go away. The implicit threat is that, if NextWave declines a lowball offer, it will suffer a death by a thousand cuts in the regulatory process.

It is not too late for the government to redeem itself. Salvation rests not in finding some or all of the $15 billion it never owned. Rather, redemption comes when it sobers up and answers a harder question: Why was it recklessly gambling on its integrity and moral authority in the first instance?

New Kids on the Block ; PCS Challenges Cellular Duopoly

RCR Wireless News

July 30, 2001

Kristen Beckman

The cellular industry was barely 10 years old when competitors started knocking on the door. In the early 1990s, Nextel Communications Inc. was amassing specialized mobile radio licenses and formulating a digital plan to make it a serious threat to cellular carriers. Meanwhile, a new brand of services was in its infancy-personal communications services.

PCS has its roots in Great Britain. The Department of Trade and Industry in 1989 published "Phones on the Move," an outline of a personal, wireless telecommunications service that would compete with cellular and other existing mobile services. In June 1989, the British government awarded three companies licenses to initiate two-way wireless communications services using Groupe Speciale Mobile communications technology.

A handful of U.S. companies borrowed the British idea and obtained licenses to test the new services here. APC and PCN America petitioned the Federal Communications Commission to allocate spectrum for PCS, which envisioned an all-digital network providing improvements in service quality. Tom Stroup, a former president of the Personal Communications Industry Association, was involved with trying to free spectrum at the FCC for PCS. While Stroup said the process of getting spectrum allocated was arduous, he said the commission was receptive to the idea, and the proposal was moved through the process as quickly as could be hoped given the size of the spectrum and the task of getting all the commissioners to agree on it.

"Certainly there were lots of intra-industry battles as to how many licenses should be allocated, whether there should be preferences, whether there should be restrictions on the amount of spectrum any one company could obtain," said Stroup.

The FCC allocated 220 megahertz of spectrum in the 1.8 GHz to 2.2 GHz band for PCS in January 1992, and included in its framework a provision for including entrepreneurs. It also awarded pioneer's preference licenses to PCS innovators including American Personal Communications, Cox Enterprises and Omnipoint Corp.

On Dec. 5, 1995, the government kicked off the A- and B-block broadband PCS auction, attracting a variety of bidders including Craig McCaw, who later dropped out. AirTouch, Bell Atlantic, Nynex and U S West banded together to bid on licenses under the name PrimeCo, and Sprint joined with cable giants Comcast Corp., Cox Communications Inc. and Tele-Communications Inc. to bid for licenses under the WirelessCo name.

The auction, which drew 18 bidders, lasted three months and netted $7 billion for 99 licenses. The big winners at the auction included WirelessCo, which walked away with 29 markets for $2.1 billion; AT&T, which bid $1.68 billion for 21 markets; and PCS PrimeCo, which bid $1.1 billion for 11 markets.

Energized by its initial success, the FCC was anxious to begin the C-block auction, which was set aside for entrepreneurs, but it was hampered by legal challenges. After several fits and starts, the C-block auction finally began one year later.

But prices quickly skyrocketed in the C-block auction, and many players were forced to drop out. The auction officially brought in $10.2 billion, $4.2 billion of which was committed by NextWave Personal Communications Inc., the largest bidder in the auction. The other notable winners in the C-block auction were DCR PCS Inc., GWI, BDPCS, Omnipoint, Chase PCS 2000, 21st Century, Wireless PCS and Urban. Questions immediately followed about how winners would pay for their new licenses. Companies began defaulting on their down payments within weeks. The eventual fallout from the auction included defaults, bankruptcies and re-auctions that continue to haunt the wireless industry today.

The final three blocks of PCS spectrum were auctioned off in the fall of 1996.

"The interesting thing from my perspective was bringing people with a background in auction theory in to speak to our members and giving them an idea what to expect," said Stroup, who is now president and chief executive officer of GroupServe Inc. "It was amazing to me how many of the things that were predicted came true, in terms of how it becomes an emotional process, how it's so easy to overbid for spectrum or for anything."

Meanwhile, APC commercially launched its PCS network on Nov. 15, 1995, in Washington, D.C., marking the beginning of the commercial PCS industry. Newly licensed PCS players had a significant challenge before them in trying to differentiate their service offering from those of the incumbent cellular carriers.

"The cellular industry was doing everything it could to stop it from happening," said Jay Kitchen, PCIA's president and CEO. "They did not want PCS to develop because it was competition, and they knew if they got competition it would drive the price down and their (return on investment) would drop dramatically as well. The cellular industry had its foot squarely on the air hose of the PCS industry."

Cellular carriers rushed to improve their systems to prepare for PCS competition. Opinions about how the new PCS service would fare varied, and some believed PCS wouldn't be able to compete head-on with cellular.

"The big challenge was when they turned on their systems, they were going to be competing with two companies that had some pretty good systems built out, and so they needed to be creative about how they positioned themselves," said Stroup.

The most immediate impact of new PCS competition was falling prices. PCS carriers entered the market with prices from 10 to 40 percent below cellular prices. PCS carriers also eliminated service contracts, which had been a mainstay in the cellular industry. Unable to match up with their cellular counterparts on coverage, PCS carriers focused instead on the messages of better quality, more features and better security with their services.

The PCS players faced other challenges as well. For the first time, carriers had to pay for licenses and bidders had to build a business plan based on forecasts of penetration and airtime rates for a service that had never before been offered.

Once they got licenses, PCS carriers were required to share in the cost of relocating microwave users that occupied the spectrum. PCIA established a cost-sharing structure that required the second and third carriers coming on to the frequencies to reimburse the first carrier for expenses they incurred while moving the microwave licensees off the frequencies, said Kitchen. PCIA also established a clearinghouse that identified more than a quarter of a billion dollars in cost-sharing obligations among PCS players.

Carriers also had to get systems built against a cellular industry that had a 10-year head start.

"The cellular carriers had the luxury of building out their systems more incrementally," said Stroup. "They received a substantial size territory and typically built from the core market outward. They really didn't face any competition other than the other carrier in the market.

"The PCS carriers really did not have that luxury," said Stroup. "They really needed to turn on a system with a wide footprint."

That created an additional problem for new PCS entrants-the ability to gather increasingly scarce resources needed to get their systems built.

"Trying to find people to handle the many aspects of building out as many systems as were under construction at one time, in addition to the cellular industry continuing to expand, was a challenge," said Stroup. "Just trying to find RF engineers was almost impossible."

Many PCS players were able to differentiate and ultimately contributed to the overall growth of the wireless industry.

"I think PCS has had tremendous impact, probably one of the most far-reaching impacts of anything that's happened in the wireless industry to date," said Kitchen. "It introduced a new technology, the most up-to-date digital technology at the time. It created competition, and through that competition, it drove prices down."

"The competition has created an environment for better service and also new service offerings, and I think we're going to see that continue as we go into this new generation," said Kitchen.

01-1243 Borden Ranch Partnership v. U.S. Army Corps of Engineers

Ruling Below: (Borden Ranch Partnership v. U.S. Army Corps of Engineers, 9th Cir., 261 F.3d 810, 2001 U.S. App. Lexis 18364, 52 ERC (BNA) 2025, 2001 Cal. Daily Op. Service 7056, 2001 Daily Journal DAR 8683, 32 ELR 20011.)

The court held that deep ripping disgorged large amounts of soil into protected wetlands and caused the destruction of those wetlands. Deep ripping was not the same as normal plowing, which would be exempt under the Clean Water Act. Tsakopoulos was in violation of the Clean Water Act, and could be penalized for each violation of the Act, not just each day he conducted activities violating the Act.

Questions Presented: (1) Whether deep ripping in a wetlands for farming purposes may result in a discharge of a pollutant for purposes of the Clean Water Act, 33 U.S.C. 1251 et seq.
(2) Whether each day in violation or each act in violation of the Clean Water Act should be counted in determining the maximum civil penalty under Section 309(d) of the Clean Water Act, 33 U.S.C. 1319(d).

BORDEN RANCH PARTNERSHIP; Angelo K. Tsakopoulos, Plaintiffs-Appellants,
v.
UNITED STATES ARMY CORPS OF ENGINEERS; United States Environmental Protection Agency, an agency of the United States, Defendants-Appellees.

United States Court of Appeals
For the Ninth Circuit

Decided August 15, 2001

HAWKINS, Circuit Judge:

This appeal concerns the authority of the U.S. Army Corps of Engineers ("the Corps") and the Environmental Protection Agency ("EPA") over a form of agricultural activity called "deep ripping" when it occurs in wetlands. We conclude that the Clean Water Act applies to this activity and affirm the district court's findings that Borden Ranch violated the Act by deep ripping in protected wetland swales. We reverse the district court's findings of liability with respect to isolated vernal pools in light of Solid Waste Agency of N. Cook County v. United States Army Corps of Eng'rs, 531 U.S. 159, 148 L. Ed. 2d 576, 121 S. Ct. 675 (2001), and remand for a recalculation of the civil penalties.

Facts and Procedural Background

[Borden Ranch was primarily used as rangeland for cattle, and contained a wide variety of aquatic habitats, including pools, wetlands, and drainage. These habitats depend on a layer of soil called the "restrictive layer" which keeps water from sinking deep into the earth.

Tsakopoulos bought the ranch and planned to convert it into vineyards and orchards, which require penetration through the restrictive layer. To accomplish this penetration, a process called "deep ripping" is used to disgorge the soil. A tractor pulls metal prongs between four and seven feet long through the earth.

The Clean Water Act requires individuals who wish to fill wetlands to get approval from the Corps. Tsakopoulos began without approval, but got retroactive permission, with limitations. Tsakopoulos went beyond the scope of the permit and was ordered to cease deep ripping after the Corp discovered his violation. Tsakopoulos continued to conduct deep ripping in violation of various agreements the Corp and EPA made with him. The EPA issued and Administrative Order to Tsakopoulos. In response he filed this lawsuit challenging the authority of the Corps and the EPA to regulated deep ripping. The United States filed suit in return.]

* * *

Analysis

I. Corps Jurisdiction over Deep Ripping

[The Clean Water Act prohibits the discharge of any type of pollutant, even soil, into the nation's waters, including wetlands near navigable rives. A permit from the Corps is required to conduct any such discharge.]

* * *

A. Discharge of a Pollutant

Tsakopoulos initially contends that deep ripping cannot constitute the "addition" of a "pollutant "into wetlands, because it simply churns up soil that is already there, placing it back basically where it came from. This argument is inconsistent with Ninth Circuit precedent and with case law from other circuits that squarely hold that redeposits of materials can constitute an "addition of a pollutant" under the Clean Water Act. *Rybachek v United States Envtl. Prot. Agency*, 904 F.2d 1276 (9th Cir. 1990), considered a claim that placer mining activities were exempt from the Act. We held that removing material from a stream bed, sifting out the gold, and returning the material to the stream bed was an" addition" of a "pollutant." Id. at 1285. The term" pollutant" encompassed "the materials segregated from gold in placer mining." Id.

Our reasoning in *Rybachek* is similar to that of the Fourth Circuit in *United States v Deaton*, 209 F.3d 331 (4th Cir. 2000). In *Deaton*, a property owner alleged that the Corps could not regulate "sidecasting," which is" the deposit of dredged or excavated material from a wetland back into that same wetland." Id. at 334. The property owner asserted that "sidecasting results in no net increase in the amount of material present in the wetland" and therefore could not constitute the "addition of a pollutant." Id. at 335. The Fourth Circuit squarely rejected this argument, in language that is worth quoting in full:

Contrary to what the Deatons suggest, the statute does not prohibit the addition of material; it prohibits the "addition of any pollutant." The idea that there could be an addition of a pollutant without an addition of material seems to us entirely unremarkable, at least when an activity transforms some material from a nonpollutant into a pollutant, as occurred here ....

* * *

These cases recognize that activities that destroy the ecology of a wetland are not immune from the Clean Water Act merely because they do not involve the introduction of material brought in from somewhere else. In this case, the Corps alleges that Tsakopoulos has essentially poked a hole in the bottom of protected wetlands. That is, by ripping up the bottom layer of soil, the water that was trapped can now drain out. While it is true, that in so doing, no new material has been "added," a "pollutant" has certainly been "added." Prior to the deep ripping, the protective layer of soil was intact, holding the wetland in place. Afterwards, that soil was wrenched up, moved around, and redeposited somewhere else. We can see no meaningful distinction between this activity and the activities at issue in *Rybachek* and *Deaton*. We therefore conclude that deep ripping, when undertaken in the context at issue here, can constitute a discharge of a pollutant under the Clean Water Act.

Tsakopoulos also contends that no case has ever held a plow to be a point source, and that a prohibited discharge must be from a point source. This argument has no merit. The statutory definition of "point source" ("any discernible, confined, and discrete conveyance") is extremely broad, 33 U.S.C. § 1362(14), and courts have found that" bulldozers and backhoes" can constitute "point sources, " *Avoyelles*, 715 F.2d at 922. In this case, bulldozers and tractors were used to pull large metal prongs through the soil. We can think of no reason why this combination would not satisfy the definition of a "point source."

B. The Normal Farming Exception

Tsakopoulos next contends, that even if deep ripping constitutes a discharge of pollutants, it is nonetheless exempt from regulation under the "farming exceptions, "which state that discharges "from normal farming ... and ranching activities, such as plowing" are not subject to the Clean Water Act. 33 U.S.C. § 1344(f)(1)(A). The section of the statute containing the farming exceptions, however, includes a significant qualifying provision:

Any discharge of dredged or fill material into the navigable waters incidental to any activity having as its purpose bringing an area of the navigable waters into a use to which it was not previously subject, where the flow or circulation of navigable waters may be impaired or the reach of such waters be reduced, shall be required to have a permit under this section.

33 U.S.C. § 1344(f)(2). Thus, even normal plowing can be regulated under the Clean Water Act if it falls under this so-called "recapture" provision. See Avoyelles, 715 F.2d at 925 (noting that § 1344(f)(2) can preclude the normal farming exceptions).

We conclude that the deep ripping at issue in this case is governed by the recapture provision. Converting ranch land to orchards and vineyards is clearly bringing the land" into a use to which it was not previously subject," and there is a clear basis in this record to conclude that the destruction of the soil layer at issue here constitutes an impairment of the flow of nearby navigable waters.

Although the Corps cannot regulate a farmer who desires "merely to change from one wetland crop to another," activities that require "substantial hydrological alterations" require a permit. *United States v Akers*, 785 F.2d 814, 820 (9th Cir. 1986). As we have explained, "the intent of Congress in enacting the Act was to prevent conversion of wetlands to dry lands[.]"

* * *

II. The Vernal Pool

[The court found that because of the recent Supreme Court ruling in *Solid Waste*, the Corps had no authority over one of the isolated pools at issue here.]

III. The District Court's Factual Findings

[The court recounted the evidence presented in the district court and found no clear error to support Tsakopoulos' claim that there was no evidence to support the district court's factual findings of deep ripping in protected swales.]

* * *

IV. The Civil Penalty

The district court found that Tsakopoulos had committed 358 violations of the Clean Water Act. It counted each pass of the ripper through a protected wetland as a separate violation. The statute provides for a maximum penalty of"$ 25,000 per day for each violation." 33 U.S.C. § 1319. The statutory maximum penalty was therefore $ 8,950,000. The court then considered a variety of factors in setting the penalty. The court found that Tsakopoulos "risked damaging rare federal wetlands because of his motivation to reap economic gain." The court also found an "absence of a good faith attempt to comply with the Act." The court accordingly set the penalty at $ 1,500,000, which is $ 7,450,000 below the statutory maximum. The court also allowed Tsakopoulos to suspend $ 1,000,000 of the penalty if he performed various restoration measures.

Tsakopoulos now makes three challenges to the district court's calculation of the civil penalty. We conclude that none of these arguments has merit.

A. Penalty Calculation per Violation

Tsakopoulos first contends that the penalty should have been based on the number of days in which illegal ripping occurred, not on the number of individual passes with the ripper. He argues that the statutory language "per day for each violation" means that he can only be assessed $ 25,000 for any day in which ripping violations occurred, regardless of the total number of rippings in that day.

We disagree. The statute imposes a maximum penalty" per day for each violation." 33 U.S.C. § 1319(d). It does not say "per each day in which violations occur" or" per day in which a party pollutes." The focus is clearly on each violation, and courts have consistently rejected attempts to limit civil penalties to the number of days in which violations occur. A contrary rule would encourage individuals to stack all their violations into one "Pollution Day," in which innumerable offenses could occur, subject only to the $ 25,000 maximum.

* * *

This case is about repeated filling of wetlands without a permit. Here, the landowner committed the same unlawful act repeatedly. Tsakopoulos argues that treating each rip as a separate violation could lead to nonsensical results in other cases. For example, a polluter who emitted 25,000 gallons of a pollutant into a stream continuously over the course of a day would be subject to a $ 25,000 maximum penalty, whereas a polluter who made three separate discharges of one gallon each would be subject to a $ 75,000 maximum penalty.

Tsakopoulos's position, however, also leads to irrational results. The incentive problems at issue in *Smithfield* are equally strong here. Once a wetland violation has occurred in part of a swale, Tsakopoulos's proposed rule would allow the landowner to rip away at the rest of the swale with impunity from that point forward, because no additional penalty could be imposed.

Although neither approach is free from difficulty, we believe the better rule is to treat each rip as a separate violation. This approach is more consistent with the statutory language, with prior judicial interpretations of the statute, and with the general policy goal of discouraging pollution. Tsakopoulos's concern about the disparate treatment of the polluter who emits several small amounts and the serial continuous polluter is not without remedy in the district courts. The district courts have substantial discretion in imposing penalties, and, as the *Gwaltney* court pointed out in response to a similar argument, the district court "could ...impose a substantially smaller penalty on [the] hypothetical polluter than on [the larger polluter]." 791 F.2d at 315.

In sum, we conclude that the district court correctly included each pass of the ripper as a separate violation. A limited remand for recalculation of the penalty is nonetheless in order. The district court included 10 passes through the vernal pool in its total of 358 violations. Since the government now concedes that it lacks jurisdiction over these violations, we remand to the district court to determine what, if any, reduction in the penalty is appropriate.

B. The Simpson Timber Consent Decree

Tsakopoulos argues that the penalty imposed here is significantly disproportionate to the penalty imposed in the settlement of violations by the Simpson Timber Company, which deep ripped 987 acres, but was subject only to a $ 30,000 penalty and a restoration order. [...]

The district court did not abuse its discretion. Tsakopoulos knowingly assumed the risk that litigation would result in a judgment more unfavorable than he might have attained through settlement. [...]

C. Further Reductions in Penalty

Tsakopoulos finally argues that the district court should have reduced the penalty further because of Tsakopoulos's good faith, the trivial nature of the violations, and the supposed uncertainty concerning the government's regulatory authority. The district court considered these arguments when setting the penalty (a penalty that was significantly lower than the statutory maximum). None of Tsakopoulos's arguments rises to the level necessary to demonstrate an abuse of discretion by the district court.

Conclusion

We affirm the district court's holding that deep ripping in this context is subject to the jurisdiction of the Corps and the EPA. We also affirm the district court's factual findings except with respect to the vernal pools. We remand for a recalculation of the civil penalties. Finally, we deny Tsakopoulos's request that this case be assigned to a different district judge on remand.

AFFIRMED IN PART, REVERSED IN PART, VACATED IN PART, AND REMANDED. Costs on appeal to appellees.

GOULD, Circuit Judge, dissenting:

I respectfully dissent. The crux of this case is that a farmer has plowed deeply to improve his farm property to permit farming of fruit crops that require deep root systems, and are more profitable than grazing or other prior farm use. Farmers have been altering and transforming their crop land from the beginning of our nation, and indeed in colonial times. Although I have no doubt that Congress could have reached and regulated the farming activity challenged, that does not in itself show that Congress so exercised its power. I conclude that the Clean Water Act does not prohibit "deep ripping" in this setting.

I would follow and extend *National Mining Association v U.S. Army Corps of Engineers*, 330 U.S. App. D.C. 329, 145 F.3d 1399 (D.C. Cir. 1998), and hold that the return of soil in place after deep plowing is not a "discharge of a pollutant." In *National Mining*, the court held that the Corps exceeded its authority under section 404 of the Clean Water Act by regulating the redeposit of dredged materials that incidentally fall back in the course of dredging operations. The court explained that "the straightforward statutory term 'addition' cannot reasonably be said to encompass the situation in which material is removed from the waters of the United States and a small portion of it happens to fall back." 145 F.3d at 1404. [...]

Those considerations are persuasive here as deep ripping does not involve any significant removal or "addition" of material to the site. The ground is plowed and transformed. It is true that the hydrological regime is modified, but Congress spoke in terms of discharge or addition of pollutants, not in terms of change of the hydrological nature of the soil. If Congress intends to prohibit so natural a farm activity as plowing, and even the deep plowing that occurred here, Congress can and should be explicit. Although we interpret the prohibitions of the Clean Water Act to effectuate Congressional intent, it is an undue stretch for us, absent a more clear directive from Congress, to reach and prohibit the plowing done here, which seems to be a traditional form of farming activity.

[The dissent distinguished *Rybachek* from this case. The miners in *Rybachek* were removing soil from the waterways, sifting it, and the discharging the remaining soil back into the water. This dumping required geographical movement of the materials for a certain period of time. The deep ripping neither moves material any distance nor displaces the material for any period of time.]

* * *

Nor is the Fourth Circuit's opinion in United States v. Deaton, 209 F.3d 331 (4th Cir. 2000), relied on by the majority, persuasive to me in the context presented. A farmer who plows deeply is not, in my view, redepositing dredged or excavated materials. While the Fourth Circuit relied on the fact that a "dredged spoil" is a statutory pollutant, the deep plowing activity here, in my view, is not the same as dredging dirt from and redepositing it in waters.

Also, even assuming that deep ripping can be viewed as a discharge of a pollutant into navigable waters, it seems at first consideration exempt as a normal farming activity. The Clean Water Act exempts normal farming activity, including plowing. See 33 U.S.C. § 1344(f)(1)(A).

The exemption as cast by Congress is not limited to shallow plowing, but would appear literally to cover the deep plowing technique referred to as deep ripping. This exemption, however, does not apply by its terms to "any activity having as its purpose bringing an area of the navigable waters into a use to which it was not previously subject." See 33 U.S.C. § 1344(f)(2). Moreover, the Corps of Engineers, by regulation, has provided explicitly that the plowing exemption does not include "redistribution of soil, rock, sand, or other surficial materials in a manner which changes any area of the waters of the United States to dry land." 33 C.F.R. § 323.4(a)(1)(iii)(D). The Corp's regulation, which we upheld in *United States v Akers*, 785 F.2d 814, 819-20 (9th Cir. 1986), must be read consistent with the statute's terms. Although this limitation defeats the exemption for any deep ripping that had the purpose of transforming land, it does not, in my view, defeat the exemption as to any unintended impairment. Most violations found by the district court involved a purposeful attempt to transform the land. But some of the transgressions (indentations in swales caused by moving the deep ripper to different locations) found by the district court here were apparently unintentional, or at least there was no finding by the district court of purposeful modification as to all of the violations.

I would hold that the district court erred in finding that the activities here required a permit and otherwise violated the Clean Water Act. The problem of interpretation here arises because Congress prohibited the discharge or addition of any pollutant to navigable waters from any point source. It did not literally prohibit any conduct by farmers or ranchers that changes the hydrological character of their land. The majority opinion, motivated perhaps by the purposes of the statute, makes new law by concluding that a plow is a point source and that deep ripping includes discharge of pollutants into protected waters. The policy decision involved here should be made by Congress, which has the ability to study and the power to make such fine distinctions. [...] The alternatives are an agency power too unbounded or judicial law-making, which is worse. I respectfully dissent.

Farm Case Wins High Court Review

Scripps Howard News Service

June 11, 2002

Denny Walsh

The U.S. Supreme Court agreed Monday to review a face-off between Sacramento developer Angelo Tsakopoulos and federal environmental regulators that could change the way the Clean Water Act is applied to the nation's farmers.

The case involves deeper than normal plowing called "deep ripping" that Tsakopoulos employed to convert thousands of acres of rangeland at his Borden Ranch near Galt to fruit crops. Two lower courts found that the plowing destroyed seasonal wetlands protected by the Clean Water Act.

At issue is whether plowing, at whatever depth, constitutes a "discharge" of fill material or the addition of a "pollutant" into drainages defined by the act as waters of the United States. The other issue is whether plowing is exempt by statute as a "normal farming activity."

Tsakopoulos and his daughter, Eleni Tsakopoulos-Kounalakis, said they were pleased by the Supreme Court's action.

"We believe it is critically important to farmers across the country that the government's desire to regulate how deep we set our plow be overturned," said Tsakopoulos-Kounalakisshe, who is serving as a spokeswoman for her father in the matter.

The multibillion-dollar agriculture industry is looking to the case to tell it where deep-root crops may be planted.

The high court does not disclose vote counts on whether to accept cases for review. All of the justices review requests, and four of the nine must be in favor.

Justice Anthony Kennedy, who is from Sacramento, "took no part in the consideration or decision of this petition," according to a notation on the court's Monday order list. Kennedy is "an acquaintance" of the Tsakopoulos family, according to Tsakopoulos-Kounalakis.

Deep ripping, which penetrates a dense layer of soil called a "restrictive layer" or "clay pan," has been used by Tsakopoulos since 1993 to turn pastureland into vineyards and orchards on the 8,400-acre ranch that straddles the Sacramento County-San Joaquin County line.

He and his lawyers have consistently argued that long-established farming practices should be immune from the meddling of regulators and have from the beginning cast the legal battle as "a national test case." When he sued the U.S. Army Corps of Engineers and Environmental Protection Agency more than five years ago, Tsakopoulos vowed to take his challenge to the Supreme Court, if necessary.

A split three-judge panel of the 9th U.S. Circuit Court of Appeals last year affirmed U.S. District Judge Garland E. Burrell Jr.'s finding that deep plowing is subject to the jurisdiction of the Corps of Engineers and the EPA, and there must be prior approval by the Corps.

The Pacific Legal Foundation, the California Farm Bureau Federation and the California Cattlemen's Association filed a joint brief with the appellate court in support of Tsakopoulos. The American Farm Bureau Federation and the National Association of Home Builders also weighed in on his side.

Upon learning of Monday's action by the Supreme Court, Tsakopoulos attorney Arthur Coon said the case "presents a tremendous opportunity for the high court to stem the creeping tide of regulatory overreaching. We strongly believe Congress never intended to require a farmer or rancher to obtain a federal permit merely to plant new crops."

Coon said he expects the matter to be argued by the end of the year and is hopeful an opinion will come down by next June.

After years of bitter debate with the Corps of Engineers and the EPA, Tsakopoulos sought a court determination. The government countersued, claiming he had violated the act by deep plowing without a permit.

Following a three-week, nonjury trial, Burrell ruled in 1999 that Tsakopoulos had violated the act 348 times by deep ripping through 29 drainages, and on 10 occasions by ripping a vernal pool.

The judge gave Tsakopoulos the option of paying a $1.5 million civil fine or paying $500,000 and restoring four acres of wetlands.

Tsakopoulos chose the latter and appealed.

The circuit panel reversed Burrell only with respect to the vernal pool, citing a 2001 Supreme Court opinion. Based on that aspect of its decision, the panel remanded the case to Burrell for a recalculation of the fine.

But Tsakopoulos' petition to the high court kept it from returning to Sacramento.

Soil Case Could Cut Wide Swath

United Press International

June 10, 2002

Michael Kirkland

The Supreme Court said Monday it would review the scope of the Clean Water Act in regard to displaced soil, particularly an agricultural preparation practice known as "deep ripping."

The National Association of Home Builders, however, said the issue goes beyond agriculture, and would affect a "vast spectrum of soil movements."

The case being reviewed by the Supreme Court comes from central California. Though not yet scheduled, it should be heard by the justices sometime next fall. The dispute involves the Environmental Protection Agency and the Army Corps of Engineers and their assertion of jurisdiction over a farmer's plowing practices. A lower court upheld the agencies' jurisdiction.

"Based on the agencies' past response to judicial decisions," the National Association of Home Builders said in a support brief filed with the Supreme Court, "NAHB submits that the Corps and EPA will attempt to use the (lower court's ruling) to justify federal regulation over a vast spectrum of soil movements (not just plowing) in all (Clean Water Act) jurisdictional waters.

"Indeed, a joint Corps/EPA regulation issued in January 2001 currently (and illegally) 'regards' that an 'earth-moving activity' caused by a machine results in a statutory 'discharge' and thus requires a (Clean Water Act) permit," the brief said.

In asking for Supreme Court intervention, California's Borden Ranch said the "fundamental issue in this case is whether a farmer and rancher may deeply plow his agriculturally zoned ranchland to plant higher value crops without need of a federal permit or ... whether the Corps has jurisdiction to regulate such traditional farming activity under the federal Clean Water Act."

A petition from the ranch partnership complains the "Corps asserts such jurisdiction in this case and others, contending the traditional farming activity of plowing alone of dry ground in areas of seasonal wetlands constitutes the 'discharge' of 'pollutants' ...."

The 8,400-acre Borden Ranch is in both Sacramento and San Joaquin counties. It is bisected by Dry Creek, which also serves as the county line.

The ranch was bought in 1993 by a partnership and the current general partner, Angelo Tsakopoulos.

Court records say Tsakopoulos wanted to convert rangeland into vineyards and orchards, then subdivide the land into smaller parcels for sale. Vineyards and orchards require deep root systems.

"Their cultivation therefore requires 'deep ripping,' a process in which bulldozers drag rippers, consisting of 4-foot to 7-foot metal prongs, through the earth," the Justice Department said in a brief filed on behalf of the EPA and the Corps. "That activity breaks up the restrictive layer and disgorges rock, sand and biological material behind the ripper .... Deep ripping alters the movement of surface and subsurface water and limits or destroys the ability of wetlands to retain water."

Even though Tsakopoulos knew when he purchased Borden Ranch that it contained wetlands protected by the Clean Water Act, and he was told by the Corps he would need a permit, he began deep ripping without a permit several times over a number of years, the Justice Department told the Supreme Court.

The Corps twice issued a "cease and desist" order without effect, the department said. When the EPA issued an administrative order saying Tsakopoulos had violated the Clean Water Act in 1997, Tsakopoulos and the Borden Ranch Partnership filed suit in federal court challenging the authority of the Corps and the EPA to regulate deep ripping.

A federal judge dismissed their claims and gave Tsakopoulos a choice of paying a $1.5 million civil penalty or paying $500,000 and restoring four acres of wetlands. He chose the latter pending appeal.

A federal appeals court largely upheld the judge, reversing only a violation involving an isolated pool.

Tsakopoulos and the Borden Ranch Partnership then asked the Supreme Court for review.

01-0963 Norfolk & Western Railway Co. v. Ayers

Ruling Below: Plaintiffs charged that Norfolk & Western Railway Co. had caused emotional distress through fear of cancer due to the presence of asbestos in their workplace. The court instructed jurors not to consider factors other than their asbestos exposure that could have contributed to the employees' fear of cancer. The jury returned a verdict in favor of plaintiffs for $5.8 million. The Supreme Court of West Virginia declined to hear the appeal.

Questions Presented: (1) Was it error for the court below to award emotional distress damages under the Federal Employers' Liability Act to retired employees who alleged workplace exposure to asbestos, but who presented no evidence of physical manifestation or other corroboration of injury related to their alleged fear of cancer?
(2) Was it error for the court below not to apportion damages under the FELA among tortfeasors?

Decision Unpublished

Circuit Court of West Virginia
for Kanawha County

The Real-life Tragedy of the Asbestos Theatre

Financial Times

May 14, 2002

Amity Shales

By now most observers are accustomed to America's tort theatre. We know all the players: the swaggering trial lawyers, the sheepish corporations that are forced to empty their deep pockets, the Robin Hood juries that hand out cash as a form of redistributive justice.

But for sheer unpredictability and scale, nothing can thrill like asbestos. In what other tort drama do the actors reach out and collar unsuspecting members of the audience (Halliburton, the energy services company, being the flamboyant example)?

Even though asbestos, the mineral, has disappeared from new buildings and products the government banned its use decades ago cases are proliferating. Last year about 90,000 new claims were filed against companies, three times the rate just a couple of years ago. Defendant companies that have had little or nothing to do with asbestos routinely go bankrupt after being hit with a penalty. And much of the cash is going to lawyers and people who are unimpaired.

The history of asbestos jurisprudence is worth recalling, if only for what it tells us about the common law. This system, with its incremental establishment of precedent through case law, is part of the Anglo-American tradition of freedom. Yet here it has been revamped into a monster with a tyranny all its own.

Just decades ago, asbestos seemed a manageable problem. On the one hand there were the visibly injured those who suffered from mesothelioma, a fatal cancer, and asbestosis, an emphysema-like condition whose illness was caused by asbestos. These were mostly workers who had substantial exposure over years wartime dock workers and pipefitters. On the defendant side, only a few companies were vulnerable: the 300 or so US companies that mined asbestos or sold asbestos products. As with other law regarding toxic substances, state statutes of limitations applied: cases had to be filed within two or three years from the time of injury.

But asbestos disease has a latency period that can run into decades and so some of the injured were unable to sue. Most states thus altered their statutes, so that the clock began running only when people became aware of their disease.

This sounded logical but in turn begat a second problem: plaintiffs began to flood the legal system. What is more, the body of plaintiffs was no longer confined to those with evident physical impairment from asbestos. Now many of the litigants and soon the majority - were unimpaired or only mildly impaired. Courts and juries began to grant large injury awards merely on the basis of smaller exposure, thus enriching many who will never experience asbestos disease.

Meanwhile, plaintiff lawyers, with acquiescence from judges, began doing what they could to expand the theory of what constituted injury. The US Supreme Court has just agreed to review another such case: Norfolk & Western Railway Co v Freeman Ayers, in which a West Virginia jury awarded six retired railway workers $5.8m because of "emotional distress" over fear of cancer after exposure to asbestos.

What a contrast to the UK, where the House of Lords is deliberating whether Edwin Matthews, a plaintiff, may recover anything if it is not clear which company was responsible.

Desperate to stanch the flooding of their dockets, judges in the US took yet another unusual step: they began to allow a form of mass consolidation that is not permitted in most classic tort categories in the US. "Bananas go with bananas" was the old rule of class action, says Victor Schwartz, co-author of the classic tort text,Prosser, Wade and Schwartz. Now judges were grouping apples (unimpaired possible casualties) with oranges (workers with diagnosed mesothelioma) in the same suit.

In order to stave off even larger settlements for the dying plaintiffs, judges and juries allowed awards to the entire group. By making litigation efficient, they encouraged more of it.

On the companies' side, the law likewise shifted. The traditional defendants that mined asbestos and sold asbestos product were almost all gone. So the plaintiffs' Bar began to take advantage of "the joint and several liability" doctrine that is especially strong in certain corners of the US. In those venues, a company need only to be proven responsible for a small share of an injury in order to be fully liable for its costs. Soon nearly any company with a connection to asbestos found itself ensnared.

It would be easy to blame this tragedy on the tort shark lawyers, who, often unscrupulously and perhaps sometimes illegally, profit from the suits. Lester Brickman, a professor at Yeshiva University's Cardozo School of Law, has pushed for the aggressive prosecution of some of these fellows (the charge would be suborning perjury). The judges are responsible, too: in a public "Letter to the Nation's Trial Judges", Mr Schwartz beseeched judges to drop their "pass them through" mentality.

A share of the blame likewise lies with Congress, which can bring the curtain down on mass asbestos actions but has declined to do so. This is notwithstanding earnest bleating and begging by the Supreme Court.

The third problem, though, is cultural: that attitude that sees big awards as compensation for all life's other wrongs. It is not the juries alone that I blame here but also the press and politicians who support the attitude that personal injury trials are a lottery. In a recent article, author Nicholas Lemann wrote that the personal injury suit may well have become, for America, "the metaphor that does the political work for liberalism".

A Common Law system, after all, is not theatre but a national privilege; it allows courts and citizens the right to make law, instead of faraway authorities. To retain that privilege, though, we have to recall that good common law is based on good common sense.

Asbestos Is Gold For Trial Lawyers

Eagle Forum

May 8, 2002

Phyllis Schlafly

Asbestos litigation has spun so far out of control that the U.S. Supreme Court has agreed to hear an appeal directly from an intermediate state court. Multi-million dollar verdicts are being awarded to healthy plaintiffs based on speculation about possible future harm from past exposure to asbestos.

A West Virginia state court awarded millions of dollars to a few workers without evidence of physical or independently corroborated emotional harm from exposure to asbestos, and without apportioning damages based on relative culpability. The case, based on the Federal Employers' Liability Act (which pertains to railroad workers), is Norfolk & Western Railway Co. v. Ayers, Freeman et al.

The Supreme Court has repeatedly implored Congress to save the courts from having to handle asbestos lawsuits. But the usual victims of this litigation are engineering companies that lack political muscle and are no match for the political clout of the trial lawyers.

America's top asbestos producer, Johns Manville, was forced into bankruptcy in 1982. By 1992, Lloyds of London was averaging nearing $3 billion a year in losses, due mostly to asbestos claims.
Asbestos litigation has pushed at least 54 companies into bankruptcy, and judgments are often imposed with little regard for proof of wrongdoing or causation. Encouraged by porous legal standards, asbestos attorneys have filed claims for more than 1.4 million persons, against more than 1,400 companies.

In 2000, the four major companies sent into bankruptcy by asbestos were Armstrong World Industries (construction products), Babcock & Wilcox (boilers), Burns and Roe (engineering and construction), and Pittsburgh Corning (glass insulation). In 2001, asbestos litigation casualties included the chemical and materials giant W.R. Grace, the prominent construction materials company G.A.F., the gypsum wallboard maker USG, and the auto-parts maker Federal-Mogul.

Just in the past six months, Fortune 500 victims of the asbestos litigation monster have seen sudden drops in their stock prices. Hit with a Texas-sized verdict last December, Halliburton stock abruptly dropped 43 percent.

In February, a Manhattan jury awarded $53 million to the estate of a deceased auto mechanic who allegedly died from exposure to asbestos in brake linings. That decision jeopardizes the entire auto industry; full-page ads for auto mechanics with lung cancer now run in New York newspapers.

In March, a West Virginia jury ordered DuPont to pay $6.4 million to a bank officer who died of mesothelioma. The banker was allegedly injured by fibers that might have attached to the clothing of his father who worked with asbestos at DuPont.

Some of the cases involve heavy, lifelong smokers who claim they have asbestosis, an asbestos-related disease. Plaintiffs and defendants bring in medical experts who testify to contrary diagnoses, and the jury is left to decide, often against the corporate defendants.

In February, 2,645 plaintiffs sued asbestos attorneys, claiming that "this case arises from corruption within the asbestos personal injury bar." Reports are that the majority of asbestos settlements enrich the attorneys, rather than going to the allegedly harmed individuals.

The demonizing of asbestos is an odd fate for a substance that exists widely in nature, including the rocks supporting highly populated cities such as San Francisco. No material can approach its versatility and effectiveness and, for decades, asbestos saved countless lives because of its remarkable strength, durability, and resistance to fire.

In 1998, the prestigious New England Journal of Medicine reported no increased risk of death from cancer because of prolonged exposure to asbestos. Based on a thorough study of mines and mills that have the world's greatest concentration of asbestos, the researchers concluded: "The [Environmental Protection Agency] model overestimated the risk of asbestos-induced lung cancer by at least a factor of 10."

Until now, the U.S. Supreme Court has been unwilling to curtail the legal circus and its calamitous consequences. The Court has manifested unusual restraint as verdicts were rendered, sometimes without any proof of wrongdoing or causation by the defendants who have been forced to pay astronomical damages.

As more claims were decided for workers involved in the manufacture of asbestos, the trial attorneys began casting their nets wider. Any firm that had any contact with asbestos is at risk for unjustified litigation, so asbestos is hastily excluded and removed at great expense.

Meanwhile, observers have noted that the replacement of asbestos with less effective material may have played a role in (1) the explosion of the Challenger [space shuttle], (2) the great New Orleans Rail Yard Fire of 1987, and (3) the premature collapse of the World Trade Towers on 9/11/2001. The government is now contradicting itself by claiming that, while asbestos lining within the towers would have been unsafe, asbestos emitted by the collapse of the towers is safe.

The unusual consideration by the Supreme Court of the Norfolk & Western Railway case may signal that the Court is no longer waiting for congressional action. But will Court action be too little and too late?

[Phyllis Schlafly is a lawyer, author, and the founder of the Eagle Forum, a national volunteer organization engaged in the pro-family movement]

01-1325 Washington Legal Foundation v. Legal Foundation of Washington

Ruling Below: (Wash. Legal Found. v. Legal Found. of Wash., 9th Cir., 271 F.3d 835, 2001 U.S. App. Lexis 24405, 2001 Cal. Daily Op. Service 9663, 2001 Daily Journal DAR 12063)

The court found that government use of interest from trust funds comprised of the pooled funds of lawyers' clients (that would not normally be earning interest) was not a violation of the Takings Clause of the Fifth Amendment. The court found the impact on the clients was trivial to non-existent, and thus was neither a taking nor justly compensable.

Question Presented: Whether the regulatory scheme for funding state legal services by systematically seizing property held in so-called IOLTA (Interest on Lawyer's Trust) accounts violates the Takings Clause of the Fifth Amendment so that the property owners are entitled to relief.

WASHINGTON LEGAL FOUNDATION; et al., Plaintiffs-Appellants,
v.
LEGAL FOUNDATION OF WASHINGTON; et al, Defendants-Appellees.

United States Court of Appeals
for the Ninth Circuit

Decided November 14, 2001

WARDLAW, Circuit Judge:

Four individuals, Allen Brown, Greg Hayes, Dennis Daugs, and Dian Maxwell, and the Washington Legal Foundation (collectively "Appellants") challenge the legality of Washington State's Interest on Lawyers' Trust Account ("IOLTA") program on First and Fifth Amendment grounds. Beginning where the Supreme Court left off in *Phillips* v. Washington Legal Foundation, 524 U.S. 156, 160, 141 L. Ed. 2d 174, 118 S. Ct. 1925 (1998), Appellants contend that the Washington State IOLTA program unconstitutionally takes the interest generated by their monies placed in IOLTA trust accounts and compels speech. We review this case en banc to consider whether there has been an unconstitutional taking, i.e., a taking without just compensation, of property belonging to Appellants. In doing so, we reject the analytical approach that "trifurcates" the Fifth Amendment issues, previously taken of procedural necessity or otherwise by other courts. Believing the better approach to be consideration of the Fifth Amendment question as a whole, we must decide whether the State of Washington, by establishing its IOLTA program and applying it to Limited Practice Officers, took property belonging to any of the five Appellants without providing just compensation therefor. We analyze this issue in accordance with the dictates of Penn Central Transportation Co. v. City of New York, 438 U.S. 104, 124, 57 L. Ed. 2d 631, 98 S. Ct. 2646 (1978), and hold that with respect to the funds deposited into client trust accounts by the Limited Practice Officers in this case, there has been no taking of property without just compensation in violation of the Fifth Amendment. [...]

I. IOLTA

[The court recited the historical background of the legal and banking professions leading up to the creation of the IOLTA programs.

IOLTA programs pool client trust deposits into one large fund that is able to accrue interest for the purpose of providing legal services for the indigent. The Washington Supreme Court created an IOLTA program and the Legal Foundation of Washington, which would administer the funding generated the IOLTA.

In 1995, the IOLTA program was extended to state-licensed non-lawyers who were authorized to complete real estate transactions. Real estate companies were then required to place their clients' funds in an IOLTA account unless specific accommodations were made for the funds to be placed in a different interest-bearing account. This was not standard practice for real estate companies because of the difficulties inherent in using such accounts. Rather, the funds would be placed in non-interest bearing accounts, and banks would provide the companies with credits towards banking fees.]

* * *

II. Procedural History

[The Washington Legal Foundation filed suits in a number of states challenging the constitutionality of the programs. *Phillips v Washington Legal Foundation*, 524 U.S. 156, 141 L. Ed. 2d 174, 118 S. Ct. 1925 (1998), was the first of these cases to be ruled on by the Supreme Court. The Court ruled only on the narrow issue of whether the interest income was private property, which the Court found it was.

This court ruled on several jurisdictional issues. It found that only Brown and Hayes had property interests at stake. Daug and Maxwell lacked individual standing, and the Washington Legal Foundation lacked representational standing. The court found that the issue was ripe.]

* * *

B. Unconstitutional Taking

The *Phillips* majority did not address the question of whether an unconstitutional taking of private property occurred[.]

* * *

In determining the existence of the property right, the *Phillips* majority stated that the accrued interest "attaches as a property right incident to the ownership of the underlying principal." *Phillips*, 524 U.S. at 168. Thus, the Court acknowledged that without the principal, there would be no interest and no property right in that interest. Because the latter does not exist without the former, we believe that it is logically sound to analyze the two in combination for purposes of determining whether a taking of property occurred. [...]

a. Per se v. Ad Hoc Analysis

[The court found the per se takings analysis to be inappropriate when dealing with money. In cases similar to this one, the court has generally used the ad hoc takings analysis employed in *Penn Central Transportation Co. v City of New York*, 438 U.S. 104, 124, 57 L. Ed. 2d 631, 98 S. Ct. 2646 (1978). The court supported its use of ad hoc analysis by citing the *Phillips* decision, the public nature of the program, and the heavily-regulated nature of the banking industry.]

* * *

b. Application of Ad Hoc Analysis

[The court defined a taking as occurring when a regulation forces some people to carry a burden for the public good that should fairly be carried by the public as a whole. The court cited three factors to consider as set forth by the *Penn Central* holding for determining when this is the case: (1) economic impact on the burdened party, (2) interference with investment-backed expectations, and (3) the character of the government action.]

(i) Economic Impact

[Most real estate companies did not previously use interest-bearing accounts. Because the IOLTA program requires interest-bearing accounts, the economic interests of the clients, as owners of the principal, has been improved, not harmed.

The price of some real estate transactions has increased because of fees assessed to cover banking charges, but the court found that this was irrelevant to the economic impact analysis because neither Brown nor Hayes showed they had been charged such fees. Additionally, the increased banking fees were the result of private pricing decisions, not mandated by the government]

(ii) Interference with Distinct Investment-Backed Expectations

[Without the government regulation, neither Brown nor Hayes could expect that their money would earn interest, thus the IOLTA program did not interfere.]

(iii) Character of Government Action

Brown and Hayes concede that they would have no interest without IOLTA, but they argue that, once interest is created, they have the right to determine what -- if anything -- is done with the interest. Viewing the accrued interest as its own entity, divorced from the principal, for the purpose of characterizing the extent of the "property" taken, Brown and Hayes assert that because the IOLTA rules dictate that all the interest earned on IOLTA accounts must go to the Legal Foundation of Washington, the IOLTA program is the equivalent of a 100 percent physical invasion of their property. We disagree.

The IOLTA rules are better viewed as a regulation of the uses of Brown's and Hayes's property, consisting of the principal and the accrued interest in aggregation. That said, the character of the government action is best viewed in the context of the industry it regulates.

* * *

[The court explained that banking and the legal profession have both been heavily regulated. The court asserts that the IOLTA program seems appropriate given that context.]

The Takings Clause does not prevent the Government from being able to regulate how people use their property but limits that ability to what is "just and fair. " Andrus, 444 U.S. at 66-67. Although "the government may impose regulations to adjust rights and economic interests among people for the public good," it may "not force 'some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.'" Wash. Legal Found. v. Mass. Bar Found., 993 F.2d at 974 (citation omitted).

Here, neither Brown nor Hayes is being singled out to bear a burden that should be borne by the public as a whole. They, as participants in our legal system, are required to place their money in IOLTA trust accounts that generate funds at no cost to them and that expand access to the legal system from which they benefit. Given the highly regulated nature of the banking and professional industries the IOLTA rules affect, this additional unobtrusive regulation does not exceed what is "just and fair" -- especially where Brown and Hayes would have earned no interest absent IOLTA. We therefore conclude that Washington State's IOLTA program does not take either Brown's or Hayes's property.

2. Just Compensation

There is a second reason why Washington State's IOLTA program does not work a constitutional violation with regard to Brown's and Hayes's property: Even if their property was taken, the Fifth Amendment only protects against a taking without just compensation. Because of the way the IOLTA program operates, the compensation due Brown and Hayes for any taking of their property would be nil. There was therefore no constitutional violation when they were not compensated.

[The court found that just compensation is putting the owner in as good a position as if the property had not been taken. The only right taken from Brown and Hayes was the right to not earn interest, which is a loss of no economic value. The court argued that Brown and Hayes were not seeking compensation for the lost interest, but for the value added to their property by the IOLTA program. Value added to property by state intervention has never been compensated under the Takings Clause.]

VI. First Amendment

The district court did not address Appellants' First Amendment claims because it concluded that Appellants did not have a property right to the interest at issue. Because this conclusion was abrogated by *Phillips*, the district court must now consider what speech, if any, is at issue and whether the IOLTA program violates any rights Appellants may have emanating from the First Amendment. [...]

VII. Conclusion

For the foregoing reasons, the district court's grant of summary judgment with respect to Appellants' Fifth Amendment claims is affirmed, and its grant of summary judgment with respect to Appellants' First Amendment claims is vacated and remanded. Each party shall bear its own costs of appeal.

AFFIRMED in part, VACATED in part, and REMANDED.

KOZINSKI, Circuit Judge, with whom Judges Trott, Kleinfeld and Silverman join, dissenting:

* * *

The majority starts down the wrong track by asserting, as if it were an established fact, that there are some kinds of private property the government may take without paying compensation: "An allegation that private property for which no compensation is due has been taken is insufficient to sustain a Fifth Amendment claim because it is the taking without just compensation that is constitutionally prohibited." Maj. Op. at 15663 (emphasis added). But, before today, no case has ever held that there are some kinds of "private property for which no compensation is due." The cases the majority cites stand for a much different proposition: They hold that the Fifth Amendment does not prohibit the taking of property, as it clearly does not; what it prohibits is the taking of property without compensation. This does not support the majority's claim that there are certain kinds of property the government may take without paying compensation.

[...] [T]he majority in *Phillips* made it quite clear that economic value is not the only interest protected by the just compensation clause: "While the interest income at issue here may have no economically realizable value to its owner, possession, control, and disposition are nonetheless valuable rights that inhere in the property." *Phillips*, 524 U.S. at 170. *Phillips* speaks directly to our case when it states: "The government may not seize rents received by the owner of a building simply because it can prove that the costs incurred in collecting the rents exceed the amount collected." *Id.*

[...] [C]ontrary to the majority's assertion, it is not true that a court is free to choose whether it prefers the ad hoc approach or the per se approach in taking cases. Rather, the two approaches reflect different solutions to different problems.

* * *

The majority's blurring of the distinction between regulatory takings and physical takings is alarming. In a complex world, a property owner will always get some benefit, real or theoretical, from a taking of his property.

* * *

My colleagues try to avoid the clear teaching of *Phillips* by arguing that the per se approach of *Loretto* and similar cases applies primarily to takings of real property. Maj. Op. at 15667-68. Of course, this is not true; if the city wants to display your Renoir in its museum, it can't just take it and compensate you with the joy of viewing it during visiting hours. [...]

For purposes of the takings clause, then, real and personal property are reduced to their cash equivalents. It thus strikes me as peculiar and quite dangerous to say that the government has greater latitude when it takes money than when it takes other kinds of property. This portion of the majority's opinion will doubtless be greeted with a rousing cheer by government officials who will eagerly look to bank accounts and other places where money is kept, with an eye to snatching a few dollars here and there, and justifying it with some sort of "ad hoc" analysis.

[...] Nowhere--and certainly not in *Sperry*--does the Supreme Court suggest that the government's obligation to pay compensation is eliminated because it takes money rather than real or personal property. Indeed, *Phillips* makes it very clear that *Sperry* does not apply to this situation, because this is not a case where the government is charging for a service it renders. See *Phillips*, 524 U.S. at 171. My colleagues again disregard the teachings of the *Phillips* majority.

* * *

[The dissent adopted the decision of the three-judge panel and reproduced it as part of its opinion].

KLEINFELD, Circuit Judge.

* * *

Defendants seem to be arguing that the government can confiscate people's money without it being a taking compensable under the Fifth Amendment, based on cases where the government provided a service and charged a reasonable user fee for the service. Taken out of the context of users' fees, the proposition is absurd. Unlike medieval England, most assets are now held in the form of fungible intangibles such as bank accounts, money market accounts, and securities. The Fifth Amendment protection of property would be eviscerated were we to construe confiscation of fungible intangibles as not amounting to a taking, as defendants urge. The Supreme Court drew precisely this distinction, between reasonable users' fees and the interest on IOLTA accounts, in *Phillips*, noting that it "would be a different case" if the state were "imposing reasonable fees it incurs in generating and allocating interest income." *Phillips* holds that *United States v Sperry Corp.*, the user fee case, has no application to complete "confiscation of respondents' interest income" by an IOLTA program where the funds are managed by banks and private individuals.

Defendants make another, more appealing, argument from *Penn Central* that the "economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations." The argument is that, because the plaintiffs could not have realized any money from the IOLTA funds, the economic impact is nonexistent, and because the IOLTA rule was in effect when they acted, the IOLTA rule could not have interfered with their expectations.

This argument fails on several independent grounds. First, the "economic impact" test is articulated in *Penn Central* in the context of regulation of the use of real estate, not deprivation in its entirety of any property. The point of the economic impact test in *Penn Central* is to distinguish government regulations of the owner's use of property permissible under its police power from those that go too far, requiring the government to compensate the owner for taking his property. That distinction is not necessary or appropriate where the government entirely appropriates a sum of money belonging to a private individual. [...]

[...] When the government permanently appropriates all of the interest on IOLTA trust funds, that is a per se taking, as when it permanently appropriates by physical invasion of real property.

Second, it is not quite correct to say that IOLTA as structured does not deprive clients of any money. The rule says that in determining whether to deposit money held in trust into the IOLTA account or an account where the client will receive the interest, a lawyer must consider "only whether the funds to be invested could be utilized to provide a positive net return to the client," based on the interest to be earned while the funds "are expected to be" deposited, and the various expenses including lawyers' fees for administering interest payable to the client. This leaves two ways in which, as a practical matter, the client may lose an economically significant amount of interest. One, probably quite common, is where the funds "are expected to be" deposited for a much shorter period than they actually are. [...]

The second way a client may lose interest is that the costs of lawyers' and closing officers' services are overestimated. As a practical matter, the lawyers and closing officers have a substantial incentive not to be bothered with crediting clients with their interest. It is therefore in their interest to say of almost all routine trust deposits that no significant interest will accrue and to place the money into the IOLTA account. But a client, whether out of desire that he or she get every penny coming to them, a feeling of getting "nickeled and dimed," or an objection to contributing money to lawyers' and judges' favorite charity, may think it is worth having a lawyer spend $ 19.95 worth of time to get the client $ 20 in interest. Also, the amount of time and trouble involved in collecting, allocating, and distributing interest to clients depends on how often it is done. If done once, it is probably a costly nuisance. If done frequently, it may become delegable to non-professional staff using off the shelf software.

* * *

Critics of Mandatory IOLTA Have Their Day

The National Law Journal

June 17, 2002

The high court's decision to resolve whether the Washington program constitutes a "takings" of clients' property without just compensation, in violation of the Fifth Amendment, came on the heels of a 7-7 decision by the 5th U.S. Circuit Court of Appeals not to hear en banc a panel ruling that the Texas IOLTA program does violate the Fifth Amendment. The Washington Legal Foundation had also challenged the Texas program.

The 5th Circuit panel ruling conflicted with the 9th Circuit's decision upholding the constitutionality of the Washington IOLTA program last January and the stars were aligned for cert review by the Supreme Court.

The basic IOLTA programs in both states are "exactly the same," said Richard Samp of the Washington Legal Foundation. "Some state programs are voluntary in the sense that lawyers can choose to participate." The Texas and Washington programs are mandatory, he explained, adding, "The Washington program is somewhat broader because it applies not only to funds held by lawyers but also to funds held by real estate professionals. It operates in the same way as to both those groups."

IOLTA programs exist in all 50 states and the District of Columbia. According to the American Bar Association, IOLTA programs represent the second-largest funding source of civil legal services in this country. Under federal banking rules, not all client deposits are eligible to be put into an IOLTA account. Any client funds that can earn more interest in a non-IOLTA account than would be consumed by bank administrative costs may not be placed in IOLTA accounts.

In the Washington case, a 9th Circuit panel said the challengers were actually seeking compensation for the value added to their property by Washington's IOLTA program.

"In other words, Brown and Hayes (plaintiffs) are seeking compensation not for the value of what they lost, but for the value of what the Legal Foundation of Washington has created," said the panel. "In the context of real property, it is clear that the owner of condemned land need not be compensated for the value created by the government's exercise of the power of eminent domain."

Although the high court will hear the Washington challenge next term, a cert petition will be filed in the Texas case shortly{...]

The Supreme Court has faced the Texas challenge once already, ruling in 1998 that the interest earned on client funds is the property of the client for the purpose of a takings analysis. Phillips v. Washington Legal Foundation, 521 U.S. 1117. But the justices left the takings question for another day that is now approaching.

* * *

A Matter of Principle

The Recorder

January 24, 2001

George M. Kraw

No matter how well intentioned IOLTA programs may be, they are wrong unless they are voluntary.

The Ninth Circuit U.S. Court of Appeals ruled this month that the interest belongs to the client. The decision found that the Washington state "Interest on Lawyers Trust Accounts" program constituted a "taking " entitling clients to "just compensation under the Fifth Amendment." It sent Washington Legal Foundation v. Legal Foundation of Washington, 01 C.D.O.S. 297, back to a lower court to determine what that compensation should be. Proponents are hoping to salvage Ninth Circuit IOLTA programs by arguing that the loss of interest is so small that in most cases "just compensation" is little or nothing.

But mandatory IOLTA programs also violate client First Amendment rights. Individual legal consumers are compelled to contribute to legal aid programs arguing public positions that some oppose.

The Ninth Circuit didn't reach this issue. The First Amendment claim will be the basis for further challenges to mandatory programs to the extent they survive this latest setback.

It wouldn't be difficult for IOLTA managers and state bars to avoid constitutional challenges. They could ask, "May we?" before taking a client's trust fund interest on a small or short-term deposit for legal aid programs.

Even though some states have made IOLTA voluntary for lawyers, most of the legal system is not used to treating client choice with similar deference. So instead we have continuing litigation over IOLTA programs that already has produced one Supreme Court decision, Phillips v. Washington Legal Foundation, 524 U.S. 156. This 1998 case held that clients had a "property interest" in trust account interest earned by the Texas IOLTA program. The decision guided the Ninth Circuit analysis.

Phillips is back in the Fifth Circuit on remand and is set for oral arguments in February, with opponents expecting to land a knock out punch on the Texas program.

That result is anticipated in a recent Texas appellate court decision which states that a client can order a lawyer to withdraw the client's funds from an IOLTA account.

Before IOLTA existed, banks kept the money earned on client trust accounts. Ethics rules prevented lawyers from receiving any interest on the accounts. Bar associations created IOLTA to capture the "lost" interest and divert it to legal aid.

This compulsory diversion was a controversial policy choice. The result has been opposition to IOLTA since day one from those who for various reasons -- political, social, economic, even religious oppose the activities of agencies that receive IOLTA funding. Critics like Suffolk University law professor Charles

E. Rounds Jr. argue that "a substantial portion" of IOLTA funds nationwide actually goes to "political activity ... lobbying and general legislative advocacy," instead of helping "the legal needs of the poor."

Leading the charge against IOLTA plans is the Washington Legal Foundation, a D.C.-based group headed by former attorney general Dick Thornburgh. It was the lead plaintiff in Phillips and the Ninth Circuit case. The Foundation's advisory committees have contributed four nominees for the new Bush cabinet. IOLTA proponents may not like the individual rights arguments made by the Foundation, but they will have to learn to accommodate them.

The other, individual challengers to the Washington state IOLTA program (which also covered certain real estate escrows) complained both about loss of interest and the activities supported by the IOLTA fund. They may have been made unenthusiastic by some of the reported cases of state IOLTA beneficiaries. Professor Rounds cites a Washington IOLTA grantee that prevented a public housing authority from evicting a resident who tried to run over his neighbor with a car.

Voluntary programs with disclosure requirements will create additional bureaucratic requirements for lawyers, who will end up being responsible for explaining alternatives to clients. More conscientious attorneys will want to spell out in detail the competing concerns raised by IOLTA.

Even legal consumers who oppose legal aid activities still may want to participate in voluntary programs. An IOLTA pooled account is cheaper in most instances than setting up a separate individual client account. Often its administrative costs will be less expensive than calculating and paying out the interest in a non-IOLTA pooled account to individual clients. Small practitioners -- who before IOLTA had to pay bank charges for trust accounts because their general accounts were too small to qualify them for a fee waiver -- would continue to receive a free IOLTA account.

Ultimately, IOLTA won't solve the representation problems that legal aid programs attempt to address. That requires top to bottom reform, and measures that drive down the costs of legal services for all consumers and also simplify dispute resolution.

But meanwhile, clients should not be forced to participate in IOLTA programs against their will. If supporters keep insisting on mandatory programs, the programs are going to continue to be challenged in the courts and other branches of government. And they are going to continue to lose.

George M. Kraw is a San Jose attorney.

IOLTA and the Takings Clause Scrooges

Connecticut Law Tribune

March 25, 2002

[...] [T]he Interest on Lawyers' Trust Accounts (IOLTA) program is the most significant mechanism to help fund legal services for the poor.

Unable to persuade the establishment bar, court rule makers or state legislatures to eliminate o[r] restrict IOLTA, IOLTA's opponents have adopted a strategy they ordinarily deride: asking federal courts to invalidate as a violation of individual rights a state program whose policy goals they find objectionable. Their theory? IOLTA constitutes a "taking" of "private property" without "just compensation" in violation of the Fifth Amendment's Takings Clause.

They claim that a state court cannot direct the interest income generated from a law firm's clients' funds account without also paying, in return, "just compensation." If accepted, this claim could doom most IOLTA programs for one obvious reason: the theoretical "compensation" owed by the IOLTA trustee would equal the very amount the trustee had received, leaving no net revenue available for legal services organizations. So why shouldn't every law firm establish a separate account for every client deposit to ensure the client is paid the de minimis interest earnings attributable to the principal amount of his short-term deposit? As every law firm administrator knows, the answer is: there are no such earnings. Or put another way, because the bank's service fees would equal or exceed whatever interest earnings might be generated from the temporary deposit, the net gain for the client is zero, or in some cases, less than zero.

Thus, IOLTA's opponents are championing the abstract and Scrooge-like proposition that citizen Ebenezer should have the unfettered right to keep his money from earning interest and to exclude fellow citizen Cratchit from ever benefiting from the money regardless of any actual-or even potential-loss in its value or interference with its use.

Unfortunately, they have found some judicial sympathy.

In June, 1998, the U.S. Supreme Court, by a 5-4 vote, held, in Philips v. Washington Legal Foundation, that the interest income generated by funds in accounts subject to the Texas courts' IOLTA program does constitute "private property" of the client within the meaning of the Takings Clause. However, the Court did not reach the ultimate questions of whether under IOLTA: (a) the client's "property" had been "taken"; and (b) if so, the amount, "if any," of "just compensation" due the client. The court majority therefore remanded the case for the lower courts' determination of those two issues.

Last October, the Fifth Circuit Court of Appeals, issued its decision on remand in the Philips case. By a 2 to 1 vote, the panel invalidated Texas' IOLTA program on the basis of the Takings Clause.

Notwithstanding the trial court's specific finding that the plaintiff-client had not established any quantifiable loss due to his lawyer's participation in IOLTA, and without any direction for an award of damages, the court concluded that, under the Fifth Amendment, the Texas IOLTA rules cannot be enforced without paying "just compensation" to every participating client. Four weeks later, the Ninth Circuit Court of Appeals, in Washington Legal Foundation v. Legal Foundation of Washington, came to the opposite conclusion. By a 7 to 4 vote, an en banc panel of the Court held that even if a deposit of client funds under the challenged IOLTA program did amount to a "taking", the theoretical "just compensation" owed the client amounted to a grand total of "nil." Therefore no constitutional violation could have occurred when Washington state's IOLTA administrator failed to pay "compensation" for a loss valued at zero.

These two rulings obviously set the stage for the Supreme Court to finally resolve the question. It is not an overstatement to say the state of legal services for the poor is in the balance. Although the test case plaintiffs can't establish that IOLTA has caused any loss to clients, a holding invalidating IOLTA will, without question, cause significant losses to legal services. In Connecticut, the Connecticut Legal Services Corp. currently depends on IOLTA for about 65 percent of its annual budget.

The present Supreme Court majority normally demands deference to a state's right to regulate its own poverty programs, at least when policymakers cut such funding. So too they ordinarily are sticklers for weeding out from the federal courts' dockets those civil rights claimants unable to meet their burden of proving an actual, rather than a theoretical, injury. With the life or death of IOLTA on the line, supporters of legal services for the poor can only hope for some judicial consistency.

01-1289 State Farm Mutual Auto. v. Campbell

Ruling Below: (Campbell v. State Farm Mutual Auto., UT Sup.Ct., 2001 UT 89, 432 Utah Adv. Rep. 44, 2001 Utah Lexis 170)

The court upheld a jury verdict of $145 million in punitive damages against the defendant. The court found the award was proper under federal and state law.

Question Presented: Whether a $ 145 million punitive damage award that punishes out-of-state conduct, is 145 times greater than the compensatory damages in the case, and is based on the defendant's alleged business practices nationwide over a 20-year period, which were unrelated and dissimilar to conduct by the defendant thatgave rise to the plaintiffs' claims, is in violation of the due process clause?

Top Court To Review Punitive Damages

National Underwriter - Property & Casualty

July 1, 2002

Steven Brostoff

The U.S. Supreme Court has agreed to review the constitutionality of a $ 145 million punitive damage award assessed against State Farm.

In *State Farm v Campbell*, the Bloomington, Ill.-based insurer is seeking to overturn a Utah Supreme Court decision imposing the award for allegedly handling a claim in bad faith and for intentional infliction of emotional distress.

The U.S. Supreme Court has addressed the issue of punitive damages several times. In a series of cases, the high court said that there are constitutional limits to punitive damages, but it has never presented a formula for determining those limits. In *State Farm v Campbell*, a State Farm policyholder, Curtis B. Campbell, was involved in an auto accident that killed one person and disabled another.

According to the opinion filed by the Utah Supreme Court, State Farm collected evidence that Mr. Campbell was at fault for the accident. Nonetheless, State Farm declined to settle. The court said State Farm's attorney assured Mr. Campbell that he would represent his interests, that his assets were safe, and that he need not hire his own attorney.

The case against Mr. Campbell went to trial, and the jury found him 100 percent liable. The jury awarded the other parties damages that exceeded Mr. Campbell's policy limits. The Utah court said that State Farm's attorney told Mr. Campbell and his wife that they should put "for sale" signs on their property.

Subsequently, Mr. Campbell entered into an agreement with the other parties to the accident under which Mr. Campbell would pursue a bad faith action against State Farm, subject to certain conditions, and the other parties would agree not to demand that Mr. Campbell pay his obligations.

Several years later, after the liability judgment against Mr. Campbell was affirmed on appeal, State Farm paid all the damages arising from the accident -- both its policy limits and the excess.

Mr. Campbell then filed the action against State Farm that led to the punitive damage award, charging that its actions were in bad faith and caused him emotional distress. State Farm argued that its decision not to settle the accident was an "honest mistake" that did not justify punitive damages.

Mr. Campbell, however, charged that State Farm's decision was part of a "national scheme" designed to meet corporate fiscal goals by capping payouts.

The jury ultimately awarded Mr. Campbell $ 2.6 million in compensatory damages and $ 145 million in punitive damages. The trial judge later reduced the punitive award to $ 25 million.

Both State Farm and Mr. Campbell appealed to the Utah Supreme Court.

State Farm argued that the $ 25 million punitive damage award was excessive. Mr. Campbell, on the other hand, argued that the trial judge erred in reducing the award, and asked the Utah Supreme Court to reinstate the $ 145 million judgment. The Utah Supreme Court ruled in favor of Mr. Campbell, and reinstated the higher award.

During the Utah Supreme Court proceeding, State Farm argued that the punitive damage judgment was excessive on several fronts. State Farm said:

* First, that the award is more than triple the actual damages -- a ratio that is seldom upheld by Utah courts.

* Second, that the size of the award violates the constraints articulated by the U.S. Supreme Court, which has suggested a three-part analytical test to determine constitutionality.

(The three-part test is the degree of reprehensibility of the conduct, the disparity between the harm suffered and the punitive damage award, and the difference between the award and the civil or criminal penalties imposed in comparable cases.)

* Third, that the Utah court erred by allowing Mr. Campbell to present evidence of a "national scheme." State Farm said allowing this evidence violated the Utah Rules of Evidence because it had nothing to do with the company's conduct towards Mr. Campbell.

The Utah Supreme Court rejected all of State Farm's arguments.

Looking specifically at the U.S. Supreme Court's test for analyzing punitive damage awards, the Utah court said that the $ 145 million award satisfies it.

First, the court said, a high award is justified under the standard assessing the disparity between the harm suffered and the award because State Farm's "fraudulent conduct has been a consistent way of doing business for the last 20 years."

The likelihood of further misconduct is high, the court said, and the effect on Mr. and Mrs. Campbell was severe, since they had to live in constant fear of financial ruin.

As for the comparison between the award and civil or criminal penalties authorized in comparable cases, the Utah court said that imprisonment is possible for the alleged conduct. That, the court said, is a strong indication that the conduct warrants high punitive damages.

State Farm Ordered to Pay $146 Mln Award by Utah High Court

Bloomberg News

October 20, 2001

William McQuillen

State Farm Mutual Automobile Insurance Co. "deceived and cheated" customers, "harassed and intimidated" claimants, witnesses and lawyers, and concealed evidence, the Utah Supreme Court ruled, in restoring a $146 million jury award against the largest U.S. auto and home insurer.

"State Farm engaged in a pattern of trickery and deceit, false statements and other acts of affirmative misconduct targeted at financially vulnerable persons," the state's highest court said in a 4-1 decision that reversed a trial judge's reduction of the jury award to $26 million.

The company's harassment of witnesses included investigating their personal lives, in one case paying a hotel maid to find out if an opposition witness had overnight visitors in her room, the court decision says. "Such conduct is malicious, reprehensible and wrong," the court wrote.

The case stems from State Farm's refusal to pay $50,000 to settle claims against policyholder Curtis Campbell, who was found responsible for a 1981 accident that killed one man and disabled another. The $50,000 equaled Campbell's policy limit.

'Bad Faith'

State Farm refused to pay, letting the case go to trial even though it knew of expert and eyewitness testimony against Campbell, court papers say. Campbell faced $180,000 in damages -- or $130,000 more than his policy limit -- after the trial.

Campbell sued State Farm for refusing to settle the claims, arguing it was part of a "national scheme to meet corporate fiscal goals by capping payouts on claims company wide," court papers say. Jurors awarded $2.6 million in compensation and $145 million in punitive damages.

"The jury found that State Farm had acted unreasonably and in bad faith in its decision to take the case to trial," the Supreme Court said.

A trial judge reduced that award in December 1997 to $1 million in compensatory damages and $25 million in punitive damages. The high court yesterday said the trial judge erred in cutting the punitive damages based solely on the ratio of punitive- to-compensatory damages.

Paul Belnap, State Farm's Utah lawyer, couldn't be reached for comment. He told the Associated Press that the company denies improper dealings and may appeal. State Farm has changed its policies and now guarantees policyholders that it will pay any judgment over policy limits if it takes a case to trial, Belnap told the AP.

Jury Orders State Farm to Pay $145 Million Insurer Ordered to Pay $145 Million

The Salt Lake Tribune

August 1, 1996

Sheila R. McCann

A Salt Lake City jury imposed $ 145 million in punitive damages against State Farm Mutual Automobile Insurance Co. on Wednesday night, siding with a retired Lewiston couple who accused the company of fraud and widespread cheating.

Jurors also awarded $ 2.6 million in compensatory damages to Curtis and Inez Preece Campbell. They were not in the courtroom when the verdict was read.

The couple sued the nation's largest auto insurer in 1989, charging State Farm with failing to protect Campbell's interests after he was sued for causing a fatal 1981 car accident in Cache County. The jury's award will be shared with the Ogden parents of Todd Ospital, 19, who was killed, and Robert Slusher, then 26, who lost partial use of his left arm.

Throughout two months of testimony, Campbell and his attorneys accused State Farm of routinely betraying its policyholders nationwide and depriving claimants of fair payments.

State Farm vehemently denied the allegations. In a statement to be released today, the company says it will seek to have the verdict set aside, through pursuing a new trial or an appeal.

The Campbells' attorney, Roger Christensen, said he was "really gratified" by the award.

"It's exactly what we had hoped to achieve," he said. "It makes the years the Campbells have maintained the battle worthwhile."

On May 22, 1981, Campbell passed a camper in Sardine Canyon near Logan as Ospital approached in the oncoming lane. Campbell moved back into his own lane, but Ospital lost control after the close pass and hit Slusher's car. Ospital was killed.

Slusher and Ospital's parents sued Campbell, but offered to settle for his $ 50,000 insurance policy limit. State Farm refused to settle and took the case to trial in Logan. Campbell denied he was at fault but was assessed $ 253,000 in damages.

Campbell and his wife then sued State Farm for putting their home and assets at risk instead of settling the lawsuits. Last November, a Salt Lake City jury found State Farm had acted unreasonably.

The new jury heard the couple's claims of fraud and intentional infliction of emotional distress and requests for damages.

State Farm is "terribly disappointed" by the verdict, said vice president and counsel Michael Bragg. He is based at the company's headquarters in Bloomington, Ill., but has been in Salt Lake City during the trial.

"We certainly thought we had done everything we could," Bragg said. "We defended them [at the Logan trial]; we fully did everything we could to protect their interests."

After an appeal failed, State Farm paid the Logan jury's full judgment plus interest, Bragg noted.

At trial, the Campbells contended they had suffered emotional distress from State Farm's decision to gamble with their assets at trial, and the subsequent delay in paying the judgment.

To show the company's alleged intent to defraud the Campbells, their attorneys presented wide-ranging testimony about the company's claims-handling practices. Former State Farm employees claimed they misled claimants about benefits and altered or hid damaging documents.

But State Farm called employees, state regulators and a statistical expert, who defended the company's work and said there was no evidence of a pattern of misconduct.

In closing arguments Wednesday, Campbell attorney Rich Humpherys asked jurors to punish State Farm and deter future wrongdoing by assessing a punitive damage award between $ 25 million and $ 100 million.

"When you have $ 55 billion in assets, what does it take to get [State Farm's] attention?" he asked. "What will cause even the president to listen?"

State Farm collects $ 4.3 million a day in surplus funds, Humpherys said. An award of $ 25 million, for example, would represent one week's surplus, he said.

Defense attorneys called the request "outrageous." Concern about the Campbell case has already led to a new regional policy, said attorney Paul Belnap.

Now, if a policyholder gets an offer to settle a lawsuit within policy limits -- but State Farm opts to go to trial -- the company will guarantee its payment of any amount over the policy limit, Belnap said.

"This is a well-run, properly motivated and honest company," he said.

"What does it take to get State Farm to change?" he asked. "It doesn't take an award like the plaintiff is claiming in this case."

Defense attorney Stuart Schultz had urged jurors to award a nominal amount -- $ 2,800 -- for State Farm's refusal to settle. He asked the jury to reject the couple's claims of fraud and emotional distress.

About a year after the Logan jury's verdict, the Campbells had negotiated a deal to preserve their assets and knew they were not at risk, Schultz noted. The Ospitals and Slusher had agreed not to foreclose on the Campbell's home, and in exchange, they will share in the jury's award.

The testimony about unrelated company claims practices "has nothing to do with the Campbell case," Schultz objected.